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Refurbishing State Capitalism: A Policy Analysis of Efforts to Rebalance China's Political Economy

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Abstract: This article provides an analysis of policy initiatives aimed at rebalancing China's political economy, especially those contained in the twelfth Five-Year Plan and other recent pronouncements. The objective is to generate a conceptual examination of these policy measures, thereby highlighting their basic intent and purpose. The analysis shows that the Chinese leadership intends to pursue policies that can centralize, standardize and regulate the political economy under continued state guidance. Due to the considerable political obstacles that Chinese policymakers face in rebalancing the political economy, a more state-centric approach is seen as necessary. China is therefore pursuing a policy package of refurbishing state capitalism. While a degree of liberalization is likely to be undertaken, the major thrust is one of revamping, restructuring and, ultimately, strengthening state control and guidance over the political economy.

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Introduction

Over the past 30 years, China's highly successful economic growth has relied on policies that support an export- and investment-driven model of development. This model proved to be highly effective as the global financial crisis hit in 2008. Beginning in 2009, China was able to rapidly jumpstart a slowing economy with a massive state-led stimulus programme that relied heavily on state banks extending credit for real estate and infrastructure projects.

Despite this recent success, China's political economy is standing at a major crossroads (Naughton 2010a). The period of export- and investment-led industrialization is gradually reaching the end of its sustainability. China cannot continue to export its way to growth, since markets abroad will be unable to handle China's increasing volume of exports and are likely to retaliate with trade protectionism and other measures (Kroeber 2009). Similarly, investment-driven growth is beginning to show signs of slowing returns (Eurasia Group 2011). As also happened in Japan during the 1980s, investment-driven growth has generated a build-up of stress points in the domestic economy: a potential bubble in the real-estate sector and non-performing loans in the banks.

The Chinese government seems fully aware of these impending limitations to the old growth model. Building on some of the original emphases in the tenth and eleventh Five-Year Plans, the twelfth Five-Year Plan for 2011–2015 seeks to steer the Chinese political economy away from a pure focus on growth to a balanced economic development model. Special weight rests on boosting consumption and incomes while expanding public welfare services and environmental protection (National People's Congress of the PRC 2011). Rebalancing China's political economy is crucial, not only for China's socio-economic development, but also for global economic growth and stability in general.

Even so, the obstacles for a shift away from an investment- and export-oriented growth model in China appear considerable. The economic successes of the last 30 years have created winners and losers. Essentially, the system has relied on the transfer of wealth from Chinese households to state-run banks, government-backed corporations and the affluent few who are sufficiently well connected (Walter and Howie 2011). Therefore, interest groups that have benefitted from the old system include big private firms and their owners, most state corporations, many professionals and the state technocratic elite. Many middle-class and poorer families have been left behind in relative terms, unable to fully enjoy the fruits of China's economic miracle. Effective restructuring and rebalancing of China's growth patterns thus could run into resistance from the powerful beneficiaries of the old system.

Many observers stress that the only means to rebalance the Chinese economy is to focus on full-scale liberalization. Huang Yasheng, for instance, argues from a strictly neoclassical economic perspective that, after the general liberalization of China's economy in the 1980s, the 1990s saw a shift to a state-led model. In a meticulous analysis of primary statistics on financing in China, he shows that financial capital has been disproportionately flowing to state-owned enterprises and urban infrastructure. This has created a deeply lopsided political economy that benefits foreign and state firms, squeezing the domestic Chinese private sector. According to him, the sole way out of this imbalanced political economy is to liberalize. Only free markets can create an efficient, equitable and sustainable political economy (Huang 2008).

The policy recommendations contained in the World Bank's "China 2030" report are not quite as rigidly neoclassical as Huang's, but similarly focus on a set of liberalization measures. The report, co-authored with China's Development Research Center of the State Council (DRC), advocates the implementation of:

> structural reforms to strengthen the foundations for a market-based economy by redefining the role of government, reforming and restructuring state enterprises and banks, developing the private sector, promoting competition and deepening reforms in the land, labor, and financial markets (World Bank and Development Research Center of the State Council 2012: xv).

In particular, the role of the state should move away from running a large state-owned enterprise sector involved in many competitive business arenas, and instead focus on providing public goods and services. Zhang Wenkui, one of the co-authors of the "China 2030" report and the deputy director of the Enterprise Research Institute at the DRC, echoes these recommendations when he argues that the distorted allocation of resources in China can be widely attributed to state-owned enterprises. Pre-emptive reforms to create a sustainable base for China's future economic growth must therefore focus on the reorganization and privatization of large swaths of China's state sector (*Wall Street Journal* 2012).

