

The Provision of Public Services in the PRC in the Age of Reform: Reconciling State, Market and Civil Society

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Introduction¹

The provision of public services has always been one of the major tasks (if not the major one) of people in power throughout history. The fundamental reason for this is quite simple: every system of power, even the most authoritarian, needs to gain support from the masses, in order to give to its decision and orders the legitimacy necessary for obtaining obedience, without having to resort to the use of force². Already in ancient times (for ex. during the Roman Empire, the Maya civilisation, Ancient Egypt, or other historical examples) people in power have always proved it necessary to satisfy the needs people were not able to meet by private means. China is no exception to this general rule.

In Western States, the consequences of the Industrial Revolution have made the provision of public services even more necessary (although with different means and with different impetus and scope). The transition from the individual mode of production to mass production, made possible by the partial mechanisation of the production process, and the division of labour (based upon the principles of Taylor's scientific management) have disrupted the traditional social structure, and in spite of the spectacular gain of productivity, they have put large numbers of workers at the

¹ In the annex of this paper the reader will find the slides that summarize part of our presentation. **Figures 1 to 4** present some of the theoretical basis of this presentation.

² Max **Weber**, *Wirtschaft und Gesellschaft*, Tübingen, Mohr, 1956, has convincingly made the case for this fundamental strategy of different types of power which wish to govern society in the most peaceful way.

mercy of unscrupulous owners and managers. The reaction to this situation, aimed at helping the workers to face the risks of this new type of life (above all, unemployment, low pay, illness, accidents, unhealthy and dangerous working conditions, poor lodging and unhealthy living conditions, and old age) has taken more than a century to set up a complete system (the "Welfare State") aimed at satisfying these needs. Starting with the first State's interventions adopted during the late XIX century³ and the Great Depression of the 1930's, and ending with those leading to the establishment of a complete Welfare State during the second part of the XX century, Western States have responded to the needs of the masses by a huge legislative and financial intervention into the social system. At the same time, States have built all kinds of infrastructures necessary to the development of the market economy, as well as an important set of regulations aimed at (1) limiting some unwanted consequences of the market (e.g. pollution), (2) sustaining the development of market economy (e.g. counter cyclical policies), (3) protecting the citizens, workers, and consumer (e.g. against false information about the goods sold in the market), and (4) at limiting (or even forbidding) some commercial practices, contrary to the classical orthodoxy of market economy (e.g. anti-trust legislation). Of course all these policies had to be financed by a substantial increase of all sorts of taxations.

The result of this State's activity (supporting the market, and at the same time limiting some of the unwanted consequences of the economy) has been on the one hand an impressive increase of wealth (measured by GDP) as well as of the average personal income (in spite of disparities between states, regions and individuals). But on the other hand, towards the end of the 1970's, the expenses necessary for financing the State's interventions could not be balanced any more by an additional increase of taxation.⁴ A huge structural annual deficit appeared, and contributed to a massive increase of public debt.

³ Bismarck's embryo of a Welfare State in Germany during the late XIX century, being the more often quoted one.

⁴ This is of course a controversial statement. But it is true that today it is generally accepted in the West.

It is at this time that neo-conservative economists and political scientists (or neo-liberal, in the usual European continental terminology) were able to come out in the open, proposing their cure to the State's illnesses, known as the New Public Management (NPM).⁵ In short, it is proposed to reduce the State's size, by privatizing and/or contracting out State's activities, with the consequence of reducing the State's burden, and thereby reducing the level of taxation. This in turn would free the economy, by using the money not taken by the State to stimulate economic growth. Finally, it is said that this new impetus would benefit the entire society.⁶

As a consequence, practically all the OECD States have adopted a strategy that, with different scopes and impetus, is based upon the prescriptions of NPM.⁷

During this period, and in fact up to the present time, it was the turn of the defenders of the Welfare State, and more generally of State's intervention in the economy and the society, to be on the defensive, and with practically no possibility of being heard.

⁵ After the Second World War, the general agreed policy among Western policy makers was to reconstruct Europe (with the aid of the American Marshall Plan). This necessity became even more compelling when, at the end of the 1940's, Europe became divided into Western and Eastern Europe. People in favour of a limited role of the State in society (and especially in the economy) had no chance of being heard. Milton Friedman complains about this kind of blackout in the preface to the second edition of his (now) famous book: **Friedman, Milton, Capitalism and Freedom**, Chicago, Univ. of Chicago Press, 1962 (1982 with a new Preface by the author). It is useful to remind that many economists belonging to this stream, got together in 1946 in a little Swiss resort (above Vevey), the Mount Pèlerin, and founded the "Society of the Mount Pèlerin" with several Nobel Prize winners, among them Milton Friedman, F. von Hayek, and others. With the support of several rich foundations (financed by the private sector, especially in the USA) they prepared themselves for the time when their expertise would seem, to many policy makers, inescapable. This has been the case, for ex., for President Ronald Reagan, and Prime Minister Margareth Thatcher.

⁶ Other measures were the adoption by the State of management techniques imported from the private sector, the deregulation of the markets, the adoption of a more transparent national accounting, and the flexibilization and deregulation of human resource management in the public sector, namely the end of the public service status. The general principle, upon which NPM is based, is that of economic efficiency.

Osborne, David, and Gaebler, Ted, Reinventing Government: How the Entrepreneurial Spirit is Transforming The Public Sector, New York, Plume Book, 1992 is generally considered as the founding statement of New Public Management, at least in the USA; see also **Osborne, David, and Plastrik, Peter, Banishing Bureaucracy. The Five Strategies for Reinventing Government**, New York, Penguin, 1997. There is a huge literature in favour of NPM (and a much less wide literature against it). See for ex. in favour: **Barzeley, Michael, Breaking through Bureaucracy. A New Vision for Managing in Government**, Berkeley, Univ. of California Press, 1992, and **Barzeley, Michael, The New Public Management, Improving Research and Policy Dialogue**, Berkeley, Univ. Of California Press, 2001

⁷ Mr. Uwe Wissenbach's paper presented to this Symposium will give us some interesting information about the NPM trends within the European Union.

It is only recently that several scholars have pointed out the negative consequences of the implementation of NPM prescriptions.⁸ This might be of some interest to Chinese decision makers, as a careful examination of some of the trends launched by the reform process in China shows that they have some similarities with the NPM prescriptions. It is enough to mention the privatisation of part of the Chinese economy⁹, the privatisation of part of the education system, the introduction of some of the human resource management practices similar to those of the NPM, etc.

