Neoliberalism and Governance in China

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Both critics and admirers of China's economic reform agree that we are witnessing one of the most extraordinary episodes of social and economic transformation in human history. Launched more than thirty years ago to reinvigorate China from the stasis of the Cultural Revolution, the market-oriented reform has greatly improved the livelihood of the country's 1.3 billion people through sustained economic growth. However, contrary to the expectation of many Western observers, economic liberalization has not led to political liberalization or democratization. Instead, it has transformed China into a highly unequal and divided society in which power and wealth are monopolized by a small elite class of party cadres and associates, while a large number of peasants and workers are deprived of land, employment, welfare and rights. This development is interpreted by some academics as a sign of a 'neoliberal restructuring' (Yan 2003). Among them, the New Left scholars are particularly vocal in their attack against the so-called 'hegemony of neoliberalism' (Wang 2004), blaming market reform as the root cause of social inequality and the break-down of the public welfare system.

In this article I argue that despite some economic policies that bear resemblance to neoliberal practices and the prevalence of neoliberal apologists among academics and government figures, China's economic reform cannot be characterized as neoliberal either from an ideological or practical point of view. There is evidence that marketization and privatization is accompanied by recurring waves of nationalization, a process that strengthens state power in China. The New Left critique is therefore ill-targeted as neither the neoliberal nor the welfare state configuration exists in China. To better understand state behaviour in China, we need to take into account the Legalist and Mao-era legacies which continue to influence state-building to the present day. Together with rent-seeking and elite alliance, they provide a more compelling explanation as to why political liberalization has stalled in spite of success in the economic arena.

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Historically, neoliberalism was conceived as a counter-movement to the Keynesian school of state intervention and a reaction to the Soviet model of socialism. One of its earliest proponents, Friedrich von Hayek, argues that giving up economic freedom to central planning will inevitably result in governmental control of every aspects of citizen's life, leading to totalitarian rule (Hayek 1944). Milton Friedman further stresses that economic freedom is prerequisite to political freedom due to its effect on the concentration and dispersion of power and that competitive capitalism promotes political freedom because 'it separates economic power from political power and in this way enables the one of offset the other.' (Friedman 1962)

As the Western world became embroiled in high unemployment, inflation and fiscal crises in the 1970s, interest in Hayek's theories was renewed with a vengeance. It was suggested that the solution lies not in the further advancement of Keynesian policies but in the curtailment of the welfare state system. Public spending should be cut, global trade and investment liberalized and the state sector privatized to promote the market provision of public goods, which is believe to be fundamentally more efficient and fair.

The neoliberals' primary concern here the conflict between the state and the market; how state decisions are made is relegated to secondary importance. In other words, neoliberalism is keen to reduce state intervention in the market, but pays less attention to whether such policies are reached via democratic or autocratic means. As a leading pro-market economist in China puts it, 'resorting to decision-making by votes is already a bad situation, because such decisions may well accommodate populist demands and damages the market accordingly.'[2]

It is therefore not surprising that the first full-fledged experiment of neoliberalism was carried out not in a democratic state, but in Chile under the dictatorship of General Pinochet. Friedman praised it as the 'Miracle of Chile'. Hayek was equally impressed. After travelling to Chile in 1981, he even wrote to Margret Thatcher and urged her to follow the Chilean model more faithfully, to which Thatcher replied, 'In Britain with our democratic institutions and the need for a high degree of consent, some of the measures adopted in Chile are quite unacceptable. Our reform must be in line with our traditions and our Constitution.' (Klein 2007)

[2] Interview with Prof Zhang Weiying, Peking University, 20 July 2010

China's reform is also heavily influenced by neoliberalism. Friedman travelled to China three times in 1980, 1988 and 1991 to advise the top leadership on monetary reform. Many officials and scholars studied in the West when the US and the UK began to embrace neoliberalism under Reagan and Thatcher. They brought home what they believed to be the essence of market economy and championed reform policies that bear strong resemblance to neoliberal practices. These include the reduction of public spending on social welfare such as education and health care, liberalization of trade and investment, privatization of state-own enterprises (SOEs) and a transformation of government functions.

If we take 'reform' as 'marketization' and 'opening up' as 'integration into the global economic system', then they do sound rather like neoliberalism. Indeed, many scholars have made strong claims about a 'neoliberal restructuring' (Yan 2003), and a 'mutated form of neoliberalism', which if left unchecked will lead to serious social inequality (Zheng 2008). David Harvey describes China as 'a particular kind of market economy that increasingly incorporates neoliberal elements interdigitated with authoritarian centralized control' (Harvey 2005). Wang Hui goes further to claim that the 1989 protest should be understood primarily as a popular revolt against the neoliberal policies forcibly imposed by the authorities, and viewed in its proper context alongside the anti-globalization protests of the 1990s that erupted elsewhere in the world (Wang 2004).

