Transparency and Interest in the People's Republic of China

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Transparency is not a concept that one would immediately associate with China. Notwithstanding the transformations of the post-Mao era, opacity still seems a more fitting characterisation of the Chinese political economy. Yet it is this very lack of transparency that makes the Chinese case study so interesting and important.

On one level, external concerns over this lack of transparency form an increasingly important component in China's international economic relations. As a result, debates over transparency has concomitantly become an increasingly live policy issue within China. On another level, discourses of transparency are primarily predicated on a largely western liberal understanding of how economic and political systems "should" be organised. They preference and privilege one paradigm over others. Applying discourses of transparency to a case study like China provides a lens through which we can understand both the nature of the Chinese political economy, and also the efficacy of the discourses themselves.

Transparency in The PRC: The Policy Context

The increasing importance of transparency in Chinese policy debates is primarily a consequence of international pressure for change. This pressure has in part emerged as a “market discipline” of participation in the global economy and from the significance of foreign direct investment (FDI)[1] in the Chinese economy. The massive boom in FDI in the mid-1990s[2] contributed much to overall economic growth and the Chinese “economic miracle”. The subsequent decline in FDI in the late 1990s has raised questions over the ability to maintain those economic growth rates required to maintain “acceptable” rates of employment and the legitimacy gained through economic success. Notably, “lack of transparency” is cited as the main complaint of foreign investors who are considering leaving the Chinese economy[3].

But pressure for reform also comes in the form of more direct requirements and bargaining through intergovernmental processes. And typically, the main agent of this direct external pressure is agencies of the government of the United States. For its proponents, transparency is depicted as an issue of equity and fairness. Increased transparency allows everybody to play by the same rules. But viewed another way, external pressure to adopt international standards of transparency can take on something of a “north-south” style relationship[4]. Representatives of developed states might be seen to be forcing paradigms and norms on developing states which benefit economic interests within the developed world at the expense of interests in developing states. And it is often noted in China and elsewhere that the major powers in the developed world did not always conform to the same standards of openness and equity that they are now calling for when they themselves were at a similar stage of development.

However, we need to insert an important caveat here – a caveat which perhaps strengthens suspicions of “northern” duplicity. What external actors are concerned about here is in allowing access to the Chinese market – to compete with protected Chinese economic interests within China. But the majority of investors in China are not competing in the Chinese market, but rather using China as an offshore production site for export industries. These investors do not face the same challenges and problems as those who are trying to operate within the Chinese market. Indeed, through collaboration with local political actors, many export based foreign investors benefit from a lack of transparency – they become allied with those domestic Chinese interests to gain access to the benefits of being on insider.

As China has incrementally re-engaged with the global economy, intergovernmental dialogue over economic relations has frequently – indeed, even typically - entailed pressure on the Chinese authorities to create a level playing field for domestic and external economic actors. Much of this pressure has focused on tariff reduction, mandatory import licenses and other barriers to participation in the Chinese market. But the question of transparency has also been raised on a number of occasions – not least in the “November road-map” drawn up by the US Trade Representative office at the WTO as a guide to required policy reform before China could join the WTO.

If anything, the agreement between US and Chinese representatives in November 1999 over WTO means that issues of transparency take on ever greater importance. As formal barriers to trade and participation in the Chinese economy are removed, then other non-tariff barriers provide a means of retaining protection for domestic producers by other means. For example, when China has reduced tariffs in the past, this has been followed by an increase in VAT. Through intimate relations with local authorities, many Chinese producers can avoid paying VAT. Through discrimination in taxation, VAT can become a quasi-tariff and a barrier to trade.

The concerns established by the USTRO in the November road-map provide a useful template for assessing key areas of concern for external actors. Thus, this paper will in turn discuss the control of the media as a means of discriminating against non-Chinese actors, the lack of opacity in decision making, and the use of data collection and provision to defend Chinese national interests.

However, the use of the concept of "national interests" needs to be considered with care. In some respects, the USTRO is correct. Non-Chinese actors are disadvantaged as information and the media are manipulated to favour Chinese actors. The Chinese authorities have clearly attempted to protect perceived national interests and specific economic sectors and interests during the transition from socialism. That the leadership has tried to gain as much as it can from participation with the global economy whilst giving as little as possible in terms of reciprocal concessions should surprise nobody.

But the idea that the national government has deliberately attempted to defend "national interests" must also be questioned. The notion that China is a single entity with a single interest is a gross over-simplification. In thinking about transparency and interest in contemporary China, we shouldn't just ask if China benefits, but which interests within China benefit? On one level of analysis, the territorial basis of interest must be addressed. In particular, the use of control of economic information by local authorities in their relationship with the central authorities has been a key cause of friction within the Chinese party-state system. On another level, we must ask which groups or classes benefit. A case study of the development of the Shenzhen stock market shows that the market was built on a non-transparent system to specifically benefit an interlocking group of leaders from the local party-state bureacracy, business leaders, and stockbrokers.

Transparency, the Media, and the National Interest

One of the complaints of external actors is that the monopoly of media resources through *xinhua* allows the government to feed economic information that serves the national interest. To a large extent, this is indeed the case. Xinhua does manage the news to ensure that the most positive impression of China is portrayed – partly to distort the image of China abroad, but also to speak to a domestic audience.

There are many examples, but just two will suffice here. The first is the embargo on reporting news of increased numbers of riots and social disorder as a result of increasing numbers of laid off workers in 1998. The second relates to emphasising the positive consequences of the joining the World Trade Organisation, at the expense of the potential pitfalls.

There has, however, been some relaxation of official control in the recent era. Chinese academics, for example, have increased freedom to publish work that questions the official *xinhua* line. It is particularly notable that the Chinese Academy of Social Science, essentially a think tank for the government, is the source of some of the most critical material on economic reform. Researchers have produced information that does not conform with official statements on the investment environment, the extent of bad debts in the banking system, the prospects of economic recovery form domestic deflation, and the extent and implications of urban unemployment[5]. When faced with a rather negative appraisal of the prospects for China's export led growth, a leading figure in CASS responded that the arguments were not very popular, and rather negative, but raised important issues that "needed to be debated". This may not sound like a Great Leap towards transparency, but in the Chinese context, such academic pluralism is still in the process of evolution.