In this respect, it is important to remember that NPM was introduced in the West at a time when its society was being organised in a fundamentally different way as compared to China. It is therefore necessary to examine with great care the possibility of transposing to China the same NPM-type reforms¹⁰. Moreover, it is necessary to take into consideration the long history of Chinese reforms (started at the end of the 1970's) and to evaluate the actual consequences of these reforms on Chinese society. Taking on this particularly difficult and demanding task, it will be necessary to fully understand the main characteristics of Chinese society, as it is today, as well as its social structure, economy, polity, and maybe even more important, its social culture, i.e. the set of the fundamental social values, beliefs, and behavioural norms. Finally, the huge size of the country (and especially of its population), as well as the great diversity between regions, and provinces, adds to the complexity of the Chinese situation.

Having said that, it is clear in our mind that the considerations we will develop in this paper, some of which might seem rather critical, should be taken by the participants,

⁸ See for ex. our article: **Urio**, Paolo, "La gestion publique au service du marché", in Marc Hufty (ed.), La pensée comptable. Etat, néolibéralisme, nouvelle gestion publique, Paris, Presses Universitaires de France, 1999, pp. 91-124. For an exceptionally complete overall evaluation of NPM, based upon empirical evidence from a variety of sources, see **Suleiman**, Ezra, Dismantling Democratic States, Princeton, Princeton Univ. Press, 2003.

⁹ It must be noted that this process is far from being as wide as some western observers think it is. The Chinese Government has explicitly said on more than one occasion that several sectors of the State's economy will not be privatised: this comprises not only the armament industry (which is quite understandable), but also public utilities, and what are labelled "strategic sectors".

¹⁰ See for example the article of Prof. Allen **Schick**, "Why Most Developing Countries Should Not Try New Zealand Reforms", The World Bank Research Observer, Vol.13, no. 1 (February 1998), pp. 123-31.

and above all by our Chinese friends, as expression of the interest, concern, and sympathy we have for this great People and Civilisation. To quote the Western proverb (but I am sure that there must be a similar one in China): “You have to be cruel to be kind ...”.

Providing public services in China: some general considerations

Providing public services¹¹ entails not only the mastering of technical, and managerial skills. It also implies the mastering of a complex set of parameters and variables. In China this task is rendered even more difficult, because it is the whole of Chinese society (with all its components) that is changing at the same time¹². The consequence of this situation is that this overall change necessitates an extraordinary capacity of analysing, forecasting, designing, adopting, implementing, and monitoring public policies, ... as well as of seeking support from the people, i.e. gaining legitimacy, which by the way was one of the main challenges facing the Chinese leadership at the end of the Moist Era.

Before we take into consideration the consequences of the economic development since the beginning of the 1980's, it might be interesting to list the types of analysis and actions to which it would be necessary to pay attention, in order to set up an efficient and effective provision of public services, i.e. capable of satisfying the Chinese People:

¹¹ See: **Mattoo**, Aaditya and **Carzaniga**, Antonia (eds.), Moving People to Deliver Services, Washington, The World Bank and Oxford Univ. Press, 2003

¹² The reforms introduced in the West since the 1980's have been considered by many observers and scholars, as a fundamental change. Some people, especially those on the far left side of the political continuum, have spoken of the “dismantling of the Welfare State”. This is also the case for some scholars: see the book of **Suleiman**, quoted in note 7 above. Nevertheless, it is worth noticing, that almost no one proposes to fundamentally change the way of organising our economy (it remains a market economy with more or less State intervention). And no one proposes to put an end to the Rule of Law, etc. Changes are important, but they modify our system only incrementally. And this makes things easier than in China.

- (a) analysis of the **actual needs of the population**, taking into consideration:
- (1) **the sociological structure of the population** in terms of
 - demography (with projections to a 5, 10, 20 years horizon);
 - mode and level of living;
 - the type of occupation in the economy;
 - the availability or lack of all sort of infrastructures – including education, health care (both preventive and curative medicine), drinkable water, etc.;
 - (2) the **income distribution** between regions, provinces (including the 4 municipalities depending directly upon the central State), and amongst people (personal or household income);
decide what type of public action is needed;
 - (3) the level of **unemployment** (national, and by regions, provinces, municipalities);
decide what type of public action is needed;
 - (4) type and level of **resources available** in regions, provinces, municipalities, and evaluation of the potential for economic development, taking into consideration:
 - financial resources
 - education & human resources;
 - natural & cultural resources;
 choose, on this basis, the sectors in which it is more urgent and/or efficient to invest: environment, education, agriculture, agro-alimentary industry, different types of other industrial sectors, services (especially social insurances and different types of financial services);
set up (or use the existing) a central government institution for the coordination of these actions;
 - (5) the state of the **environment**, evaluate what intervention is needed;
 - (6) evaluate the **expectations of the Chinese people**, especially those living in less developed provinces and municipalities, as well as those living in more developed provinces and municipalities.

Take into consideration that information about the standard of living of well-developed provinces and municipalities is nowadays easily available in China. It is reasonable to forecast that people living in less favourable situations will expect to improve their standard of living in the near future;

- (7) evaluate the **flow of internal migration** from the less developed areas (mainly rural) to the more developed (urban) and evaluate the consequences, especially those needing State intervention for urban infrastructure and social services;
 - (8) identify the actions necessary to improve the **productivity of the agriculture**, and the **industrialisation of the rural areas** (starting with agro-alimentary industry).
- (b) based upon analysis of point (1) to (8) above, **evaluate the fiscal policy needed to finance the provision of the public services thus identified:**
- (1) **evaluate the fiscal capacity (taxation)** of each region, province, and municipality, and adapt the fiscal system accordingly, in terms of:
 - types of taxation;
 - personnel needed for collecting direct and indirect taxation; and
 - perequation between rich and poor provinces, etc.;
 - (2) based upon analysis (1) to (8) above, **evaluate the amount of financial resources needed** to satisfy the needs identified during the need analysis;
 - (3) decide the **priorities**.¹³ This decision should be taken simultaneously with the decision about **the hiring and/or training of the people needed to perform the public services chosen**, as well as the infrastructure and technical equipment necessary for this purpose;
 - (4) decide **how to finance State's action**: through normal budgetary means (taxation) or through extra-budgetary means; evaluate the risk of increasing the public debt;

¹³ As these will have to be decided on the basis of political consideration, it is upon the Chinese leadership to set up the criteria necessary to this decision.