But there is a risk of overstating the case. The term 'neoliberalism' has been used so frequently in so many situations that it has become synonymous with almost anything associated with globalization and modern capitalism. We need a clear definition that is both informed by the historical development of the idea and applicable to such entities as the state. I have chosen two criteria:

1) The ideology of neoliberalism: the state must subscribe to the belief that unregulated markets are more efficient and maximise individual happiness; state intervention distorts the optimal function of markets; global trade and investment should be promoted because it allows the market to function best.
2) The practice of neoliberalization: This includes privatization, deregulation, cuts in public spending, floating exchange rates, protection of property rights, liberalization of trade and investment, and limits to state power.

China meets neither of the criteria. Ideologically speaking, Deng Xiaoping did not start the reform with a commitment to neoliberalism (Breslin 2006), nor did he wish to revive capitalism in China through marketization. Instead, in his radical rethinking about China's future development, Deng was pragmatic enough to recognize the market's positive role in providing better allocation of resources and its ability to promote efficiency and 'free the forces of production'. As a result, marketization was identified as a means to rectify the failures of Maoist central planning, a necessary complement to building a more rational socialist economy. As Nonini points out, 'in no way did the reformers' admiration of markets extend to accepting the neoliberal claim that unregulated markets are excellent and maximize social happiness and individual satisfaction' (Nonini 2008). An unregulated market would go against the Four Cardinal Principles[3] that Deng dictated at the outset of the reform, weaken the Party's control over China's economy and jeopardize its rule. Subsequent statements of the Party's ideological directions, from Jiang's Three Represents[4] to Hu's Harmonious Society contain no reference that could remotely support the doctrine of neoliberalism.

Among the Party's claims to legitimacy, nationalism has risen to prominence in the post-Mao era. According to this doctrine, the Party will not only lead the vast population of China to prosperity, but also guard the country against foreign hostile forces. Granting foreign capital and products free access to China's market is out the question. Such ideas invoke the painful memories of the 'century of humiliation', with the Opium War being a prime example of how Western imperialism sought to open up an unadulterated market in China only to enslave and exploit the Chinese people. It is evident that despite tacitly integrating the country into global economy, the Party firmly rejects the neoliberal doctrine that the free flow of goods and capital across national borders is desirable. Various restrictions are in place on how foreign firms can set up joint ventures in China, and subsidies are provided to key state industries to raise their competitiveness in the global market. In the 1997 Asian financial crisis, China remained relatively unharmed thanks to its tight control over capital flow and currency exchange, while the more deregulated markets such as Malaysia and Thailand were severely battered. A number of scholars have noted that apart

[3] 'The upholding of the socialist path, the people's democratic dictatorship, the rule of the Communist Party and Marxist-Leninist-Maoist thought.'

[4] 'The Party represents advanced social productive forces, the progressive course of China's advanced culture, and the fundamental interests of the majority.'

from market liberalization and privatization, China's reform departs sharply from the model prescribed by the IMF/World Bank, which favours the free flow of capital, the use of undistorted market price and minimal state intervention (Liew 2005).

From a practical point of view, China's reform fails to achieve one the core objectives of neoliberalism – the limitation of state power. When Deng initiated the reform, the 'transformation of government functions' (Deng 1983) was one of his priorities. Several waves of administrative reform in the 1980s and 90s did make progress in the direction of 'small state, big society' by reducing the size and responsibility of the government. However, after the tax reform in 1994, the state has steadily eased its welfare burden while strengthening its extractive capacity. As Prof Chen Zhiwu from Yale demonstrates, China's tax revenue was equal to the disposable income of 330 million urban residents in 1978; the figure dropped to an all-time low of 146 million in 1995 but has been on the rise since. In 2007 it exceeds 370 million, exceeding the pre-reform level. This shows how the size of the state has rebounded. In terms of income growth rate, rural and urban residents grew by 120% and 160% cumulatively from 1995 to 2007, while government income jumped 570% in the same period, a shocking figure that could be even higher if we include the profits from state-owned enterprises (SOEs) and the appreciation of state-hold assets (Chen 2008). With unprecedented capital at hand, local governments are behaving more like corporations, with strong impetus to intervene, invest and profit from the market.