This academic research may not be widely read by either domestic or international audiences, but there is also more (though limited) pluralism in the Chinese media. To be sure, many of these rely on the same basic information from *xinhua*, and also face sanctions from the authorities if they transgress too far. We should not forget that the Shijie Jingji Daobao, a source of alternative information in the mid-1980s in Shanghai, was brought to book by the authorities when political problems emerged in 1989. However there is, for those who can read it and can look for it, information from sources such as the Shenzhen Tequ Bao (Shenzhen Special Economic Zone Daily) and the Hexun Caijing (Homeway Financial News).

The development of myriad web pages has also given easier access to financial information. The Chinese Government has established several web sites (among which www.cei.gov.cn and www.moftec.com.cn are the most significant) in Chinese and English which carry government news and the texts of newly promulgated laws and regulations. However, one of the problems here is that the Chinese government is constantly altering domain names, which makes keeping in touch with these web sites harder than it could be.

On another level, external media sources are allowed to operate more freely within China – or at least, within parts of China. Reuters, for example, operates with comparative freedom as a source of economic information for external customers. Reports from Shanghai and Shenzhen are filed to the regional offices in Taiwan with almost total freedom – as long as the reports are restricted to purely economic affairs. There is an implicit compact between Reuters and the local and national governments that the line will not be crossed. Indeed, the main problem that Reuters have faced in their Chinese operations is the imposition of ad hoc fees and charges by local governments – an issue we will return to below.

Control of the media, then, has been relatively relaxed – but the key word here is "relatively". The government retains the right to remove licenses and privileges from those who transgress – both domestic and external actors. Domestic newspapers and journalists can be – and indeed are – closed down and arrested if they transgress. And external media agents can and do have their licences and permissions revoked if they transgress[6].

Transparency and Markets

Debates over transparency tend to be built on an understanding that for a market system to work "properly" certain key conditions must be met. One of these is the free and open flow of information to allow all economic decision makers to act "rationally" and in open and fair competition with other economic actors.

Hence these complaints from US officials in particular, but also from other external governments and non-state actors, that the lack of transparency in China does not allow an equal playing field. In this respect, they are right. But essentially, the complaint here is that China does not have the liberal political and economic system that it "should" have – an argument that many in China might contest.

China may no longer have a state-planned and state-owned system, but it certainly does not have a market system – or at least, not what those in the west might recognise as a market system. There are some institutions in China that might look similar to market institutions, but as these are often designed to support the state and state interests, this similarity is more apparent than real. Quite simply, China is not a market economy, and not surprisingly, the transparency that might be needed to support a market economy is not present in China.

State Ownership and state influence

The state owned sector remains a significant element in the Chinese economy. For example, at the end of 1998, SOEs accounted for 63.5 per cent of all manufacturing assets, utilised 70 per cent of the national budget, and employed around 55 per cent of all urban workers. In 1996 four major state owned commercial banks held more than 90 per cent of all credit funds and extended 90 per cent of them to state owned enterprises[7].

Furthermore, even theoretically private enterprises are often not as separate from the state as might appear. First, private entrepreneurs in China find it difficult to make headway unless they have a good relationship with the party-state elites. Even those who have no formal contacts with the party-state are essentially dependent on strong support from local authorities in order to survive. Krug (1997 p.21) notes that local entrepreneurs and local enterprises face low transaction costs and have considerable freedom of action when they operate solely in their own locality. However, this situation changes radically as soon as “private exchange exceeds the jurisdictional boundary”. Local barriers to trade abound in China, and anybody that wants to transport goods across local administrative boundaries has to gain the cooperation of the local administrative authorities. Indeed, successful “private” local enterprises frequently, more correctly usually, succeed thanks to the protection and aid afforded to them by local state elites. In an economy where land, raw materials, transport and finance capital are still in relatively short supply, occupying a gatekeeper role (or knowing somebody who does) has an important economic premium. As such, a form of business-local state is an essential pre-requisite for successful economic activity.

Second, Goodman (1995, p.135) notes that many of the non-party economic elites owe their new positions to the old elites. Wong and Yang’s (1995) survey of the growth of township and village enterprises in southern China found that the new managers and directors had previously served as party officials and state administrators. Crucially, in all cases in Wong and Yang’s survey, these new “private” actors retained close personal and institutional relations with their former colleagues within the state sector, and many of the new enterprises had come into being through the initiative of local state actors. Third, in order to guarantee this close hand in glove relationship, it is common for state officials to take a seat on the board or a management position in theoretically independent economic enterprises. Thus, as Walder (1992 pp.331-2) puts it, businesses in China cannot be considered to be independent economic entities, but should instead be more accurately described as "quasi-autonomous divisions within a corporate structure".

Fourth, in many cases, the relationship between external non-state actors and Chinese local state actors is more clear cut. Anita Chan (1996) has shown that many of the Chinese partners in Joint Ventures with foreign capital in southern China "are actually local government organs and departments".

So, one of the most significant features of the Chinese reform process is the transformation of relationships between existing state actors, and the changing basis of their power. On one level, we can identify the beginning of the transformation of political power into economic power. Particularly at the local level, power holders are switching the prestige, influence and wealth that came from forming part of the political structure for the wealth that comes from being a factory manager, or a member of the board. To be more accurate, they are not so much swapping one source of power for another, but using their political positions to increase their economic potential and bargaining power.

Furthermore, Krug and Goodman's research has shown that new entrepreneurial elites are trying to stabilise their positions by joining the party. There is a symbiotic relationship (at the very least) between state elites and new economic elites. They have co-opted each other into an alliance that mutually reinforces each other's power and influence, not to mention personal fortunes. What we see, then, is a process of reformulation of class alliances within China that has both created the opportunity for external actors to become involved in the Chinese economy, and has been reinforced by interaction with external economic actors.

In particular, the property rights of the township and village enterprises (TVEs) are extraordinarily difficult to disentangle. And whether the Chinese economy is now dominated by state, or non-state enterprises, essentially depends on how you interpret the TVEs. It might sound rather facetious, but its probably fair to say that those TVEs designated as owned by the collective are probably privately owned, but registered as collective to avoid taxation and to gain access to preferential treatment. Conversely, those that are registered as privately owned are owned by people who are party-state officials, or families of party-state officials, or in close cooperation with party state officials.