As noted, the "China 2030" report was co-authored by the DRC, a reform-oriented research unit affiliated to China's State Council. The DRC's co-authorship shows that liberalization measures enjoy potential support among segments of China's economic policy-making community, including among some top leaders. As such, further measures to liberalize the Chinese political economy are likely to form an important component of any rebalancing effort.

Nonetheless, advocating that China should simply opt for full-out liberalization misunderstands the dynamics of China's political economy. The Chinese party-state is unlikely to follow the U.S. model and pursue a full-blown policy of economic and, especially, financial liberalization. As before, the policy package being advocated attempts to avoid the risk, often associated with economic liberalization, that social stability could be disrupted. Economic reforms aim to retain a significant degree of state control while gradually rebalancing the political economy.

China is thus unlikely to follow the strict neoclassical prescription for economic reform that Huang Yasheng advocates and that many Western observers interpret the "China 2030" report to be implying. Tellingly, the "China 2030" report shies away from emphasizing full-blown financial liberalization that could accentuate existing distortions. It rather advocates measured financial liberalization that is preceded by strengthening regulation and supervision over the Chinese financial sector (World Bank and Development Research Center of the State Council 2012: 135).

In essence, the thrust of the reforms being advocated to rebalance the Chinese political economy can best be conceptualized as refurbishing state capitalism. Instead of a singular reliance on liberalization measures, the Chinese government seems intent on pursuing statist solutions, including efforts to recentralize, standardize and better regulate various aspects of the political economy. This parallels earlier major reform initiatives in China that have consistently balanced liberalization measures with concerted efforts to sustain and strengthen state control. I therefore argue that Chinese policies aimed at rebalancing the political economy are highly unlikely to follow a liberal U.S. inspired approach, as advocated by Huang and many observers in the West. Quite to the contrary, China is pursuing a model of refurbished state capitalism.

Two caveats: this article concentrates purely on an analysis of policy measures announced by the Chinese government; specifically, those contained in the twelfth Five-Year Plan and other recent pronouncements. It does not purport to provide an analysis of the wide-ranging policy debates that have generated the present policy package. Neither does it delve into policy agency: who pursues what, when, and why?

Secondly, the article, due to space constraints, cannot investigate all the implementation constraints that face these policy initiatives and their actual implementation (cf. World Bank and Development Research Center of the State Council 2012: chpt. 9).

My main objective is, therefore, to provide a conceptual examination of Chinese policy measures, thus highlighting the basic purpose and intent of these attempts to rebalance the political economy and their implications for China's changing capitalism. I start with a brief conceptualization of refurbished state capitalism, including its relation to earlier forms of state capitalism. I then detail the various elements shaping China's political economic imbalances. This is followed by an examination of several crucial policy initiatives that have been announced to rebalance China's political economy. The article ends with an analysis of the Chinese policy framework, including its aims and implications for China's emergent capitalism.

Refurbished State Capitalism

State capitalist systems have been conceived of in many different ways. Traditionally, state capitalism has often been identified with Stalinist political economies, including state ownership of most productive assets and central planning. However, state capitalism also has been associated with a range of other political economic frameworks, ranging from market socialism to neo-corporatism, mercantilism and fascism. More precisely, therefore, modern state capitalism denotes a political economy in which the state directs and controls key productive forces, yet follows capitalist principles. This can occur even in a nominally socialist system such as China's.

Contemporary state capitalism is often conceived of as standing in direct contradistinction to liberal free market principles, such as those associated with the Washington Consensus (Bremmer 2010). However, 21st century state capitalism is a variegated force, encompassing a diverse range of capitalist systems in which the state continues to perform key economic functions. There can be considerable differences in the role of the state, the reach of state-controlled enterprises and the degrees of openness to foreign investment and capital flows. In addition, contemporary state capitalisms have emerged in an era of intense neoliberal globalization. In the case of China, this has generated a "market-liberal form of state capitalism" (ten Brink 2010). All present forms of state capitalism have introduced capitalist practices, such as performance incentives for top managers of state firms, mergers and acquisitions, advisory services by international fund managers, international accounting standards, stock market listings and other efforts at corporate restructuring.