- (5) evaluate the possibility of re-directing **foreign direct investments (FDI)** towards the areas in need of development;
 evaluate what are the measures the public authorities must take to achieve this goal.

Providing public services in China:

taking into consideration the consequences of reforms since 1979

The economic development achieved by China thanks to the reforms introduced by Deng Xiaoping since 1979 is quite impressive. In its report of 1997 (i.e. before the reform trend was to be confirmed by the September 1997 congress of the CPC): the World Bank compares the time needed for doubling the GDP by several countries: the United Kingdom needed 58 years (from 1780 to 1838), the USA 47 (from 1839 to 1886), Japan 34 years (from 1885 to 1919), South Korea 11 (from 1966 to 1977), and China only 9 years (from 1978 to 1987), not only once, but twice (the second time from 1987 to 1996), and even more impressive, during 2 consecutive periods of 9 years.¹⁴ Even though this type of comparison must be made with care (the overall situation at different historical periods of time is quite different and can, at least in part, explain the difference in speed), the achievements, when measured by GDP, are quite impressive. Other data comfort this impression:

- (1) the general standard of living has considerably improved (even though, as we shall see, it is counterbalanced by the increasing disparities between regions, provinces, and between individuals within provinces),
- (2) extreme poverty has been eradicated,
- (3) housing has been improved, especially in the coastal regions,
- (4) communication infrastructure has been improved (railways, roads, telecommunication),

¹⁴ **World Bank**, *China 2020*, Washington, D.C., 7 volumes, vol. 1, 1997, p. 4. For a general overview of China's economic transformation: **Chow**, Gregory C., *China's Economic Transformation*, Oxford, Blackwell, 2002. For the changes in China's public management: **Lee**, Peter Nan-Shong, and **Lo**, Carlos Wing-Hung (eds.), *Remaking China's Public Management*, Westport, Connecticut & London, Quorum Books, 2001

- (5) the education system has been improved at all levels, illiteracy has almost completely disappeared, etc.

Nevertheless, some important negative consequences of economic development have appeared. Moreover, some of the features of the organisation of Chinese society seem to constitute serious obstacles to the further development of the well-being of the Chinese People. Several scholars, both in China and in the West, have pointed out these difficulties since the mid 1990's¹⁵.

Let us try to summarize the **major problems of the Chinese market**. The transition from a command to a market economy must be able to master the following processes:

- (1) of **privatisation**, in order to free private initiative and resources,
- (2) of **reforming the SOEs**, in order to make them competitive in the market, (especially since the entry of China into the WTO),
- (3) of **reforming the State's Banks**, making them competitive by getting them rid of the non-performing loans (NPL), in order to sustain the development of the economy,
- (4) of **regulating the financial market**, so that Chinese enterprises can drain the capital they need,

¹⁵ There are not only very pessimistic analyses like the one by **Chang**, Gordon G., The Coming Collapse of China, New York, Random House, 2001, but also several more balanced and objective ones. See for ex. from Chinese scholars.: **Chi Fulin**, Reform Determines Future of China, Beijing, Foreign Language Press, 2000, **Chi Fulin**, China's Economic Reform at The Turn of the Century, Beijing, Foreign Language Press, 2000, **Wang**, Shaoguang, and **Hu**, Angang, The Chinese Economy in Crisis. State Capacity and Tax Reform, Armonk, New York, & London, M.E. Sharpe, 2001, **Wang**, Shaoguang, and **Hu**, Angang, The Political Economy of Uneven Development. The Case of China, 1999; and from western scholars, for ex.: **Nolan**, Peter, China and the Global Business Revolution, Houndsmill, UK, Palgrave, 2001, **Nolan**, Peter, China and the Global Economy, Houndsmill, UK, Palgrave, 2001, **Nolan**, Peter, Transforming China. Globalization, Transition and Development, London, Anthem Press, 2004, **Nolan**, Peter, China at the Crossroads, Cambridge, UK, Polity Press, 2004, **Lardy**, Nicholas R., China's Unfinished Economic Revolution, Washington, D.C., Brookings Institution Press, 1998, **Lardy**, Nicholas R., Integrating China into the Global Economy, Washington, D.C., Brookings Institution Press, 2002, and **Domenach**, Jean-Luc, Où va la Chine?, Paris, Fayard, 2002; for the Chinese political system: **Saich**, Tony, Governance and Politics in China, New York, Palgrave, 2001; **Zheng**, Shiping, Party vs. State in Post-1949 China, Cambridge, Cambridge Univ. Press, 1997; **Lin**, Yi-min, Between Politics and Markets, Firms, Competition, and Institutional Change in Post-Mao China, Cambridge, Cambridge Univ. Press, 2001. On the development of the private sector: **Garnaut**, Ross and **Ligang Song** (eds.), China's Third Economic Transformation. The Rise of the Private Economy, London, Routledge, 2004

- (5) of **correcting the unwanted consequences of the market economy** (namely the increasing *unemployment*, the increasing *disparities*, the consequences of the aging population) and the **deterioration of the environment** (both physical and human), in order to make the economic development more equitable and respectful of the physical and human environment,
- (6) of **eradicating corruption**, so that public money and public manpower are entirely used for the implementation of public policies, and not for private purposes,
- (7) of setting up a **legal system capable of supporting the development of market economy**, so that it becomes the source of an important part of the fiscal resources of the State.
- (8) For many of these policies China needs an **improvement of its fiscal capacity**, on the one hand of the taxation system, and on the other of the efficacy and efficiency of its expenses (public policies).¹⁶
- (9) The problems mentioned above should be implemented while maintaining the social and political stability of the country.

In short, an efficient and effective provision of public services will depend on the mastering of the following factors:

- (1) A precise evaluation of the needs (of people, enterprises, and government)
- (2) The availability of sufficient financial resources, this depending upon an efficient taxation system
- (3) The availability of human resources (with good knowledge, skills and attitudes, and sufficient in number) for the implementation of public services
- (4) An economic system capable of:
 - 3.1. providing sufficient resources to both people and enterprises, and at the same time of
 - 3.2. providing an economic basis sufficiently wide and stable, in order to allow the government to drain, through different forms of taxation,

¹⁶ Here again, the problem of curbing corruption seems to be an important one.

the financial means necessary for sustaining the implementation and development of public services; this second objective should not frustrate the initiative of investors and entrepreneurs, and should sustain the improvement of the people's standard of living, especially of those living in the less developed areas.