In essence, the division between the private and the public is extremely blurred – if not to say murky. And it is arguable that transparency is something that only emerges – perhaps even is only necessary – in market systems. The problem, if it is a problem, is for those external actors who want to participate in the Chinese market, and the problem for the Chinese is that it is increasingly difficult for a non-market economy to fit easily into a global economy dominated by other economic paradigms.

State ownership, influence and the financial structure

Another example of the lack of market institutions in China comes from an analysis of the difference between the theoretical and actual functioning of China's banks. Take, for example, the Chinese central bank. It appears to function as an independent central bank in accordance with The Law of the People's Bank of China enacted in 1995. But the Central Bank essentially remains a government department under the State Council, and has to submit major decisions to the State Council for approval[8].

Indeed, the entire banking system in China is built around serving the interests of domestic political constituents. Such is the level of political control over the banks that investment decisions that Wang, Liu and Liu refer to them as “policy based lending” or “para-fiscal investment”[9]. In particular, bank loans have become a major way of providing funds to support state owned enterprises in the transition from socialism. Indeed, in some respects we can argue that the lack of transparency in China is a mechanism through which the government has attempted to provide a palliative for those who would have otherwise suffered (even more than they have) from the transition from socialism.

Thus, the pricing structure of basic commodities remained under state control to ensure incomes for farmers, and a relatively equable distribution of basic food requirements. Prices and markets were also distorted to allow continued supplies, production and markets for state-owned enterprises – to protect them not only from international competition, bur also in large part to protect them from domestic competition. And the financial system and institutions have remained under strong political influence to bail out loss making enterprises in the final instance.

Financial systems are designed to serve political purposes and meet political ends. The construction of a free market liberalised financial system with full transparency is not apolitical. It serves the ends of specific economic interests, and specific political interests. That the Chinese authorities have restricted transparency in an attempt to protect domestic interests as China moves away from the plan should be no surprise at all. Neither should the fact that US and other external economic actors want to pressure the Chinese to increase transparency and aid the economic interests of US and other external firms.

Damn Lies, Statistics, and the Chinese Economy

A final area of dispute revolves around the use (or otherwise) of a common and accepted set of statistics as the basis for even and equal economic decisions. Or out another way, a basic understanding of what transparency really means in practice for some is ensuring that "we are all using the same numbers"[10]. Indeed, for some observers, a key cause of the Asian financial crises was a lack of standardised economic data from Asian states which resulted in short term lending to developing states being made without proper understanding of risk[11].

There are two key issues here. The first is that there is an assumption that there is a correct method of calculation that all states should move to. But the move towards common norms and standards does have significant implications. Statistics are political – and the way they are calculated as well as the way they are received and used have considerable political ramifications. Indeed, the promotion of the concept that statistics are neutral is, in itself, highly political.

Lets take as a first example the question of calculating the size of the Chinese economy. Like many countries, China's reported GNP figures are received with, to say the least, scepticism, by many western states. This is partly because China is still a non-market economy. Incomes in the state sector in particular are skewed by the provision of considerable non-salary rewards. Thus, there is a need to factor in to salaries HEW and housing benefits that don't appear in Chinese statistics in order to generate comparable statistics. In addition, there is also some suspicion that GNP figures were deliberately deflating during the 1980s to qualify for low interest rate loans from the World Bank, Asian Development Bank and so on.

The use of PPPs to calculate the size of the Chinese economy clearly irks both Chinese officials and academics. They feel that these figures are used to deliberately inflate the size of the Chinese economy, its importance in the global economy, and in particular, its threat to the West. It perhaps goes without saying that the major focus of this displeasure is the US.

The Politics of Trade Statistics

While these debates over how to calculate the real size of the Chinese economy have created some problems, the more significant discrepancy lies in determining Chinese trade. Again, disputes with the US are the main focus of attention here.

From an academic viewpoint, we face a problem of how we interpret the significance of trade in Chinese growth. Depending on which GNP figures we use, China's trade to GNP ratio ranges from 40 per cent to only ten per cent. But these discrepancies are simply based on conflicting calculations of the size of the Chinese economy. If anything, these are dwarfed by conflicting notions of the size of Chinese trade. Trade data used in all Chinese publications and statistics originate from the PRC General Administration of Customs. If anything, these figures understate the growth of exports (and therefore total trade and China's trade surplus) because of the difference between Chinese and Western methods of calculating exports.

For example, according to US official estimates, the US-China trade imbalance in 1998 was around US$57 billion while Chinese official data showed an imbalance of “only” US$21 billion[12]. To add a third set of figures, Feng and Liu[13] have recalculated Sino-American trade taking into account the difference between FOB and CIF prices, re-exports through Hong Kong, and also smuggling. They conclude that the Sino-US trade imbalance in 1998 was around US$35 billion – almost (but not quite) half-way between the Chinese and American figures.

Part of the problem results from fact that Chinese figures don’t include insurance and freight. And for low unit cost goods, this can be as much as the actual production costs. However, a further and greater complication arises from the question of how to calculate bilateral trade that passes through a third place.

For example, China calculates that 60 per cent of exports to the US pass through a third place on route - primarily Hong Kong[14]. According to Chinese statistics, on average, once the good leaves China, there is an extra 40.7 per cent value-added in the third place, and in the case of toys and textiles, the subsequent value added even exceeds 100 per cent. As US statistics count exports through Hong Kong as Chinese exports, the Chinese argument is that this misses the huge value added that occurs once the goods leave China.