Moreover, contemporary state capitalism is not a 21st-century creature of traditional mercantilism (Bremmer 2010). All its practitioners are deeply enmeshed in the international trading system, host multinational corporations and attempt to take advantage of global production and knowledge networks. The defining characteristic of modern state capitalisms in comparison to liberal market capitalism is in the end a considerable distrust of markets and full-out economic liberalization. This does not mean that markets are unimportant, but that markets are used pragmatically. Most modern forms of state capitalism rely on state guidance to manage and develop economies. This includes the use of domestic financial systems and industrial policy tools to foster national innovation systems and national champions, the creation of sovereign wealth funds and other state-guided measures.

State capitalist systems, therefore, distinguish themselves by sharing a strong belief in the potential benefits of state power, a belief that undergirds their economic management philosophies. Economic development has to be carefully managed by statist measures, rather than left to unpredictable and fickle market forces. While having adopted various capitalist practices, modern state capitalisms differ in their ideas, interests and institutions from the ideal-typical liberal conception of capitalism. They often actively "manage" markets for specific policy ends, and the state attempts to assure economic control not due to some ideological principle, but for purely practical reasons: to build national economies and capture shares of future leading sectors.

The Dimensions of China's Imbalances

The last 30 years of China's opening and reform period were primarily characterized by a desire to ensure social stability and high-speed growth. *Bao ba* (保八, meaning "protect the eight" to assure 8 per cent GDP growth per year) remained a central yardstick for evaluating all Chinese Communist Party (CCP) cadres. Despite much talk about structural reform, China continued to use credit from within the state financial system to ensure high GDP growth.

The shock of the financial crisis and ensuing fall-off in external demand led to a rapid reaction by China's leadership. First, the CCP hierarchy was mobilized into ramping up investment projects. Second, the financial system supported these projects by extending large amounts of credit. For the whole of 2009, at the height of the stimulus spending, bank credit increased to 9.6 trillion CNY or triple more normal levels (Naughton 2010b). This stimulus programme succeeded spectacularly, but also created increasing risks of overheating and inflation. In particular, the real estate sector became a target of bank lending and speculation, creating soaring property prices.

During 2010 and especially 2011, the ruling CCP leadership undertook efforts to tamp down credit expansion and to seriously move toward structural reform. The emphasis on fast-paced economic growth is now being replaced with a focus on structural goals such as energy efficiency and income redistribution. In the communiqué issued after the Fifth Plenary Session of the 17th CCP Central Committee, "a new growth pattern that is jointly driven by consumption, investment and exports" was proposed (*Xinhua* 2010).

Sceptics will note that such pronouncements have been made before to little avail. Nonetheless, the country's economy seems to be nearing a crucial threshold where imbalances become so pronounced as to threaten continued growth. The challenge is to unwind the imbalances in an economically and politically sustainable manner. The following examination of select key dimensions of China's imbalanced political economy illustrates this challenge.

The first dimension of China's domestic imbalances remains an overly rich and large state. *Guofu, minqiong* (国富民穷, the state is rich, the people are poor), is a popular Chinese saying that captures the crux of this dimension (Anonymous 4, 5, 6). Although China's economy has been liberalizing, the Chinese party-state continues to retain control over the commanding heights of the economy via large state firms. An ambitious effort at state enterprise reform starting in the mid-1990s under the policy of *zhuada fangxiao* (抓大放小, grasping the big and letting go of the small) created a much more profitable state sector. Under this policy, most small- and medium-sized state-owned enterprises were privatized or closed; large state firms, however, saw a wave of corporate restructuring under continued state control.

The result has been fewer, but much larger, state firms. Many of these are in oligopolistic markets in the oil, gas, energy, mining, tobacco and telecoms sectors. Limited competition domestically and large support by the state in terms of finance and policy have kept state sector profits high (World Bank 2010). In 2007, the Chinese state sector as a whole is estimated to have produced profits of about 6.2 per cent of GDP, a rather astounding figure (Naughton 2008: 19). More recent statistics from the Chinese Ministry of Finance show that state firms made an aggregate profit of about 2 trillion CNY (303 billion USD) in 2010, up 37.9 per cent over the previous year (*China Daily* 2011a). If China's total GDP for 2010 is estimated at 37.9 trillion CNY (CIA 2011), then state enterprise profits would be about 5.3 per cent of GDP, which is still extremely high.