One feature that distinguishes China from the Chilean model is the nationalization and recapitalization of SOEs that goes hand-in-hand with the process of privatization. In the 1990s, the strategy for SOE reform was 'grasp the large and let go of the small', *i.e.*, the state retreats from low-profit and ill-managed sectors to a few key industries. Observers generally agree that this was a period when 'the state retreats and the private sector advances'. The trend has been reversed in recent years. The Chinese government has pumped more than $540 billion into the four state-owned banks to cancel non-performing loans (Liu 2010). Large SOEs are racing to the Hong Kong and Shanghai stock exchanges to recapitalize, setting new records for the largest ever IPO in history. In contrast, the private sector is struggling to raise funds through the stock market as they are crippled by tight regulations and frequent subjected to the so-called 'macro-economic adjustment policies'. One defining moment of this is the 'Tieben Incident' in 2004: a $1.5 billion steel project led by a private enterprise in Jiangsu was halted in favour of a similar project by the state-own Shanghai Baosteel Group. Similar incidents happen across the nation, for instance in Shannxi, where many small private oil firms were forcibly nationalized with negligible compensation.

Dubbed as 'the state advances, the private sector retreats', this new trend has seen tremendous growth in the public sector both in size and profitability. From 2003 to 2009, the total assets of central government-controlled SOEs increased from $1.1 trillion to $3.2 trillion. According to government figures, the combined profit of China Mobile and China Petroleum, who netted $22 billion and $15 billion respectively, is larger than the profit of the largest 500 private businesses put together, which stands at a mere $33 billion (Su 2010). The $600 billion stimulus package announced in 2008 to minimize the impact of the global financial crisis focused on housing, infrastructure and transportation industries, sectors traditionally dominated by the state. The additional $1.5 trillion bank loans made available in 2009 were mostly shared among SOEs. The latest stimulus programme for the 10 key industries is the clearest statement yet of the government's preferential treatment of the public sector, some of the plans even contain detailed merger and acquisition plans for SOEs. All of these developments run directly contrary to the core practices of neoliberalism.

We have shown that despite limited marketization and privatization, China's economic reform can hardly be characterised as neoliberal, either from an ideological or practical point of view. But if it is not neoliberal, then the New Left critique that neoliberalism brings about severe inequality and the breakdown of social welfare will be difficult to substantiate. Are there more fundamental reasons behind these grievances?

It could be said that neoliberalism in the West tends to cut the state's provision of public goods, but one must not forget that in a welfare state the provision of public goods is an inescapable state obligation. The Chinese state does maintain a nominal commitment to socialist values, but is fares rather poorly in terms of accountability. Like in past dynasties, social welfare is more of a manifestation of power - a charity through the 'emperor's kindness'. It is something to revere and be grateful to, as vividly captured in such phrases as 'parental officials, 'the Communist Party and Chairman Mao are our great saviours,' and the recent Internet catchphrase 'thank the state, thank the party'. One only has to turn to the TV news to get a sense of the prevalence of this relationship in Chinese society.

In China, the provision of welfare is based on privileges. The higher rank you are, the more benefits you claim. According to China's vice Health Minister, 80% of China's budget for the public health service is spent on the 8.5 million Party and state cadres, while 79.1% of the peasants have no social care or health insurance of any sort (Ministry of Health 2004). The same goes for public housing. Officials take the lion's share in the allocation of public-funded housing, and they can purchase the properties at a nominal cost with full state subsidy. The unemployed and the peasants enjoy no such benefits at all. It is evident that China has never been a welfare state. The system is more like what Qin Hui calls a 'reversed welfare state' (Qin 2010), in which redistribution only benefits the rich and increases social inequality.

One might argue that surely there is the similarity that both the current Chinese state and neoliberalism leave the poor to 'swim or sink' in the market. But there is a crucial difference: Under neoliberalism the poor at least enjoy some guarantee of civil rights and the liberty to seek benefit on the market, whereas the Chinese state has no comparable commitment to the notion of liberty. The residence permit system creates a virtual 'apartheid' of rural and urban dwellers, making it illegal for migrant workers to reside permanently in cities or seek benefits. In the cities, ghettos are torn down as 'illegal constructions', street vendors are frequently harassed by urban administrative officers. Beggars and vagrants are 'cleansed' from the street and sent to repatriation centres, where they could well lose their lives, as Sun Zhigang[5] did in 2003. These are arguably contemporary embodiments and continuation of an old Legalist tradition that stretches back to the founding days of the Chinese imperial system. As an early Legalist writes, 'the poor and the weak are either extravagant or lazy; if the King levies the rich in order to distribute alms among the poor, it means that he robs the diligent and frugal and rewards the extravagant and lazy.'[6] The 4th

[5] Sun Zhigang is a university graduate who had gone to work in Guangzhou (Canton). On 17 March 2003, he was questioned on the street by a police officer and detained for not holding a temporary resident permit. Three days later he died in the detention centre and autopsy report showed a savage beating before the death. The case attracted such public outcry that some amendment was made to the procedures of custody and repatriation.

