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The Political Economy of Development in China: Political agendas and economic realities

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Abstract:

China's fourth generation of leaders have re-focused the political agenda away from growth agendas to broadly defined developmental issues - primarily driven by concerns about the political implications of growing inequality. However, this paper suggests that central leaders may not have the agency to direct economic activity in a way that will allow developmental promises to be achieved.

Keywords: Poverty; 'harmonious development'; inequality; welfare reform; unemployment; state capacity

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Introduction

On a visit to Beijing in the summer of 2006, Jeffrey Sachs suggested that ‘we can see from China's experience that the end of poverty is absolutely palpable and real in the space of a very few years’ (Watts, 2006). While the reduction of poverty in the post-Mao era has indeed been impressive in terms of both extent and speed, it is somewhat premature to suggest that the job of poverty reduction is over. Indeed, if your only source of information on China was the official speeches and reports of China’s top leaders, then the focus would be on China’s myriad developmental problems rather than success. For example, at the annual plenary session of China’s parliament, the National People’s Congress in March 2007, Premier Wen Jiabao’s government work report focussed on the list of problems that required urgent remedial action. Chief amongst these was heading off an environmental disaster and the environmental sustainability of China’s pattern of growth. But not far behind the environment come a whole host of what Wen called “serious problems” that reflect rather badly on the government’s developmental credentials. The provision of and access to health, education and all forms of social welfare (particularly, but not only, in the countryside), low incomes and continued poverty, and already huge and growing inequality all, in Wen’s view, threaten social stability and “harmony” and thus implicitly the party’s continued monopoly of political power in China.

Such a focus on China’s developmental problems, and their challenge to political and social stability, have been increasingly common in China since Hu Jintao took over as party leader from Jiang Zemin in November 2002 and Wen Jiabao replaced Zhu Rongji as Premier the following Spring. Or perhaps more correctly given that the shadow of the previous leadership did not disappear overnight, since the Hu-Wen leadership began to assert their own agenda in the summer of 2004 – an

agenda that in many ways was a specific reaction to their predecessors faith that economic growth on its own would ultimately solve China's developmental problems. Without active government intervention to redistribute resources and to help the poor, there was a real change that China might slip into what was termed a "Latin-American" mode of half the population stagnating in poverty for generations (Zha, 2005: 780-4). Relying on growth had not only failed to generate solutions, but the type of growth that China attained had actually exacerbated existing problems.

In terms of how many people are affected on a daily basis, and also in terms of the long term implications, the environment is the single most serious and urgent developmental challenge. Both the severity and urgency of this challenge is recognised by China's leaders who have now accepted that slower growth is a price worth paying for cleaner and more sustainable growth - albeit only a planned reduction from ten to eight per cent in 2007 (Wen, 2007). And as is the case across the world, it is the already vulnerable that face the biggest and most immediate environmental challenges to subsistence and existence in China. Nevertheless, partly because the environment is too important and also because its significance is widely acknowledged, the following section will concentrate on those development challenges that are not always at the forefront of non-specialist perspectives of China.

Inequality and Social (In)Stability

The main spur for the transformation from a growth driven strategy to a more developmental approach appears to be the understanding that growing inequality was incompatible with social stability. According to a Central Party School investigation in 2005, the party faced a 'yellow alert' (People's Daily, 2005a) – a situation where there were regular and often violent protests against specific grievances, but where

these grievances had not coalesced to ‘constitute a direct and fundamental challenge to the legitimacy of the regime’ (Yep, 2002: 5).(1) There are many causes of this social unrest, but not surprisingly, they almost all have their roots in protests by groups that feel that economic reform has served them less than well. The closure of the State Owned Enterprises (SOEs) that once formed the spine of the planned economy (and in particular the subsequent non-payment of benefits) has been particularly important in those areas that used to be the heartland of the old system. In the countryside, the extent of rural taxes, the way they are collected, and the ad hoc fees charged by many local authorities in have probably been the major overall cause of disturbances. More recently, ad hoc land seizures by local governments, where peasants have simply been thrown off the land with either minor or no compensation has been a major source of violent unrest.