In conclusion, the good health of the economic system seems to be the necessary condition (if not the sufficient one, as we shall see hereafter) for succeeding in this endeavour.

The strategic choice of the market economy

In order to increase the performance of the economic system, the Chinese leadership has opted in favour (at least partially) of a market economy.¹⁷ The market can be viewed as a set of laws (based upon economic theory) and technical tools and arrangements (based upon theory and on practical experience). It is our opinion that this view of the market is not sufficient for the mastering of this very special and demanding way of organizing the production process. This is not the place to dissertate upon how market economy in the West traces its origins back to Greek philosophy and Roman law, to the reorganisation of European society during the Middle Ages, to the role played in the economy, politics, and the legal domain by the Catholic Church, to the role of the universities and the professions (lawyers, theologians, scientists) and finally to the three major revolutions that have made it possible to impose this type of economic system as the best means of producing and distributing wealth. In short, it has been a long transformation process involving all the dimensions of society.¹⁸ Moreover, the West has developed a special type of

¹⁷ **Brook**, Timothy, and **Blue**, Gregory (eds.), China and Historical Capitalism, Genealogies of Sinological Knowledge, Cambridge, Cambridge Univ. Press, 1999

¹⁸ See **Annex, figures 5 to 9** summarize the origins of market economy, its major economic characteristics, as well as its link to the State. For the contemporary analysis of various forms of capitalism: **Bottomore**, Tom, Theories of Modern Capitalism, London, Allen & Unwin, 1985; **Hall**, Peter A., and **Soskice**, David (eds.), Varieties of Capitalism. The Institutional Foundations of Comparative Advantage, Oxford, Oxford Univ. Press, 2001. For a contemporary western critique: **Meiskins Wood**, Ellen, Empire of Capital, London, Verso, 2003. For the origins of capitalism: **Meiskins Wood**, Ellen, The origins of Capitalism, London, Verso, 2002. For the rise of market economy and an international comparison about "the wealth of nations" see, among the vast literature:

relationship between market and State, that has made it possible for this type of economy to develop.

This is not to say that a market economy will necessarily need to be sustained by the same type of State, and the same type of relationships connecting State, legal system, economy, and citizens in every country in the World, based upon the Western model. We just want to suggest that it would be foolish not to take advantage of learning something useful from the success, but also from some of the dramatic failures, that have characterized the long history of market economy in the West.

Moreover, it is certainly legitimate to explore the possibility of discovering (and eventually of experimenting) some other ways of organising these relationships. We are asking at this point this fundamental question: are there in the Chinese society and culture some “functional equivalents” to the Western way of organising the interface between market and society, between market and politics? Before we try to find an answer to this question, let us try to summarize the major obstacles facing the Chinese leadership.

The major obstacles can be summarized as follows:

- (1) the weakness of the economic and financial basis,
- (2) the difficulties of managing the centre-periphery relations,
- (3) the weaknesses of the legal system, and
- (4) some of the characteristics of the Chinese culture inherited from the past.

Wallerstein, Immanuel, The Modern World System, New York, Academic Press, 2 vol, 1974 et 1980; **Wallerstein**, Immanuel, Le capitalisme historique (translation of Historic Capitalism) Paris, La Découverte, 1985; **Landes**, David S., The Fable of the Horse, or The Industrial Revolution Revisited; **Landes**, David S., The Wealth and Poverty of Nations. Why some are so rich and some so poor, New York, Norton, 1999 (with 2 chapters on China Japan). For the link between economic development and the development of science: **Needham**, Joseph, Science and Civilisation in China, New York, Cambridge Univ. Press, 7 volumes, 1954-2004. For a comparative analysis of the rise of the natural sciences: **Huff**, Toby E., The Rise of Early Modern Science. Islam, China, and the West, (second ed.) Cambridge, Cambridge Univ. Press, 1st edition 1993, 2nd edition 2003. For the eastern origins of western civilisation: **Hobson**, John M., The Eastern Origins of Western Civilisation, Cambridge, Cambridge Univ. Press, 2004 (Ch. 3 and 9 on Chinese influence on the West)

The figure on the following page summarizes these problems, difficulties, and obstacles, as well as the policies needed to overcome the difficulties, by indicating the main links between these sets of variables.¹⁹