[6] From Han Fei, 'Xian Xue' (The Prevailing Doctrines) in *Han Fei Zi*

century BC reformer Shang Yang once proclaimed: 'those who are poor due to laziness are to be rounded up as slaves'[7].

Thus, neither the neoliberal nor the welfare state configuration can be found in China, and the New Left critique looks more like Don Quixote's attack on the windmills. In a recent paper, Wang Shaoguang suggests that social welfare in China entails a two-fold problem: the state's capacity to afford such welfare programmes and its willingness to support it (Wang 2008). While he dwells on how to strengthen the state's 'extractive capacity', he provides no solution to the 'willingness' question. The state, it turns out, is increasing revenues through renewed 'extractive capacity', but with unconstrained power, there is no guarantee that it will use the money on social welfare, and not to its own end.

If China's authoritarian structure and the Party's unlimited power are naturally averse to political liberalization, then the market reform does aggravate the problem by providing further justification and incentives of maintaining the current system. The emphasis on efficiency, profit and GDP growth means that political issues in China are increasingly framed in market terms. Improvement in governance is now perceived as a problem of increasing the efficiency rather than accountability of the government. Authoritarianism is said to be more suitable to China because it is intrinsically more efficient than democracy in terms of mobilizing social resources. Granting citizens political liberty would only increase the cost associated with decision making and decrease the state's efficiency of governance.

Another example is the marketization and commodification of power. This is particularly true in the state-led privatization process. By using unconstrained political power, the administrators of public resources and the managers of SOEs are able to transfer large amounts of state-assets either to themselves or to people with close connections to them. This creates an alliance between the economic elites and the political elites, both born out of the ruling class of Party cadres. In this mutually dependent relationship, the economic elites rely on the state to provide economic stability, preferential access to market and protection of their business interests; the political elites then take every opportunity to cash-in through rent seeking and the appropriation of state assets in the disguise of market transaction (He 1998; Dickson 2008). One reason that this alliance

[7] From Sima Qian, 'The Biography of the Prince of Shang' in *Records of the Grand Historian*

remains stable is that the nationalization and re-capitalization process creates an inexhaustible source for future appropriation, a self-perpetuating cycle, as Qin Hui puts it, 'the state can now rob the mass with its left hand and give the money to the elites with its right hand.'[8]

This has resulted in startling inequality in China. According to a government research, from 1988 to 2007, the income ratio of the top 10% earners against the bottom 10% has widened from 7.3 to 23 times (Chang et al. 2009). A recent *Financial Times* article reveals just how the 'princelings' have come to dominate the lucrative private equity business in China (FT Reporters 2010). This is only the tip of the iceberg. Family members of high-ranking officials now occupy a sizable portion of the senior positions in the manufacturing, resources, construction and financial industries.

The alliance of the economic and political elites favours the freedom of the few over the freedom of the many. What they are building is not an unregulated market that neoliberalism hopes to establish, but a highly distorted market in which political power and state intervention helps the privileged few to benefit. Political liberalization will empower the public to put the elites under greater scrutiny, lower them to a level field of market competition and expose the corruption in their dealings, all of which threatens the very livelihood of the elites. The argument that political liberalization will lead to economic instability has replaced Maoist ideology as one of the most common excuses against political reform in China. Instead of becoming an independent force and challenging the regime for more political rights, the economic elites are not creating pressure for political change and seem to prefer the *status quo*. As Andrew Nathan writes, 'under conditions that elsewhere have led to democratic transition, China has made a transition from totalitarianism to a classic authoritarian regime, and one that appears increasingly stable' (Nathan 2003).

From the above discussion it is clear that China's economic reform conforms to neither the ideology nor the practice of neoliberalism. There is a danger of applying the 'neoliberal versus welfare state' dichotomy to China, as neither model exists there. Contrary to the New Left's claim, the gross social inequality stems not from a neoliberal restructuring but is deeply rooted in the 'reversed welfare' configuration and the state's unlimited political power, which helps the

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[8] Interview with Prof Qin Hui, Tsinghua University, 09 September 2010

public sector to advance at the cost of the private sector. The dual processes of nationalization and privatization more than complement each other, and this loop enables the economic and political elites to form a stable alliance so that they can collude on rent-seeking and take advantage of the less privileged. China's very economic success and this elite alliance have created further obstacles towards political liberalization, as the latter wound destroy the *status quo* and the chain of profit for the elites.

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