These discrepancies are not just a matter of statistical interest. There are two main consequences that emerge from this short debate. The first relates to the specifics of Sino-US conflict, and the second to the role of statistical "norms" in north-south economic relations. First, then, as Chinese exports have boomed, so trade friction has increased between China and the US in particular, and the West in general. And the size and importance (or otherwise) of China's trade surplus with the West varies depending on which figures you use. Thus, the Chinese authorities are accused by the West of deliberately deflating the importance of Chinese trade, while the Chinese accuse the West of unfairly exaggerating the significance of Chinese exports. Or as the Minister of Foreign Economics and Trade (now Cooperation), Li Lanqing, put it when Western governments questioned Chinese trade figures in 1992:

> "We are of the view that these trade imbalances [are] caused mainly by *unreasonable* methods of keeping international trade statistics" [emphasis added][15]

Second, the way in which trade statistics are calculated is, it is argued, unfair on developing states. Indeed, we can perhaps question the extent to which national based levels of statistical analysis really explain the dominant forms of economic relationships in the global economy. The suggestion here is that the US (in particular) should not calculate China's trade surplus based on the value of the good that leaves China. Rather it should factor in the value of the good as it is imported into China, and consider the other elements to be part of its trade relationship with other states. In other words, it is unfair, not to say wrong, to simply count the last country in a production chain as the country that you have a trade relationship with for that commodity. In particular, the diffused nature of production means that the final stage in the production chain is usually labour intensive component assembly and/or finishing semi-finished produce – in other words, areas with low value added.

Indeed, in his assessment of China's role in the global economy, Lardy calculated that imported components typically account for 90 per cent of the value of exports from foreign enterprises operating in China. As the processing trade now accounts for around half of all Chinese trade, the implication is that around half of the value of Chinese exports is in fact the value of goods imported from other states[16].

Banking Debt

Lets return to the issue of bank debts here and discourses on accounting in the financial sector. On one level, our understanding of the extent of government debt depends on our view of the role of banks and their relationship with the political system. For example, official figures for the government debt balance as a proportion of GDP in 1997 was 8.07 per cent. However, this figure increases to 33.12 per cent if you include non-performing loans as part of the government's debt[17]. And I would argue – as do many within CASS – that the banks are essentially quasi-state agencies and their debts must therefore be considered to be quasi government debts. As Chen Yixin puts it:

> "With directed lending operations (especially those financing the working capital of SOEs) still ongoing, the specialized banks can hardly be said to be commercial in any real sense."[18]

As loans that are not yet overdue, but which won't be paid off, aren't counted as bad loans, the debt to GDP ration might be even higher[19].

But just as Li Lanqing argued that foreigners used “unfair” methods of calculating Chinese trade, so Dai Xianglong, governor of China’s central bank, argued in January 2000 that the debt problem was not as severe as many in the west suggest. Quite simply, China uses different accounting standards, and as a result “foreigners frequently misunderstand the bad loan problem in China’s banking industry”.

The only point of clarity that emerges from this is the lack of clarity, lack of consensus, and lack of certainty – and the frustration and even anger of Chinese officials at attempts to impose “foreign” and “unfair” standards to impose common standards and accountancy methods.

Unemployment

A final area that I want to mention here is the issue of unemployment. The official urban unemployment rate remains below four per cent. But these figures ignore laid off (xia gang) workers – and workers can be laid off for up to three years before they count as officially unemployed. While urban unemployment increased by about 8 per cent per annum in the 1990s, the number of laid off workers increased by around 40 per cent a year. Thus, while in 1993, laid-off workers accounted for around 3 per cent of the total urban payroll, the figure had risen to 8 per cent by 1996[20].

As such, official statements on the health of the Chinese economy have to be considered with care. Statements that China has an urban unemployment rate of only four per cent and debts of no more than eight per cent of GNP are technically correct on some calculations. But so too would statements that the debt ratio is a third of GNP and that 12 per cent of the urban workforce are currently without jobs. Clearly, ones interpretation of the current state of the Chinese economy might vary depending on which figures you choose to accept.

Transparency and Trade: The National Interest?

It is in the area of trade, and particularly market access, that most external pressure has been placed on the Chinese to increase a more transparent system. Apart from the November 1999 WTO agreement with the US authorities, the most significant reform came in the signing of the 1992 bilateral market access Memorandum of Understanding. The MOU laid the foundation for China to improve the transparency of its trade regime, including the publication of a central repository for all central government trade regulations and publication in the provinces of all trade and investment-related trade regulations. The MOFTEC gazette was also established to carry official texts of all trade-related laws and regulations at the national level.

The MOU did result in an increased flow of information on the formal legal structure. However, four complaints are frequently aired that go a long way to understanding the bases of transparency – or more correctly, lack of transparency – within the Chinese economic system.

Incrementalism and ad hoc reform

First, there is often confusion over conflicting jurisdictions and conflicting laws and regulations. This results not from any deliberate act or design, but is a dysfunctional consequence of the way in which reform processes have evolved. We need to distinguish between two different processes here. The first is the vertical basis of policy making and reform. By this, we refer to the way that bureaucratic agencies negotiate reforms within their own specific area of competence and responsibility. What is lacking is overall coordination so that, for example, changes in the fiscal structure do not undermine or even conflict with reforms in the banking system.

Second and very much related to this issue, vertical relationships dominate the bureaucratic structure, and there is often little coordination between different agencies. Thus, though MOFTEC did provide information through its gazette, there was no information on laws and regulations from other agencies that can have a significant impact on external firms. A further example comes from the creation in 1998 of a new tripartite supervisory/regulatory system. The new system gave different areas of responsibility in to thethe Central Bank, the China Securities Regulatory Commission, and the China Insurance Regulatory Commission. As Xie Ping notes:

> "the three authorities do not communicate and cooperate with each other well enough to take actions against, but only dispute over problems in the overlaps [with each other]"[21]

Third, legal innovation in China is characterised by a system of incrementalism and ad hoc experimentation. In the case of experimental reforms, what might be the case in one area may not be the case somewhere else leading to confusion for Chinese actors, let alone external ones. New regulations can also be introduced on top of existing ones instead of replacing them. It is possible – indeed, far from uncommon – for these laws and regulations to be contradictory. To return to the example of supervisory regulation, Chen argues that:

> "The securities market is among the worst regulated. China has promulgated more than 250 administrative rules and local regulations on securities, and discrepancies between them are commonplace."

It is not that the government is deliberately ignoring transparency to serve the national interest, but that this lack of transparency is an unintended consequence of reform. And these unintended consequences are exacerbated by the fourth area of complaint – namely the way in which different local authorities have different economic and legal structures. We need to be careful not to ascribe too much agency to the central government in developing a system that benefits the "national" interest. Indeed, in many respects, the notion of a "national" interest misses the entire point about the way that the Chinese political economy has developed in the recent era. Here we need to move away from a national perspective to other – either regional or class based perspectives – of who gains.