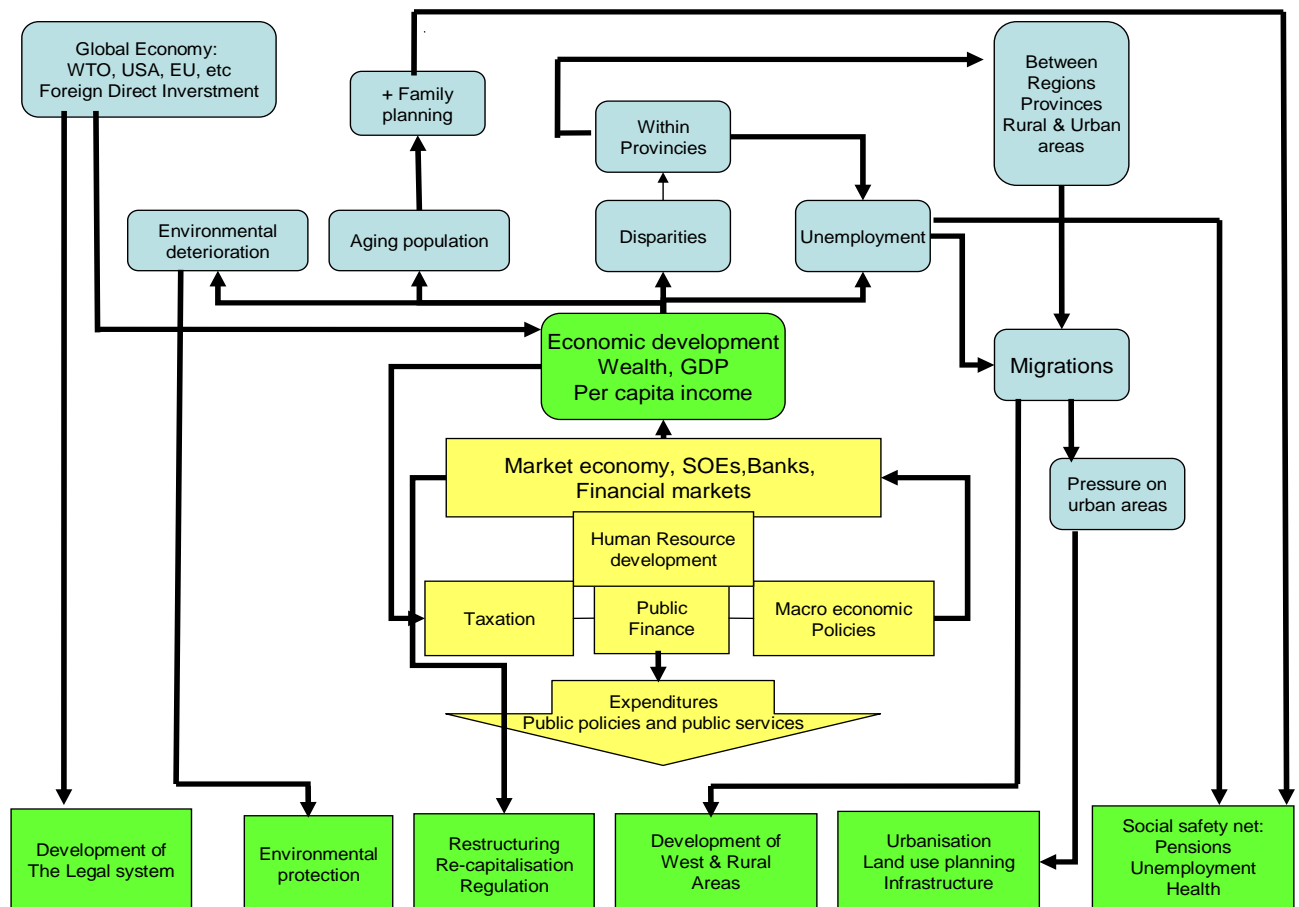
A thorough analysis of the relationships (summarised by this figure) shows that one of the major problems to be tackled is that of the availability of financial resources for the central (and provincial) government. The second problem, closely connected to the first one is the availability of competent civil servants capable of mastering the formidable tasks of designing and implementing a more efficient taxation system.

Moreover, the Chinese leadership will have the difficult task of convincing the taxpayers (households, enterprises, and local governments) to accept an increase of taxes levied by the central Government.

Closely linked to the problems of increasing the taxation, is the development of the social safety net. According to the analysis, and first realisations, made under the guidance of the Ministry of Labour and Social Security, the new system (which is supposed to free the SOEs from the financing of the traditional safety net) will need a huge amount of capital. This is likely to be financed by joint contributions of employees, employers, and government. This increased perception on

¹⁹ It goes without saying that the causal links suggested are purely qualitative in most cases. To our knowledge there is today no quantitative model able to take in consideration the complexity of these links. There is nevertheless sufficient empirical evidence that the arrows connecting the sets of variables, represented in the figure by the rectangles, are reasonably based upon a causal relationship.

Problems, Obstacles, and Policies facing the Chinese Leadership in the Age of Reform



households and enterprises will inevitably constitute a burden for both enterprises and households, and a significant limitation of their capacity to use part of their own earnings as they please. It is therefore of the greatest importance that the money collected by the central government be used to provide services, that will be valued by both households and enterprises. It is in this context that the struggle the PCP is conducting against corruption will acquire a central importance.

Of course, the components of a safety net can be provided either by government or by the private sector, and they can be made compulsory or left to the decision of the people. If the financing of a compulsory safety net would be considered too heavy a burden for the government and/or the enterprises, it would be tempting to leave it to the discretion of the people. History of the implementation of a safety net in the West

shows that if this solution is quite satisfactory for well-to-do people, it is totally unrealistic for people at the lower end of the income distribution continuum. These people have generally to spend their meagre income to cover immediate needs, and are not likely to freely subscribe to private social insurances. Therefore, setting up a compulsory (even if limited) safety net seems to be a must, as one of the major goals (probably the most important) of the Chinese leadership is to maintain social and political stability of the country. Once the government has made the safety net (or at least part of it) compulsory, it has to decide whether the insurance providers will be private, public or both.²⁰

But, as we have already pointed out, the major asset for the implementation of effective and efficient public services will be the health of the economic system. Let us now turn to the major difficulties. It is important to note that the dominant opinion in the West is that considerable improvements have been achieved by the Chinese leadership in all domains, but that there is still a lot to be done for completing successfully the transition from the command to the market economy.

The weaknesses of the economic basis

There is a huge literature pointing to these weaknesses. The best short presentation has been made by the 2002 OECD Report on China (see figures 11 and 12 of the annex). In short, the interrelated, and mutually reinforcing, weakness of State's banks and SOEs (poor governance, poor operations, bad loans, poor credit quality) make it

²⁰ There is a huge western literature (and practical experiences) on this topic. It must be pointed out, however, that the changes introduced during the last 25 years in the West, must be considered with great care, because the general situation of these countries is quite different from the Chinese one. It would be more interesting to analyse, and eventually be inspired by the early western States' intervention in this domain (from the end XIX Century up to the 1960's). Among the vast literature on the Welfare State, see: **Esping-Andersen**, Gosta, *The Three Worlds of Welfare Capitalism*, Princeton, Princeton Univ. Press, 1990 ; **Esping-Andersen**, Gosta, *Welfare States in Transition*, London, Sage, 1996; **Esping-Andersen**, Gosta, *Social Foundations of Postindustrial Economies*, Oxford, Oxford Univ. Press, 1999; **Esping-Andersen**, Gosta, *Why we Need a New Welfare State*, Oxford, Oxford Univ. Press, 2002; **Barr**, Nicholas, *The Economics of the Welfare State*, Stanford, Stanford Univ. Press, Second edition, 1993; **Goodin**, Robert E., **Heady**, Bruce, **Muffels**, Ruud, and **Dirven**, Henk-Jan, *The Real Worlds of Welfare Capitalism*, Cambridge, Cambridge Univ. Press, 1999; **Swank**, Duane, *Global Capital, Political Institutions, and Policy Change in Developed Welfare States*, Cambridge, Cambridge Univ. Press, 2002; **Hacker**, Jacob S., *The Divided Welfare State*, Cambridge, Cambridge Univ. Press, 2002; **Gilbert**, Neil, *Transformation of the Welfare State. The Silent Surrender of Public Responsibility*, Oxford, Oxford Univ. Press, 2002.

difficult for the government to restructure and to obtain sufficient funds.