A look at China's savings distribution further clarifies the nature of China's state-centric political economy (Naughton 2010a). China's savings behaviour has undoubtedly been extreme, with savings reaching a stratospheric 51.4 per cent of GDP in 2008 (Wiemer 2009; World Bank and Development Research Center of the State Council 2012: 11). This is more than double the average world rate. There are considerable debates on what exactly accounts for China's high savings rate, especially concerning whether households, enterprises, or the government are most responsible for creating China's savings glut (cf. Wiemer 2009; Kuijs 2009; Anderson 2009).

While different data sets point to different conclusions, it is clear that the profits and with this the savings of China's state-owned enterprises increased rapidly after their massive restructuring in the late 1990s (Wiemer 2009; Kuijs 2009). Jonathan Anderson, for instance, argues that, from 2001 to 2008, overall industrial production and sales revenue more than doubled relative to GDP. As a result, industrial profits and the savings they generate are in part responsible for China's savings behaviour (Anderson 2009: 34).

The second component is the government itself, which saw rapid revenue growth in the 2000s. The budget consequently moved into surplus; but rather than spend money on social welfare or grants to poor local governments, the government retired debt and saved for a rainy day. As Calla Wiemer puts it, "The extreme parsimony of government is one of the major causes of the big increase in the national saving rate during the 2000s" (Wiemer 2009: 28). Both corporate and government savings are leading causes for China's saving and consumption imbalances.

Finally, households saw their share of savings decline while state enterprise reforms were in full swing during the late 1990s, but then increase during the 2000s. Undeniably, Chinese households display extreme frugality, resulting in their consumption share of National Disposable Income dropping from an already low 16.2 per cent in 2001 to only 13.4 per cent in 2007 (Wiemer 2009: 28). Chinese households over-save and under-consume, but why?

Several factors form part of an explanation. First, the demographic effects of China's one-child policy have produced a declining dependency ratio over the 2000s, giving Chinese families more room to save (Wiemer 2009: 29). Second, Chinese households practice precautionary saving due to a lack of social safety nets and credit for large purchases. They delay consumption and save ahead of time for large outlays, such as for medical bills, real estate purchases and school fees.

Finally, China's increasing income inequality has produced some very rich households with a high propensity to save. China's household survey indicates that in 2007 the top 20 per cent of income earners accounted for 48 per cent of overall household saving, while the bottom 20 per cent only accounted for 3 per cent (Kuijs 2009: 32). As in all societies, China's wealthy households tend to save more as a percentage of their income, a fact that is most likely accentuated by China's unequal distribution of income, especially if unreported household income is taken into account (Kroeber 2010: 20–21).

In essence, China's mounting income inequality reflects China's "rich state-poor people" and saving-consumption imbalances. The imbalances are largely congruent, as an emphasis on state-guided investment and exports reinforced imbalanced saving and consumption behaviours, as well as an imbalanced income distribution. Data from 2007 by the United Nations, for instance, indicates that China's Gini coefficient is 0.469, placing China among those countries with the widest wealth gap in the world (United Nations Development Programme 2008). This is especially significant given that, at the outset of reforms in 1978, China was considered to have one of the most even distributions of wealth in the world.

The "rich state-poor people", saving-consumption and rich household-poor household imbalances, furthermore, echo the fourth and in some ways most glaring imbalance: that between rural and urban residents and regions. China's urban regions, as in most instances of capitalist development, have seen the lion's share of investment, trade, technological upgrading and social welfare expenditure. Generally, such urban-rural inequalities trigger rural-urban migration that defuses the social pressures created by the inequalities. However, despite massive migration, the *hukou* (户口, residency permit) system continues to divide China's population into rural and urban households (Chan 2012).

Urban households in general have access to certain social welfare services in their city. Rural migrants, however, cannot access these urban social services when they move to cities. While they often perceive themselves as improving their and their children's life chances by moving to urban areas, they also endure exacting working conditions, low wages and minimal social welfare support in the cities. Rural migrants now make up a sizeable part of China's population, with former premier Wen Jiabao indicating that rural migrants number 240 million, slightly less than one fifth of China's overall population (Chinese Government 2011).

One major aspect in addressing China's imbalances is, thus, to stop discrimination against migrants and their children, while providing the social infrastructure for them to settle in cities permanently and receive education, training, housing, medical care and other social services. The rural-urban imbalance further echoes the fifth dimension of China's imbalances: the large developmental gaps between China's affluent coastal regions and much poorer interior regions.