The Gini Coefficient, which admittedly is a rather rough guide to who gets what, nevertheless gives a rough indication of how inequality has grown as the Chinese economy has grown. From a low of around 0.29 in 1981, the figure was around 0.39 when China began to engage the global economy in a meaningful manner in the mid 1990s, reading 0.47 in 2005. What this means in practice is that the richest 20 per cent earn half of all income in China, with the poorest 20 per cent earning 4.7 per cent. Notably, wealth is highly concentrated at the top end of this richest quintile, with the richest ten per cent earning 45 per cent of all income (and the poorest ten per cent earning 1.4% of the total). For those who take the gini coefficient seriously, reaching 0.4 is a sign that social stability is under threat. Although the income gap between those living in China’s coastal provinces and the rest of the country continues to grow, the main determinant of income level remains the urban-rural divide. The income of the average urban dweller is over three times more than their rural

counterpart, and is even higher when non-income benefits (that most rural residents have to pay for out of their net income) is taken into account – perhaps as much as six times higher (Chai, 2004). But in reality, there isn't an average urban or rural dweller. In the countryside, for example, the less dependent the individual is on agricultural production for their income, then the richer they are. Farmers in the richer coastal provinces with easy access to major urban centres also earn more than those doing similar work in other parts of the country – the richest earning perhaps as much as four times more than China's poorest farmers in Guizhou Province.

Does inequality matter? Other countries, perhaps most notably the USA, have maintained high levels of inequality for many years without the political system crumbling. In one respect inequality matters because Chinese elites think it matters and it thus becomes an important focus of study for those who follow internal political discourses in China. And it matters for China's elites as they are aware that inequality undermines legitimacy in two main ways. First, because they are aware that many believe that this inequality is based on party state elites grabbing the main benefits of economic reform for themselves – either illicitly through corruption or through being part of a network of insiders who simply know how to use the system (Chen, 2003: 148). It is not just that it is unequal, but that it is unfair. Second, because one of the party's mechanisms for maintaining legitimacy is through holding out the promise of joining the *xiaokang* (小康) society of the relatively well off.(3) If the prospect of upward mobility look distant, or perceptions of what it means to be relatively well off change as some get even richer, then the party might be judged to be failing to deliver on its promises. And while this perhaps suggests that the issue is some people not being as well off as they think they should be, in some parts of China the discourse is still about real, not just relative, deprivation.

Rural and urban poverty

For example, let's return to Sachs and the issue of poverty. Finding agreed and accepted means of measuring poverty in China is an almost impossible task. Official Chinese figures calculate that the number of rural Chinese living in poverty has dropped from 250 million in 1978 to around 25 million in 2006. A further 100 million or so live just above the poverty line, but are considered to be vulnerable to falling back into official poverty in the face of floods and/prolonged droughts, or through a SARs-like health epidemic (China Daily, 2005) - as happened when those living in poverty increased in 2003 largely as a result of natural disasters (Watts, 2004).

However, Chinese poverty figures are based on what is needed only to ensure what the Asian Development Bank (ADB) terms 'a basic level of survival' (ADB, 2004: 4) based on an index linked basic standard of living survey taken in 1985, and are not widely considered to be internationally comparable. If we take the World Bank US\$1 a day standard, we then face the problem of how to translate US\$1 into Chinese Renminbi (RMB) given that currency controls mean that the US\$ to RMB exchange rate is not set by the market. Using Purchasing Power Parity calculations to try to get over this problem (a process that is itself the subject of considerable criticism), then the US\$1 a day figure comes out at about 90 million living in poverty with the CIA Factbook which also uses PPPs giving a figure of 130 million for 2006 (<http://www.cia.gov/cia/publications/factbook/geos/ch.html#Econ>, accessed 8 May 2007).

In large parts of the countryside, corrupt excising of taxes and the imposition of ad hoc fees and charges by local authorities mean that income figures bear little relationship to the ability to consume (Bernstein and Lu, 2003). In addition, when

expenses for medical care are taken off incomes to provide a closer like with like basis of comparison with earlier eras when provision was free, then the percentage of the rural population living in poverty rises from 7.6 per cent to 10.6 per cent (Liu, Rao and Hsiao, 2003). To offset these problems, some analysts use consumption rather than income figures, which generate even higher figures in the region of 200 million.