From Central to Local Interests

When he was informed that China was on target to meet an 8 per cent growth figure in 1998, Premier Zhu Rongji replied that he simply did not believe it[22]. The figures, in his view, had been exaggerated by provincial officials who wanted to ensure that their provinces met the growth targets stipulated by the premier earlier in the year. Zhu added that rather than use the figures provided by the provinces, he would instead simply use that information collected by the central state statistical bureau.

This anecdote is just one example of how crucial internal domestic issues need to be resolved before China can really start to conform with international standards and norms of transparency. Indeed, the attempt to regain control from the national authorities has been an important component of major financial reforms implemented by the national government after 1994.

It is not that (the now) Premier Zhu Rongji wants to recentralise economic authority in a manner akin to the old planning system – far from it. On the contrary, the idea is to take back much of the power that has become lodged in the hands of powerful local governments, and to allow a market system to flourish more freely. In essence, the national government is concerned about the internal lack of transparency that is in their views obstructing the development of rational economic decision making from a national perspective.

A lack of transparency, then, is being used by local leaders to serve specific local ends irrespective of (often in direct contravention of) national plans, goals, strategies and aspirations. Here I provide three example; the fiscal system and local government revenues, local control or influence over local financial institutions, and the development of stock markets.

The Fiscal System and Local Government Revenues

One of the most significant attempts to overcome this perceived problem came with the fiscal reforms implemented after 1994. Prior to the reform era, theoretically at least, there had been no correlation between the collection and control of revenues[23]. Local authorities were charged with the task of collecting revenues that were then remitted to the central authorities, who in turn allocated finances. But the essence of debates over transparency is that control over information is a powerful political tool, and as Donnithorne suggests, local authorities were in a position to distort the information (and therefore, the money) that they passed to the central authorities[24].

The fiscal reforms of 1994 were partly designed to redress what was perceived as a structural imbalance between central and local control of fiscal revenues. Decentralisation of economic authority in the 1980s was deemed as having shifted the balance of revenues to firmly to the provinces, and starving the central authorities of funds. But the reforms were also partly aimed at overturning the local authorities power of information.

Thus, the reforms were built on two basic principles. The first was almost a formal recognition that China has become a de facto federal economy. Taxes were divided between those that accrued to the provincial government, those that accrued to the national government, and those that would be shared between the two. The second was a de facto admission that the national government did not trust the provinces, in that a new national tax service was established to collect both central taxes, and those taxes that are subsequently shared with the local governments[25].

In theory, the main consequence of the reforms should have been a redistribution in fiscal revenue between centre and province. This did indeed occur as the proportion of fiscal revenue accruing to the central authorities rose from around 30 per cent to around 50 per cent. It is notable that central fiscal revenues have subsequently increased more than local revenues as those areas subject to national taxes have continued to expand while the domestic economy went into deflation in 1998. By the end of the decade, the balance of centre-province shares of total tax revenue had reached 58-42[26]. But in addition to changing the balance of revenues, the total amount of fiscal revenues also increased, suggesting that previous tax revenue regimes had not been as rigorous as they might have been.

"fees exceeding taxes"

On the face of it, then, the fiscal reforms have been successful in that they have increased the total volume of fiscal resources. More important, they have partially redressed what the central leadership perceives to be a structural imbalance in the division of finances between centre and locality. However, tax revenues are only part of government income in China – indeed, only 40 per cent of all government revenue. The majority of government income is termed "extra system" revenue, which Gao Peiyong defines as those

> "revenues whose regulations are formulated independently by various departments and localities and which are collected and disposed of by them as well….If this state of affairs lasts for a long time, it will inevitably jeopardize the unification of national administrative orders and China's long-term stability."[27]

Complaints about impositions of ad hoc fees by local authorities rank high in the list of problems faced by foreign companies operating within China. But while foreign companies might feel that they are being treated unfairly, they are effectively being treated in the same way as many Chinese companies. Essentially, anyone or anything that makes a profit is likely to face new fee charges.

The main difference emerges in the operation of China's customs regime. Here the domestic and the external are treated rather differently. It is also an area where the tripartite division between national, local, and personal interests are difficult to disentangle. As noted above, US and other foreign businesses selling goods into China frequently complain that VAT is used as a hidden tariff on imports. In essence, when tariffs have been reduced, VAT is usually increased, and most domestic companies negotiate VAT exemptions. Thus, China is charged with using an opaque tax system as a hidden means of enforcing tariffs on imports.

On a local level, different ports of entry may charge significantly different duty rates on the same products. Flexibility at the local level in deciding whether to charge the official rate, means that actual customs duties, like many taxes, are often the result of negotiation between business persons and Chinese Customs officers. Customs and other tax duties are used to serve the local, rather than just national, interest[28].

Local Control of Financial Institutions

The importance of fees as a sources of local revenue is just one example of how the Chinese financial system has proved difficult for the central authorities to control. Another example – perhaps more important for an understanding of the domestic context of the transparency debate – is the way in which banking reforms altered the relationship between central and local authorities.

In 1985 China switched from a grant based to loan based investment system – a reform that resulted in a huge boom in investment in capital construction by local governments[29]. While investment in state planned projects recorded a 1.6 per cennt year on year increase in 1985, investment in unplanned projects by local governments increasing by 87 per cent[30]. Crucially, while state planning agencies and financial authorities controlled the provision of 76.6 per cent of internal national investment capital at the start of the reform process, this proportion fell to 33.2 per cent in 1986 as a result of the new banking reforms[31].