The interior actually should be conceived of as several macro-regions, each with its own endowments, potentials and challenges. Overall, rapidly rising costs along the coast and better infrastructure have created more favourable conditions for development in the interior. Already, cities such as Chongqing and Chengdu in the Sichuan Basin are seeing rapid development spurred by infrastructure investment, increased foreign direct investment and the relocation of manufacturing activities from the Eastern Seaboard. As with other regions in China's western interior, these cities began to benefit developmentally from the initiation of the "Open up the West Strategy" (西部大开发, *xibu da kaifa*) in 2000 (McNally 2004). Moreover, in 2007 both Chengdu and Chongqing became testing grounds for various new policy experiments, including the integration of rural residents into urban communities, technology development and reform of the rural land and *hukou* systems (Chen and Gao 2011; Miller 2011).

Nonetheless, many regions in China's interior still suffer from poor geography, infrastructure and governance. It will take time to overcome these handicaps. In this respect, the interior regions stand at the forefront of facing the sixth and final dimension of the imbalances that I include here: the lack of environmental sustainability and energy efficiency in China's development. This dimension of rebalancing is likely to prove one of the most vexing. Various aspects of China's environmental condition have been well illustrated and documented (Economy 2010; Song and Woo 2010; Day 2005). Basically, unbridled development, as a result of the country's GDP growth mania, has caused immense degradation of China's air, water and soil. Although steps to improve environmental protection have been taken since the 1990s, local cadres often circumvent laws and regulations, in large part because China's Leninist incentive system encourages them to pursue economic growth over environmental sustainability.

The present push to rebalance China's political economy, though, seems to be generating a stronger emphasis on balancing economic growth with environmental sustainability. In essence, the CCP's fixation with social stability is prodding Chinese leaders to take the environment more seriously, since the current situation, whereby there are too few environmental protections in place, could feed social instability. Also, China is seeking to implement serious energy efficiency targets, especially in terms of the efficiency of each unit of GDP growth.

All of the six dimensions of China's imbalanced political economy examined above have been present for at least the last decade. A state-centric orientation that fosters income for state firms and the government, the saving-consumption imbalance, the imbalance in incomes and assets among households, the rural-urban imbalance, the interior-coast development imbalance, and the imbalance between man and nature in China's growth model all have been intensifying over the past years. China's political economy, however, is unlikely to sustain this development model for much longer. The country's impending demographic transition will mean fewer workers and rising wages. It also implies that the savings rate is likely to move lower as a larger share of workers retires. As a result, China's sea of cheap capital in the state banking system could shrink in relative terms, making massive state-guided investment booms more difficult to sustain. In addition, rapid growth in exports cannot be sustained, thus diminishing the export-driven element of China's economic growth model (World Bank and Development Research Center of the State Council 2012: 8).

Moving towards a model of growth based on domestic consumption, industrial upgrading and environmental protection is evidently a necessity if the CCP wants to maintain economic growth and social stability. But how will this occur? Will liberalizing, integrating and deregulating markets take centre stage? Or will the main political and policy thrust in China's rebalancing efforts continue to put the state full-square and centre?

Rebalancing China's Political Economy

Initial policy pronouncements on the need to rebalance the Chinese political economy already began to appear in the early 2000s, including in the tenth Five-Year Plan. The concept of the "Harmonious Society" was first raised by former president Hu Jintao in 2004. The construction of a "Socialist Harmonious Society" and the pursuit of a "Scientific Outlook of Development" then became the official themes of the seventeenth Party Congress in 2007. These slogans express how the Hu-Wen CCP administration has tried to create a more "pro-people" oriented platform, in which the Party represents the interests of all Chinese people (Zheng 2010: 85).

However, greater emphasis over the 2000s on environmental protection, social services and income redistribution has actually done little to rebalance the Chinese political economy. Rather than focusing on the quality of growth, the cadre performance review system remained fixated on speed, mainly because GDP growth is easier to measure and compare across different jurisdictions. As Joseph Fewsmith remarks, "It was difficult to refocus attention on quality when, in practice, local cadres are rewarded […] for pursuing speed" (Fewsmith 2010). Rebalancing, therefore, implies deemphasizing the ingrained "GDP maximization" culture on the part of local cadres to effectively evaluate and compare them along a wide array of social measures (World Bank and Development Research Center of the State Council 2012: 44; World Bank 2010: 17).

The twelfth Five-Year Plan released in March 2011 seems to express a distinct political focus on the quality of growth, especially on rebalancing the political economy by promoting consumption, urbanization, the service sector and industrial upgrading (National People's Congress 2011). Ultimately, China only needs to look at Japan's failure to restructure an investment-driven system that stifled domestic consumption to take home the lesson that the present pattern of growth is on an unsustainable course (Devine 2010). China's future development requires rising incomes that boost consumption and much more technology- and skills-intensive industry, so that higher-value added jobs can replace jobs in low-value sectors, such as textiles and toys (cf. World Bank and Development Research Center of the State Council 2012: 11).