So finding a consensus on the exact figures is highly problematic. However by considering the various analyses we find the same three basic messages. First, economic reform has pulled many millions out of rural dwellers out of poverty, but the task of poverty reduction is far from complete.(2). Second, at best, the rates of reduction of rural poverty have flattened out and may have reversed (ADB, 2004; Chen and Ravallion, 2004). Third, an increase in floods, draughts and disease threatens to pull tens of millions back into poverty. The message also seems to be that urban poverty is on the increase – although it is even more difficult to reach consensus on the figures as there is no accepted Chinese definition of what the urban poverty line actually is. Individual municipalities set their own benchmark where Minimum Living Standard Scheme benefit payments kick in, and these vary significantly with poorer cities setting lower thresholds. Around seven per cent of the urban population (c.22 million people) qualify for these payments (ADB 2004: 4-5), but as almost all migrant workers are not currently eligible, this is only a very rough indicator. Regulations have been brought in to extend coverage to migrant workers, but according to a 2006 government survey published on Labour Day, these are almost never actually implemented by local governments (People's Daily 2006). Solinger (2005: 3) started with an internal investigation on poverty, added on official estimates of the number of poor migrants in the towns and cities, and comes up with a figure of 70 million urban poor and growing. As with the rural situation, the claim that

urban poverty is increasing is strengthened when those payments for health, education and welfare that were previously provided by the state via the work-place are taken into account - and even more so when consumption considerations factor in significant increases in relative food prices (Meng, Gregory and Wang, 2005).

The growth in urban poverty is partly a side-effect of rural poverty. The initial drive for more efficient agricultural production in the 1980s saw millions leave the land, but not the countryside – by 1993 over 120 million rural Chinese were employed in locally run and largely small-scale Township and Village Enterprises (Jin and Qian, 1998: 773). But as the growth of this sector slowed drastically in the second half of the 1990s and declined after 1996 (Johnson, 1999; Jiang, 2000; Wang, 2004) the existing trend of migrating to the cities to find jobs accelerated. How many migrants are now resident in the cities for at least some of the year is unclear – figures of 120-200 million are typically cited, but when migration from village to town within a single province is included, 200 million is probably closer to the mark. But what is clear is that the growth of migration has made a significant impact on the growth of urban poverty - and in some respects simply made rural poverty an urban phenomenon.

The growth of unemployment

Urban poverty is also increasing as a result of the transition from state planning and ownership towards a more market efficient basis for economic activity. The official urban unemployment rate has typically remained around four per cent. But while the Chinese authorities are moving to a more transparent system, most Chinese unemployment statistics will not include the ‘laid off’ (*xia gang* 下岗) – and workers can be laid off for up to three years before they officially count as ‘unemployed’ (*shi*

ye 失业). While urban unemployment increased by about eight per cent per annum in the 1990s, the number of laid-off workers increased by around 40 per cent a year. Two thirds of these laid-off workers were from SOEs - and, as with all things in contemporary China, there are large geographic variations. In essence, the old industrial bases have both the highest levels of unemployment and the highest levels of laid off workers. In addition, the officially 'unemployed' does not include men over the age of 50 and women over 45 or those who have migrated to the cities and are thus not registered as formally urban dwellers. Based on John Giles' work on unemployment data, (<http://www.msu.edu/~gilesj>) and interviews with officials and academics, a guesstimate of 15 per cent is towards the top end of estimates, but not a wholly unrealistic assessment of the urban situation. Rand have factored in those in the countryside who effectively have nothing to do and comes up with a figure of 23 per cent of the work force without a job (Wolf, 2004).

Underlying many of the issues relating to poverty – either rural or urban – is the incomplete transition from the workplace delivered welfare of the socialist system to other forms of welfare delivery. As the socialist system has withered away, the government has been experimenting with new forms of welfare insurance since as early as 1986. From the outset, the reforms displayed a massive 'urban bias' (Duckett, 2003) with a primary goal of preventing social instability in industrial centres. For example, in 1998 the government introduced the 'three guarantees' of a basic level of subsistence – but only for those urban residents laid off from SOEs. The same is largely true for medical and old age insurance. Experiments in extending social security in rural areas have also been extended – but at best estimates only cover about a tenth of the rural population (Duckett, 2004: 170).