Paradoxically, these difficulties are the consequence of governmental interferences into the governance of these enterprises and banks.²¹

Another source of weakness is to be found in the poor transparency of the enterprises' accounting practices, and in the not sufficiently regulated financial market. This of course explains the difficulties to attract investments from both Chinese and foreign investors. Of course the size of FDI has considerably increased in recent years, and China has become the first FDI receiver before the USA. But as Peter Nolan and others have shown, part of these FDI is in fact Chinese money sent abroad and then placed in China for the purpose of obtaining a favourable fiscal treatment. Moreover, parts of these investments are directed towards foreign or joint venture companies operating in China. And many of these companies are producing for the international market and not for the Chinese one.²² If in addition to this, one takes into consideration that foreign enterprises prefer to have the majority of the capital, and total control of the management, one can have some doubts about the benefits China is gaining from these FDI. It would be necessary to set up the conditions for attracting and directing FDI where capital is more needed.²³

But it is our opinion that the major source of weakness must be found in the strategy adopted for developing the country after the Maoist Era. This is quite a controversial thesis, and by no means the most widely accepted. But it has some rationale. The figure 14 of the annexe summarizes this thesis. Normally, western observers of Chinese politics, praise the way Chinese leaders deal with time, and more particularly their ability to wait for the right moment. Our opinion is that the type of development chosen at the beginning of the 1980's has on the one hand produced a spectacular and rapid economic development of the coastal areas (especially thanks

²¹ OECD, China in the World Economy. The Domestic Policy Challenges, Paris, 2002, pp. 16 and 21. OECD people are very polite. I suppose that they meant: party interferences.

²² For ex.: Peter Nolan, op. cit. 2004, pp. 10 and 181, note 6, and pp. 22 and 182, note 8.

²³ See for example OECD, China, Progress and Reform Challenges, Ch 1, Paris, 2003; Mehmet, Ögütçü, Foreign direct investment and regional development: sharing experiences from Brazil, China, Russia and Turkey, Paris, OEDC, 2002; OECD, Foreign Direct Investment for Development, Paris, OECD, 2003

to the special economic zones), but at the same time it has left the other regions (and more particularly the western provinces) well behind the rest of the country.²⁴ The consequences of this (too) rapid development are the necessity for the Chinese leadership to reconcile the interests of the increasing middle class in the urban areas (not to speak of the very rich) and those of the rural areas whose immediate needs are quite different and necessitate some important State's actions.²⁵ Moreover, a massive number of internal migrants are leaving the less developed areas and are moving to the urban areas (sometimes on a seasonal and non permanent basis) and are putting a heavy pressure on the infrastructure of the urban areas to where they emigrate. Of course these phenomena have their own advantages for the Chinese economy: these migrants, similar to the tens of millions waiting to find jobs in the second and third sectors, constitute a huge reservoir of cheap labour. This will allow several sectors of the Chinese export economy to remain competitive in the global market for many years to come. But the question is: for how long these migrants (and potential migrants) will be willing to work under such conditions.

This situation adds to the necessity of setting up a safety net not only for urban people, but also for the migrants, and in the medium term also for the people in the rural areas. Moreover, there is a great need of improving the working conditions of the better-educated people in the rural areas; otherwise they will leave, and some are already leaving the rural areas for the urban ones, where their knowledge and competencies are better rewarded and the living condition more appealing. This exodus of well-educated people is putting some heavy burden on the rural areas.²⁶

²⁴ **Riskin**, Carl, **Zhao**, Renwei, **Li**, Shi (eds.), China's Retreat From Equality. Income Distribution and Economic Transition, New York, M.E. Sharpe, 2001; **Khan**, Azizur Rahman, **Riskin**, Carl, Inequality and Poverty in China in the Age of Globalization, Oxford, Oxford Univ. Press, 2001

²⁵ In order to solve these problems the Chinese Government has launched a series of public works in the western regions, as well as a policy developing the human resources in these areas. Apart from the fact that these policies are mainly financed by extra-budgetary funds, which could in the long run become difficult to sustain, these policies (launched too late, in our opinion) have not prevented until now the massive flow of internal migrants from the less developed areas to the urban ones. On the problems of disparities, rural areas development, poverty alleviation, poverty in urban areas, etc.: IFPRI Research Report 125: S. Fan, L. Zhang, and X. Zhang, Growth, Inequality, and Poverty in Rural China, 2002; **Saich**, Tony, Governance and Politics of China, Houndsmill, UK, Palgrave, 2001, Ch. 2; UNDP, China Human Development Reports, Geneva, 1999, 2002; World Bank, China: Promoting Growth with Equity, Report No. 24169-CHA, October 15, 2003; Athar Hussain, Urban Poverty in China: Measurement, Patterns and Policies, Geneva, International Labour Office, January 2003.

²⁶ On the situation of Chinese workers, see for. ex.: **Chan**, Anita, China's Workers Under Assault. The Exploitation of Labor in a Globalizing Economy, London, M.E. Sharpe, 2001. On the situation of rural

Another policy for mastering these problems would be to transfer financial resources from the more developed provinces to the less developed ones. But, as history shows (and not only in China), the latter are generally reluctant to accept to do so.

Two additional weaknesses are worth noting. The first is that the Chinese market (as an economic space where production factors and goods and services are free to move) is not yet completed. This is due to the local (provincial) policies aimed at protecting the local economy from competition from other parts of China.²⁷ The last weakness is to be found in the weak fiscal capacity of the Central government to collect the financial means necessary for the implementation of its policies. This has been rather dramatic during the fiscal decentralisation of the 1980s and early 1990s. But even after the reform of 1994, the fiscal capacity of the central government has not improved to the point that a more drastic reform is considered necessary to many experts.²⁸

The weaknesses of the legal system

This is, according to the overwhelming majority of western scholars, one of the major weaknesses of the Chinese political and administrative system.²⁹ We refer here to one of the most complex problems of the mastering of market economy in China, as it is deeply imbedded into some of the features of the Chinese culture, of which we will speak in the next paragraph.