Despite exhortations from central leaders calling for restraint and a cut back in investment, local authorities continued to make the most of the banking reforms. It was not until Li Peng replaced Zhao Ziyang as Premier (in 1987) and implemented an economic retrenchment campaign in the Autumn of 1988 that investment spending began to come under control. As a 1990 World Bank report commented:

> "It has taken the People's Bank of China nearly four years, since its designation as a central bank in 1984, to gain <u>a measure</u> of control over credit expansion and deflect the demands of local government authorities on its provincial branches. Earlier episodes of credit tightening in 1985, 1986 and 1987 could not be sustained in the face of provincial opposition." [emphasis added][32]

Dual Control and Dukedom Economies

Here we need to focus on the notion of dual control of local level organisation in China. Administrative organisation is built on twin and simultaneous functional and geographic channels. Thus, a provincial branch of a bank is vertically responsible to the bank's central offices, and ultimately to the Ministry of Finance. But at the same time, it is also responsible to the provincial finance bureau and the provincial government. The latter has the advantage of hands on contact with the branch, since it is in direct day-to-day contact with bank officials. Furthermore, it possesses considerable power in terms of allocating goods, services and personnel to the banks. Thus, while not formally an agency of local government, local branches of banks often act as if they are part of the local government structure.

The power of local authorities[33] to collect and impose fees and local influence (of not control) of local banks contributes to the characterisation of many local governments as running “dukedom economies” (zhuhou jingji)[34]. The notion of dukedom economy is not just that the local government is in control of finances etc, but also controls the judicial system as well; “Since courts and judiciary departments are subject to local Governments, justice cannot be brought along in many fields”[35].

Local control of the judiciary, then, cuts against the imposition of national regulation in many respects. It should be noted here that this is not just an issue of economic regulation. The situation with environmental planning and control is remarkably similar. From a position where the environment was all but ignored in 1972, China has developed an impressive array of legislation. Environmental planning is now considered a “fundamental state policy” (*jiben guoce*). But as with dual control of financial institutions, there is dual control of environmental agencies, and if anything, local control here is even stronger. The local government has the right to appoint and dismiss heads of Environmental Planning Bureau, and also provide the bulk of funding for their operations. Furthermore, the local government is the source of virtually all information on potential transgressors – if they deem that it is not in the local interest to prosecute, then the information is simply not passed on. Finally, even when information is forthcoming, there is the final obstacle of the legal system to overcome. As Sinkule and Ortolano put it:

> "despite the legal basis for regulatory programs, EPBs could not make aggressive use of sanctions against polluters unless they had the backing of local government leaders....***leadership and institutional authority dominate legal authority***"[36] [emphasis added]

Local influence over local banks is only part of the equation. As we have seen local authorities can raise finance by raising fees on an ad hoc basis. They also have significant influence over local financial institutions. For example, at the end of 1998, there were 243 International Trust and Investment Companies (ITICs) with total assets of over RMB 460 billion Yuan. Of these, 21 were under central government control at the national level, with the remainder controlled by various levels of local governments[37]. In addition, there are literally thousands of small scale locally controlled rural and urban credit cooperatives. For example, even after 2000 urban cooperatives had been merged to form 87 urban commercial banks by 1999, this still left around 2000 and around 50,000 rural credit cooperatives[38].

<u>The Case of the Shenzhen Stock Exchange</u>

The development of two stock markets, one in Shenzhen and one in Shanghai, provides a particularly pertinent case study here. In some respects, stock markets are the very essence of capitalism. They also appear to require the institutions of capitalism in order to function. But stock markets reflect the political and economic structures within which they exist. In the Chinese case, what might appear at first sight to be a sign of the move towards the market instead reflects the underdeveloped nature of Chinese capitalism.

The stock markets were designed as a means of raising capital for Chinese enterprises – nothing out of the ordinary there. The system was also designed to provide only a minimal role for foreign capital, with non-Chinese restricted to dealing in the limited number of B-shares (in Hong Kong dollars). But one of the most interesting features of the new system is the way that stockbrokers work within the system. Stockbrokers emerged from within the state system, and operated in companies owned by the local governments. Furthermore, there was no prohibition on them dealing on the markets as personal and individual actors.

This created a situation where the local government was in a position of privileged information within the emerging structure. Through its relationship with local banks and other financial institutions, it had privileged knowledge of investment decisions – indeed, it was often the initiator of these decisions. Through its control and/or influence over local enterprises, it also had privileged knowledge of management decisions. And through its control over stock-brokers, it had influence and privileged access to the stock-market.

A network of insiders, then, dominates the decision making process. A network of people who are organisationally linked through a governmental structure, and also linked through personal contacts and connections. Their insider knowledge of future key economic decisions gives them considerable advantage over "private" investors. And as insider dealing is not illegal, they utilise this insider knowledge to "buy low and sell high". When asked where this leaves private investors, the reply was "vulnerable"[39]

The extent of this use of information for local gain prompted the reorganisation and strengthening of supervisory and regulatory mechanisms in 1998, and a new securities law on 1 July 1999. But the case of the stock market highlights two important elements when considering transparency in the Chinese context. The first is the fact that the interests that are benefited and not "national", and that the national government is striving to restore national control where possible. The second, an issue I shall return to below, is the blurred dividing line between local interest and corruption.

Reasserting national control?

Reorganising the PBC

Attempts to impose greater regulation on the stock exchanges form part of a wider programme designed to restore national economic control over the economy. Local control of local financial resources has helped sponsor growth throughout the reform period. It has provided the capital, and in many cases the initiative, for local projects that have boosted the local economy. Nevertheless, for reformers in the Chinese leadership, "it has become the important and urgent tasks of financial reform …to readjust the types, number and business scope of local financial institutions"[40]. There are three main elements to this "urgent task". The first was changes to the structural of the People's Bank of China in August 1998. The central bank abolished its 49 provincial branches and replaced them with nine multi-provincial regional offices:

> "The purpose of these reforms were to put an end to local government (mainly provincial government) disturbance in monetary policies and financial supervision of the Central Bank; and to set free state-owned commercial banks from the intervention of local government."[41]

Controlling Local Financial Institutions

The second was an attempt to reduce the number of locally controlled financial institutions. The main solution is through forced mergers, but in the key case of the GITIC, bankruptcy was the solution. GITIC – the Guangdong International Trust and Investment Company – was ordered to close by the PBC on 6 October 1998. By the time of its collapse, GITIC had become China's second biggest foreign currency bond issuer, and had foreign debts of US$2.4 billion including US$500 million in matured debts. While bad debts in the banking system have resulted in subsidies for employment, the problem in GITIC was that loans had been used to fund consumption or for speculation. It is particularly notable that real estate projects in China failed to provide expected returns on investment in the second half of the 1990s.