China's Developmental Trajectory: State Objectives and State Capacity

These, then, are some of the 'serious problems' that the Hu-Wen leadership are committed to resolving by promoting 'harmonious development' (*hexie fazhan* 和谐发展). And in proclaiming then new polity, some of the language of the fourth generation of leaders echoes that of previous generations when central planners had more (if never total) ability to direct the spatial distribution of growth and development; for example, 'building a socialist new countryside'. As Goodman points out (2004: 318), pronouncements that the focus of development will be moved from the coast to the interior understandably generated similar conclusions (fears for some) that this could only be achieved by stepping back from liberalism towards state planning. But there are three reasons why we should question the extent to which this is really a 'new' departure in China's developmental trajectory.

First, the new policies aren't as 'new' as they are sometimes made to appear. For example, both the need to rebalance the economy and focus on the countryside and also the drive to 'open the west' were first proclaimed by Jiang Zemin – indeed, the State Council 'Office of the Leading Group for Western Region Development' opened its doors in 2000. The depiction of these policies as new perhaps reflects a desire make a clear break with those liberalising policies of Jiang Zemin and particularly Hu Jintao – most notably the liberalisation associated with joining the World Trade Organisation in 2001 – and to be more in tune with the growing voices of concern within China that economic liberalisation was going too far too quickly and generating social instability.

Second, the 'socialism' of the new countryside has little in common with what socialism meant in China in the second half of the twentieth century. For Wen Jiabao building the socialist countryside entails the abolition of the agricultural tax and the

phasing out of ad hoc fees, more central and local government spending to ensure access to compulsory education and the long term eradication of all tuition fees, more investment in science and technology to introduce new crop strains and agricultural technology, the renovation and modernisation of hospitals, and the extension of contributory cooperative medical care systems. This is clearly significant and entails an important reorientation of policy – and will cost a huge amount of money.

However, it entails a reorientation of policy *within* the parameters of the existing polity, not a change in the fundamental basis of polity. Similarly, it is true that central agencies will need to take a greater role in allocating more budgetary resources to projects away from the coast (particularly infrastructure and energy related projects) to redress regional imbalances – but only in much the same way that many governments across the world use budgetary revenues for development projects.

Furthermore, one of the strategies for promoting development away from the coast is to encourage foreign investment into previously closed sectors. By providing special incentives through the ‘Catalogue of Priority Industries for Foreign Investment in the Central-Western Region’ and in some cases encouraging foreign mergers and acquisitions of SOEs in the northeast, the regional development strategy in one part at least entails more, rather than less, liberalisation.

Third, there have to be serious question marks over whether the leadership has the capacity to deliver on its developmental promises. This is an economic system where central leaders cannot simply dictate patterns of activity by administrative fiat. It is one where market forces, external actors, and local governments are also key determinants of what economic activity takes place where. For example, the government can create incentives for investors, but they cannot make them locate their money away from the coast. Nor has the central government been able to capture

enough of the fiscal benefits of economic growth to fund its own developmental goals (Wang and Hu 2001). And what it does spend on developmental projects is often lost to corruption – for example, Jiang Zemin announced that up to 20 per cent of the official budget was going missing every year in 2000, while the National Audit Association calculate that a tenth of the government’s specific poverty alleviation spending goes astray (Watts, 2004).

State capacity and globalisation

This notion of a China struggling to deliver on developmental projects sits rather oddly with popular visions of a booming Chinese economy – and in particular, with a Chinese economy that appears to be an increasingly powerful force in the global economy. But this mismatch between what appears to be two different China’s is largely (though very roughly) a good indication of the different experiences of economic reform that have been generated in China. And its probably fair to say that China’s ‘successes’ are more visible to the outside eye than China’s residual development problems – more visible for most of those who visit China, and more visible in terms of the astonishing growth of the “made in China” phenomenon for consumers in the West.

Yet even when the focus is on China’s success both in terms of attracting investment and in producing exports, the developmental spillovers are not as clear (or as large) as might appear at first sight. Those who invest in China to produce exports are increasingly sourcing more of their components from domestic suppliers, though Lemoine and Unal-Kesenci (2004) argue that the increased use of local content is largely explained by foreign investors sourcing from other foreign investors with factories in China rather than from domestically owned companies. Non-processed

exports (those that are not reliant on imported components) were also the main source of export growth in 2005. But looking back over the last 20 years as a whole, we can argue that overwhelming majority of foreign producers in China have sourced their hi-tech/higher value added components/resources overseas: to date, the level of value added within China and the developmental consequences in terms of the upgrading of domestic industries has been relatively low.