China and the problems of migrant labour see for ex.: **Oi**, Jean C., Rural China Takes Off. Institutional Foundations of Economic Reform, Berkeley, Univ. of California Press, 1999; **Murphy**, Rachel, How Migrant Labour is Changing Rural China, Cambridge, Cambridge Univ. Press, 2002

²⁷ For ex.: Nolan, 2004, *op. cit.*, and Lardy, 2002, *op. cit.*

²⁸ For ex.: Ehtisham **Ahmad**, Li Keping, Thomas Richardson, and Raju Singh, "Recentralization in China?", IMF Working paper WP/02/168, October 2002, OECD, China in the World Economy, *op. cit.*, Ch. 18.

²⁹ On the importance of law for a market economy and law in the Chinese contemporary context: **Malloy**, Robin Paul, Law and Market Economy. Reinterpreting the Values of Law and Economics, Cambridge, Cambridge Univ. Press, 2000; **Oi**, Jean C., and **Walder**, Andrew G (eds.), Property Rights and Economic Reform in China, Stanford, Stanford Univ. Press, 1999; **Angle**, Stephen C., Human Rights and Chinese Thought. A Cross-Cultural Inquiry, Cambridge, Cambridge Univ. Press, 2002.

First of all it is necessary to point out that the Chinese tradition in this domain is quite different from the western one, where behaviour based upon inter-personal relationships prevails over behaviour oriented by formal rules (laws and regulations). Since the political liberal revolution of the end of the XVIII century and all along the first part of the XIX century, the idea of a legal structure to which all the people, including those in power, are subordinated, has been widely accepted by all political families. Separation of powers, checks and balances, multiple party systems, and freedom (sanctioned by constitution and laws) for all sorts of interests to organise (interest groups), representing autonomously (i.e. without any State's interferences) the various segments of the social structure, have become fundamental features of the western system of government.

The major features of the Chinese culture that make it difficult to set up a legal system based upon the rule of law, are summarised in the figure 13 of the annex. It is true that under pressure from the policy of opening up to the outside world, and even more after the entrance into the WTO, China has embarked on a process of completely redesigning its legal system, either by amending the existing legislation or by passing an impressive amount of new laws and regulations. But the road which leads from the "rule by law» to the "rule of law" is still a long one.³⁰ The result is that the legal norms are too often undetermined, and subject to interpretation, most of the time by political interferences (at least for important aspects of the management of the legal norm - from its preparation, adoption, and implementation). This may be one of the sources of difficulties for giving impetus to the private sector (both Chinese and foreign enterprises) as one of the major imperatives of market economy is that law, government and administrative behaviour, should be as predictable as possible.

Chinese culture and the market economy

³⁰ The difference is of course substantive. See for ex.: **Lubman**, Stanley B., Bird in a Cage, Legal Reform in China After Mao, Stanford, Stanford Univ. Press, 1999; **Lubman**, Stanley B., China's Legal Reforms, Oxford, Oxford Univ. Press, 1996; **Peerenboom**, Randall, China's Long March toward Rule of Law, Cambridge, Cambridge Univ. Press, 2002

Figures 15 to 19 of the annex summarize the main features of the Chinese culture that seem to constitute an obstacle to the development of a market economy. In the last part of this paper we will examine, with the help of the writings of a Chinese scholar, if Chinese culture can provide a substitute (a “functional substitute”) to the features that coexist (and in fact support) the development of market economy in western countries.

First of all, what strikes the western observer of Chinese culture is the propensity for what someone has called “the cult of secrecy”, which has the consequence of making the functioning of the whole system rather opaque, i.e. contrary to one of the requirements of a sound market economy: transparency. Some of my Chinese friends have pointed out that this might be the case for a westerner observing the functioning of Chinese society, but that Chinese people are quite aware of what is going on. Granted, but it remains that dealing in a global economy, especially when one wants to have commercial intercourse on that global market (selling and buying), and when one wants to attract foreign investments from that same global market, it seems that the economic game in that market should be played according to that market’s rules. It is, in my opinion, a simple question of rational and efficient behaviour, and not a question of defending one’s own cultural difference. Moreover, as we have pointed out before, it is in part this lack of transparency that constitutes a serious obstacle to the development of an efficient financial market.

The second cultural feature is the preference for practice and techniques as opposed to theoretical thinking. It is well known that Chinese scholars have made enormous progresses since the beginning of the XX century when several universities have been created. And in the natural sciences Chinese scholars are second to no one in the world. Nevertheless, one can have some doubts whether this trend has touched the economic and social sciences as well. No doubt, many Chinese economists (and I personally know some of them) are quite competent. But it seems that they have some difficulties of being heard by the political leadership. The case of social scientists is even more dramatic. True, even in the West, people in power have often regarded the social scientists with some suspicion. After all, it is the duty of their science to discover what works and, more disturbing for the people in power, what doesn’t work in our societies. Nevertheless, it is true that economists (and to a lesser

extent) social scientists have been (and are still) able to provide expertise to the people in power, of expressing their findings and opinions in the open, and of being heard by the policy makers.

Moreover, it seems that in the domain of economics and social sciences there has been an import of foreign ideas (or more precisely of foreign ideologies, even if they have been adapted to the Chinese situation) and that the practical consequences deriving from those ideas (or ideologies) have been implemented without thorough scientific scrutiny. This is maybe one of the reasons that explains the poor management of the time factor when implementing these ideas. It is necessary here to refer to the adoption of a soviet-type command economy; we have already referred to the Great Leap Forward (see figure 16 of the annex) and to the strategy of economic development adopted at the end of the 1970's, that is clearly based upon an interpretation of parts of classical liberal market economy. At that time, the negative consequences of market economy were well known in western literature (especially in the mainstream of welfare economics, and in the writings of those favourable to the establishment and development of the welfare state). It is surprising that it is only 15 to 20 years after the beginning of the reform process that these negative consequences have been publicly recognised by the Chinese leadership, alerted, it must be remembered, by some of the most skilful and imaginative Chinese scholars.

But the facts are here: during the last 25 years there have been several important negative consequences of the development of the economic system based upon market economy and opening up to the world economy. These difficulties-problems must now be tackled, at a time when pressures from both within the Chinese society and abroad are quite compelling.