The fact that GITIC was allowed to go bust rather than being merged or bailed out (as was the case with previous failures) was a significant symbolic act by the central leadership. It showed that ultimately (though still very rarely) the financial sector would have to bear responsibility for its actions, and couldn't simply rely on the central government if things went wrong. Crucially, though the central government agreed to cover any losses, it was only committed to guaranteeing loans that had gone through the proper channels of approval. Those who had bypassed the central leadership and gone direct to the GITIC were thus not under the government's umbrella.

The GITIC case is important as it shows the extent to which external actors were stung by a misunderstanding of legal processes. The guarantees were only extended to those who had first registered their dealings with the central government. Those that went straight to the local government – in essence, most of them – found that there were no guarantees or bail-outs. Furthermore, the choice of GITIC as an example through bankruptcy is evidence that there is no clear process or pattern for dealing with financial chaos. It is an ad hoc system that is all but made up as they go along, and a system where political patronage is still clearly crucial, where political choices and decisions are crucial, and where the politics of making an example continues to be important.

Nevertheless, despite the high profile case against GITIC, regulation has not always been enforceable. Indeed, this quote from Xie Ping provides a succinct assessment of the impact of localism on the financial system:

> "a considerable number of financial institutions to be restructured are jointly invested by local Governments and controlled by them. It is local government's intervention of senior management and business that cause the loss and difficulties of these financial institutions. Consequently, upon merger, restructuring and closure or even bankruptcy of these financial institutions, on the one hand local governments are only responsible for liabilities up to the amount of their investment, but on the other hand for the local interest their intervention in the described processes are severe. Even judicial justice can not

be guaranteed since local judicial departments have to obey the orders of local governments."[42]

Anti-Corruption and Anti-Localism

The third area of reform is that the recent anti-corruption drive can be seen as part of this wider campaign against localism[43]. For example, returning to the example of local flexibility in enforcing customs duties, in August 1998, Customs officials launched an ambitious program to standardise regulatory enforcement as part of an anti-smuggling campaign.

A key area of concern has been the increase in illegal capital outflow. Despite the existence of these controls, Chinese academics and policy makers are now realising that China cannot make policy in isolation, and simply ignore comparative real exchange rates[44]. In particular, interest rate adjustments are unofficially "pegged" above the US rate to prevent the sort of illegal capital flight that saw US$20-40 million leaving China in 1998[45]. As credit is now so cheap within China in the wake of the financial crises, the fear is that illegal capital flight would see institutions borrowing money in China, and simply depositing it in overseas banks.

The campaign against corruption can be divided into the general and the specific. At a general level, there has been a wide-scale attempt to stop illegal capital flows – including an amnesty for offenders in October 1998. There is also a specific attack on corruption (associated with localism) in Guangdong and Fujian provinces. For example, Guangdong Xinhui City Tourist Bureau, was charged with illegal exchanging US$ 36 million dollars. More recently, the President of the Yuanhua

Group and the vice mayor of Xiamen fled the country after dozens of provincial officials were arrested during investigations into a US$10 bullion smuggling scandal (case four two zero).

Conclusions: Transparency, Reform and Interest

The opaque nature of decision making and information flows certainly creates conditions where corruption can flourish. As China moves from a state system to whatever it is moving too, political power and the position of gatekeepers becomes more, not less, important. Gatekeepers can and do use their position as key political actors to also become economic actors.

The key features here are the lack of institutional transformation. China remains a system that is individual and power based, rather than rule and legally based. The judiciary remains an element of state power, and is utilised to support state interests and power. In addition while there are private firms, there is not a private sector. Van Wolferen argues that Western notions of what is public and what is private do not fit the Japanese context. There is no real understanding in Japan that the public and private are separate from each other.

The same concept can be applied to China. Yes there are non-state enterprises, and yes there is legal protection for legally defined private enterprises. But in the current stage of the transition from socialism at least, there is no clear understanding of the need for transparency partly because of the lack of a clear distinction between private and public.

The USTRO is in some ways correct to accuse the Chinese government of protecting the national interest by the slow introduction of transparency. But the national interest is becoming increasingly difficult to define in contemporary China. Rather, the lack of transparency in the Chinese system largely benefits the local and the personal. Through privileged market access and privileged market information and privileged access to investment and the judicial system, networks of insiders are in a position to benefit more than most from limiting openness and access to the things that they control. And even if – and it is a big if – China implements the concessions it promised in its attempts to join the WTO, transparency – or more correctly, opacity – may become an important mechanism in protecting these interests in the face of new economic challenges.

Notes and References

[1] And importantly, the related increase in export growth generated by this FDI.

[2] Particularly in 1993 when there was more FDI than in the entire preceding fourteen years of reform put together.

[3] The top five complaints in order are; 1. Corruption and the lack of transparency; 2.Poor infrastructure; 3.Foreign investment is not permitted in some sectors; 4.Economic instability; 5.Political instability.

[4] Or at the very least, they can be perceived (or depicted) as such within developing states.

[5] Importantly, much of this research is available in English.

[6] A key problem for the leadership here is the extension of the internet, and its implications for control and censorship. While difficult to regulate, the CCP authorities have tried to control as far as possible, with new restrictions introduced from November 1999. The State Press and Publication Administration imposed new restrictions on the dissemination of economic information under the guise of an attempt to control the unregulated spread of “state secrets”. China News Digest, 28 November 1999.

[7] Gao Zhanjun and Liu Fei (1999) “The Closure of GITIC: Latent Financial Risks and Government Approach” World Economy and China 3-4 pp.54.

[8] Xie Ping “Financial reform in China: Review and Future Challenges” in World Economy and China 9-10 1999 p.5.

[9] Wang Luolin, Liu Shucheng and Liu Rongcang “An Opportunity to Raise the Ultimate Consumption Rate while Restarting the Economy” in World Economy and China 5-6 1999 pp.6

[10] Robert Gray “Burden Sharing: A Private Sector Perspective” and Barbara Matthews “International Finance, Venn Diagrams, and Gravity: the Role of Financial Institutions and Regulators in Shaping the Normative Landscape for Financial Intermediation” What is To Be Done? University of Amsterdam, February 2000.