One of the consequences is that the financial benefits of export led growth built on foreign investment have not been as large as the headline figures might suggest. For example, foreign invested enterprises (which produce the majority of Chinese exports) imported goods to the value of 87.2 per cent of their exports in 2005. Furthermore, with local governments competing with each other to attract investment (not to mention with other developing countries) by the time that help with start-up costs and tax breaks have been taken into account, the net financial gain for the Chinese side can be remarkably low – perhaps even in some cases negative. The influential Chinese economist, Yu Yongding (2006), has argued that the dominance of the processing trade in Chinese exports means that the process of integrating with the global economy has not proved to be an effective way of promoting domestic industrial upgrading. For Yu, the emphasis on attracting investment for processing and assembly should be overturned if China is to fundamentally move from a growth oriented economy to a development paradigm. And the first task is to ensure that growth rates for investment and exports are no longer considered the benchmark against which local officials are judged, and the criteria on which promotions are decided as this encourages a focus on quantity and raw figures rather than quality and net gain.

Conclusions

What this suggests, then, is that the rapid growth of the Chinese economy that has garnered so much attention for good reasons has perhaps not resulted in the developmental outcomes that the casual observer might expect. Much has been done, but even ignoring the negative environmental consequences, much also still remains to be done before the study of development in China can be consigned to a task for historians alone to conduct.

Of course things are changing fast. Investment in education and R&D is already resulting in Chinese companies occupying higher stages of the production chain in some industries. And there is a very real commitment in the top levels of the Chinese leadership to more equitable distribution of wealth, the removal of unfair financial burdens on those who can least afford it, and the provision of new welfare safety nets for those who need it most. There is even an acceptance that lower levels of growth might be better than double digit figures over the long term by focusing on the “quality” of that growth in terms of long term sustainability – both environmentally and economically. For example, in his 2004 government work report, Wen Jiabao noted that lowering growth rates to around seven percent was more sustainable than the previous “high-speed” model (People’s Daily, 2004).

In the event, the economy grew by ten per cent,⁽⁴⁾ and the central government’s objective of slowing economic expansion (and in particular, slowing investment in fixed assets) was less than successful. In some respects, this reflects a dichotomy between the rhetoric of political leadership in China and the reality of economic management. It also casts doubt on the attainability of reducing growth rates in 2007 as outlined in the introduction to this paper. This is not to say that the central Chinese state is powerless – far from it. Compared to many other central

governments and many other economies, the hand of the central state remains remarkably strong in China. But through a combination of devolution of some power to markets and the decentralisation of other powers to local authorities, the central government simply does not have the ability to control and direct economic activity in the way that some of the rhetoric suggests.

Nor is it to say that China is a developmental disaster – again, far from it. Compared to what has happened (or hasn't happened) in other developing states, then the Chinese experience does have many positive messages and lessons. But it is to say that while we rightly debate the causes of the astonishing economic growth in China and the way in which the lives of millions have changed dramatically, we should not forget that fighting poverty and achieving other developmental objectives remains an incomplete task – and in some respects a task that has been made more difficult by the way in which growth has been achieved. In short, we need to temper the occasional awe that China's growth generates with a recognition of the 'serious problems' that China's leaders are so keen to address if they can.

Notes

(1) The officially reported number of labour disputes increase over fivefold from 1993 to 2002 to 181,000 (Guo, 2003: 15) while 'public order disturbances' reached 87,000 in 2005 (McGregor, 2006).

(2) Xiaokang literally means "small well being". More recently, the terms 'middle class' and 'middle income class' have also been used to describe what people should aspire to become.

(3) To add even greater statistical uncertainty, it is widely thought that the figure of 250 million represented a massive underestimation. At a time when popular confidence in the party was at an all-time low, admitting to a much higher figure may have been deemed politically unwise.

(4) Originally reported as a 9.5 per cent, it was later amended to 10.1 because accounting methods had missed RMB2.13 trillion of the activity in the tertiary sector (People's Daily, 2005b).

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