To overcome these problems, the Chinese leadership seems to count on another cultural feature: the sense of cultural superiority, based upon a very long history, and the faith in the political genius of the Chinese People. This, combined with the obsession for unity (also a cultural trait coming from that long history) leads to an obsession for political and social stability, and this in turn leads to little tolerance for the formation of autonomous social organisations, as they are interpreted as a

menace to the leadership of the CPC. Moreover, the PCP seems to want to control all kinds of organisations (e.g. Trade Unions, and Women's Organisations), and we have already pointed to the will of the CPC to interfere with all the stages of the legislative process (management of the legal norms).

In this context it is interesting to note that in the West the existence of different sources of power, and the tolerance for the expression of different opinions in the open (for or against the actions of those in power) has submitted the leadership to a type of control that most of the time has permitted to avoid mistakes, or at least to correct them in time.

Another cultural feature further reinforces the above-mentioned ones, namely the obsession for power and prestige, both domestically and internationally (see figure 18 of the annex). This seems to be linked to the preference for grandiose, (and rapidly producing spectacular results) projects: again the Great Leap Forward, but also the establishment of the Special Economic Zones, the will to accelerate the economic development, and the desire to rapidly restore China as one of the major world powers. We have already seen the consequences (positive and negative) of this strategy.

The implementations of the development strategy, its positive consequences, but also the negative ones, raise the fundamental question of the legitimacy of the existing power structure (see figure 20 of the annex). It is difficult for a western observer, not to suggest the legitimating strategy used in our countries to gain support from the people in a society where the increase of wealth has gone hand in hand with the development of information, skills, and knowledge available to the masses, and their consequent will to have their say in the management of society. But of course this would be an ethnocentric statement, that would not take into account the capacity of the CPC (probably the only force capable of driving the country towards modernity and prosperity, while maintaining political stability) to find an answer to these problems that will have Chinese characteristics. Here we pose again the question of the existence of "Chinese functional equivalents" to the way western States sustain the development of the market economy, without leaving with little or no advantages those who do not fully benefit from it.

Are there some Chinese “functional equivalents” to the western way of sustaining market economy?

With the last ideas in mind, we will end this paper by briefly referring to the stimulating book of a Chinese scholar of the Social Science Division of Hong Kong University of Science and Technology.³¹ Comparing the failure of the Soviet Union to introduce market mechanisms within a Planned economy to the success of the Chinese strategy since the beginning of the 1980s, Lin finds that “these changes have taken place without the overhaul of the political system”. Moreover, these transformations “have been accompanied by a significant growth of political corruption and, relatedly, rent-seeking activities.”³² With the aim of explaining these apparently contradictory phenomena, Lin traces the decline of central planning to the interplay between two emerging markets: an economic market for the exchange of products and resources, and a political market for the diversion to private interests of state authority and assets. He argues that the two markets have been mutually accommodating ... also suggests, in contrast with some views, that the expansion of concrete markets for products and resources does not necessarily signify the ascendance of “the market”, nor does it bear a linear relation with the rise of a legal-rational state.”³³

Figure 22 of the Annex summarizes Lin’s theory and findings. In short, there are two markets³⁴:

- (1) “an economic market where the exchange of goods, services, and resources takes place between economic actors”;
- (2) a political market, which in fact is subdivided into 2 markets:

³¹ Lin, Yi-min, Between Politics and Markets, Cambridge Univ. Press, 2001

³² Ibidem, pp 2-3.

³³ Ibidem, foreword by the editor. Lin quotes several western scholars, who argue that corruption and rent seeking are detrimental to economic growth. Ibidem, p. 2. His working hypothesis is that “in the reform era, effective manipulation of state action ... constitutes a necessary condition for the success of firms.”, p. 6

³⁴ Lin refers to western authors like Charles **Lindblom**, Politics and Markets: The World’s Political-economic System, New York, Basic Books, 1977, and William **Parish**, and Ethan **Michelson**, “Politics and Markets: Dual Transformation”, American Journal of Sociology, 101, 1996, pp. 1042-59

(2.1.) “a political market where exchange takes place between economic actors and state agents”, and
 (2.2.) a political market where exchange takes places “among state agents themselves with regard to the use of state authority and assets.” Lin further considers that the concurrent rise of these markets in the reform era “represents ... an essential feature of China’s transforming economic and political institutions”.³⁵

These markets have the following consequences and functions:

- (1) “the exchange relations between economic actors and those involving state agents are mutually inducing and accommodating. Exchanging favours with state agents helps reduce regulatory and resource constraints on favour seekers and thereby enhances their ability to enter and compete in the growing economic space outside the plan. (...);
- (2) political market 2.2. has weakened mutual monitoring ... and has facilitated the growth of exchange relations in the political process;
- (3) competition among economic actors for favours from the state has reduced “entrenched barriers to economic freedom and growth. It also limits the preferential treatment of firms, forcing them to look beyond special favours for ways to compete on economic grounds while exploring additional areas for rule bending”.³⁶

Nevertheless, Lin admits that there are also some unfavourable consequences for the development of the market. These institutional arrangements contribute:

- (1) “to an overbuilding of production capacities and creates growing pockets of slack in under-performing enterprises” and, more important for the topic we are dealing with in this paper:

³⁵ Lin, op. cit., p 17

³⁶ Ibidem, pp. 17-18

- (2) **“It also stimulates state agents’ attempts to increase the diversion of public resources, which consequently drains the state’s capacity to provide goods and services.”³⁷**

Conclusion

At the end of this paper, we have to recognize the spectacular achievements of China during the last 25 years in the economy, especially if we evaluate them by using aggregate data like the GDP. On the contrary, the results of the development strategy adopted at the end of the seventies are less impressive if we take into consideration the distribution of wealth among regions, provinces, and households, the impact on the environment (both physical and human), the weakness of the economic system (especially of financial services and SOEs), the increasing unemployment, the aging population, the difficulties in setting up a viable and efficient safety net, and last but not least the weakness of the central government’s taxation system. As a consequence, several formidable challenges are facing the Chinese leadership. In spite of the improvements in the management of the economic and political markets (according to the findings of Lin) it is clear that corruption and “rent seeking” strategies, as well as the weaknesses of the legal system, are likely to divert substantial amounts of resources (both financial and human) away from the provision of efficient and effective public services needed by the Chinese people. Some further reforms seem therefore necessary in the near future, otherwise it would be quite difficult for the Chinese leadership to maintain social and political stability within their vast and diverse country.

³⁷ Ibidem, p. 18