[11] See Stiglitz, Joseph The Role of International Financial Institutions in the Current Global Economy”, Address to the Chicago Council on Foreign Relations, 1998. http//www.worldbank.org/ html/extrdr/extme/jssp022798.htm.

[12] And while trade with the US dominates discussions within China, similar discrepancies can be found in bilateral trade with virtually every nation - while China reported a US$1473 million trade deficit with Germany in 1996, Germany reported that China had a US$4690 million surplus. Zhongguo Tongji Nianjian (China Statistical Yearbook), Beijing: China Statistical Information and Consultancy Service Centre, 1997, and IMF Direction Of Trade Statistics Yearbook, Washington, DC: International Monetary Fund, 1997.

[13] Feng Guozhao and Liu Zunyi, “A New Estimation on the Trade Imbalance Between America and China”, *International Economic Review (Guoji Jingji Pinglun)*, 1999, (5-6).

[14] Even this figure is disputed, as the US claims it is 80 per cent.

[15] Chen Qiuping “News Brief”, *Beijing Review*, February 1993, p.15.

[16] Lardy, N (1994) China and the World Economy (Washington: Institute for International Economics). This may partly be explained by transfer pricing. Despite considerable liberalisation in China, many foreign companies still face problems in repatriating profits due to incomplete currency convertibility and the imposition of myriad *ad hoc* charges on the profits of foreign funded enterprises. Furthermore, those foreign interests operating Joint Ventures with Chinese companies or local authorities have to share a proportion of any profits with their Chinese partners. As such, it would be rational for foreign companies operating in China to locate as much of their profits as possible in operations outside China by overcharging factories in China for imported components supplied by factories in other countries.

[17] Yu Yongding “China’s Macroeconomic Situation and Future Prospect” in World Economy and China 3-4 1999 p.12.

[18] Chen Yixin (2000) “Financial Services Liberalization in China: Conservative Gradualism” RIIA Briefing Paper 11.

19 Wang Dayong "270 Billion Special T-Bonds: What For" World Economy and China 3-4 1999.

20 Hu Angang (1999) "Employment and Development: China's Employment Problem and Employment Strategy" World Economy and China (5-6) pp.23-4.

21 Xie Ping "Financial reform in China: Review and Future Challenges" in World Economy and China 9-10 1999 pp4-13

22 James Kynge "Zhu assails padded growth figures" in Financial Times 17 December 1998

23 Nicholas Lardy (1975) "Centralization and Decentralization in China's Fiscal Management" The China Quarterly (61) p.57.

24 Donnithorne, A. (1976) "Centralization and Decentralization in China's Fiscal Management" in The China Quarterly No 66, pp.328-340.

25 Yongnian Zheng (1999) "Political Incrementalism: Political Lessons of from China's 20 Years of Reform" Third World Quarterly 20 (6) 1999, pp.1168-9.

26 January 11 Xinhua News Agency

27 Gao Peiyong "Further Improving China's Financial and Taxation System" World Economy and China (3-4) 1999 p.41 and p.45

28 But at the same time, we should not ignore the simple and straightforward motivation of corruption – an issue that we shall return to below.

29 See Huang Da (1985) "*Guanyu Kongzhi Huobi Gongjiliang Wenti de Tantao* (Probe into the Problem on Money Issue Control)" *Caimao Jingji* (Finance and Trade Economics) (7), pp.1-8.

30 "Construction Boom Stunts Development" in Beijing Review 15 July 1985, p.7. Local investment spending roughly doubled in eight coastal provinces, with the biggest increase in Guangdong.

31 Zhu Li (1987) "*Zijin Fengpei de Zhuyao Gaibian* (Major Changes in the Distribution of Funds in China)" *Jingji Guanli* (Economic Review) (9).

32 World Bank (1990) China: Between Plan and Market (Washington D.C.: World Bank) pp.24-25.

33 We should exercise care in assuming that there is a single local interest at work in each local authority. Duckett's investigation of Tianjin Municipality, for example, found that different departments within the local government were following their own independent policies which entailed independent strategies for raising capital. Jane Duckett (1998) The Entrepreneurial State (London: Routledge).

34 For example, see Shen Liren and Tai Yuanchen (1990) "*Woguo `Zhuhou Jingji' De Xingcheng Ji Chi Biduan He Genyuan* (The Creation, Origins and Failings of `Dukedom Economies' in China)" *Jingji Yanjiu* (Economic Research) (3).

35 Xie Ping (1999) "Financial reform in China: Review and Future Challenges" World Economy and China (9-10) pp4-5

36 Barbara J Sinkule and Leonard Ortolano "Implementing Environmental Policy in China" Praeger, Westport, 1995 p.19.

37 Gao Zhanjun and Liu Fei (1999) "The Closure of GITIC: Latent Financial Risks and Government Approach" World Economy and China (3-4) pp.53.

38 Wang Dayong (1999) "270 Billion Special T-Bonds: What For" World Economy and China (3-4) 1999 pp.30.

39 Interviews with stockbrokers, Shenzhen, 1998.

40 Xie Ping (1999) "Financial reform in China: Review and Future Challenges" World Economy and China (9-10) p.8.

41 Xie Ping (1999) "Financial Reform in China: Review and Future Challenges" World Economy and China (9-10) p4.

42 Xie Ping (1999) "Financial reform in China: Review and Future Challenges" World Economy and China (9-10) p.13.

43 Yongnian Zheng (1999) "Political Incrementalism: Political Lessons of from China's 20 Years of Reform" Third World Quarterly 20 (6) 1999.

44 Yu Yongding (1999) "China's Macroeconomic Situation and Future Prospect" World Economy and China (3-4) p.11.

45 Through early remittances of profits by joint ventures; unauthorised outward investment; moving foreign debt repayments forward; delaying the remittance home of dividends and

profits; faked payment for patents, commissions, travel expenses, and transportation insurance; over pricing invoices of imports; and through forging documents. Zhao Linghua (1999) "An Analysis of the Forms of Irregular Capital Flows in China" International Economic Review (3-4).