In addition to the twelfth Five-Year Plan, a raft of policy measures adds to the impression that the Chinese leadership is more serious than in the past about effectively rebalancing the political economy. The following will briefly highlight several policy areas that illustrate the rather unique state-centric form of economic rebalancing that China is attempting to undertake. Due to space constraints, not all initiatives can be discussed.

As noted above, China's domestic imbalances are in part due to an overemphasis on the state sector. Although most state firms have been corporatized and listed on stock markets, they continue to act as quasi-monopolies or operate in managed oligopolies that keep state sector profits high. The Chinese party-state, however, does not seem inclined to undermine the oligopolistic positions of these large state firms by introducing more market competition. Rather, policies are trying to extract a larger share of state sector profits into the state treasury, thus providing an increasing fiscal base to support social spending. Efforts to this effect began in 2008, when the Chinese government required for the first time since 1994 that China's centrally-administered state firms hand over a portion of their 2007 post-tax profits to the state in the form of dividends (Ulrich 2008). At that point, China's publicly listed state firms already were paying dividends to their public shareholders. However, their main shareholder – the state – did not collect dividends, but instead left the funds in the firms themselves to be reinvested. In part, investment from these retained profits is what has been driving China's investment-led growth pattern, causing industrial overcapacity and speculative bubbles.

The dividend payout rate in 2008 was established as 10 per cent of post-tax profits for 18 energy, telecommunications and tobacco groups; and 5 per cent for most other centrally administered state firms in more competitive sectors, such as steel and electronics (Ulrich 2008). In late 2010, the Chinese government announced that most large state-owned companies would have to pay larger dividends in 2011 to help rebalance the economy. According to a directive from the Ministry of Finance, China's largest petrochemical, tobacco, telecom and power generation companies are required to pay 15 per cent of their post-tax profits to the state, up from 10 per cent. Large state-owned companies in the trade, construction, transport, mining and steel sectors are to hand over 10 per cent of post-tax profits, up from 5 per cent (Anderlini 2010). At the 2012 Strategic and Economic Dialogue with the United States, China further committed to improving the state-owned capital returns collection system by steadily raising the dividend payout ratio of state-owned enterprises and increasing the number of both central and provincial state firms that pay dividends to the government (U.S. Department of the Treasury 2012). The goal is to increase the average dividend payout level of large state companies to be in line with international norms of between 30 to 40 per cent of post-tax profits to be paid as dividends (Ulrich 2008).

It is clear that the Chinese central government hopes that, by reducing the amount of funds that state firms have to invest, it can curb wasteful spending and reduce industrial overcapacity. Perhaps more importantly, the payment of state sector dividends into public coffers will provide a fiscal source to support China's underfunded social obligations, including spending on pensions, health and education. Greater allocation to social welfare is one way to alleviate the pervasive uncertainty that hinders development of China's consumer economy, and thus helps to increase the share of consumption in the country's growth pattern.

So far, the government agency that exercises the state's ownership rights, the State-owned Assets Supervision and Administration Commission (SASAC), has not released an exact account of the progress of China's state-owned capital returns collection system. However, reports note that SASAC has found it difficult to force some powerful state enterprises to hand over the required dividend payments (Anderlini 2010). Although powerful state firms are not inclined to hand over bigger dividends to help finance social spending, they are ultimately owned by the state and their top personnel fall under the CCP's Organization Department. Since they are part of the state and belong theoretically to "the people", the robust profit growth of state firms creates a socio-political risk: Chinese citizens are increasingly asking why the dividends of these large firms are not used to fund direly needed expenditures on education, healthcare and other social services (Anonymous 1, 2).

In the final analysis, asking state firms to pay more dividends to the national treasury can address three major imbalances. If the dividends are invested in social services, this policy will lower the share of GDP that goes to the corporate sector, while raising the share that goes to consumers. In this manner, it redresses the "rich government, poor people" and saving-consumption imbalances. Furthermore, effective investment in social security, health, education and public housing can also address income inequalities to some extent. Put differently, the state sector dividend policy could "clip the state sector's wings" to support the expansion of state involvement in a new area: social services.

Over the past years, the Chinese government has begun the process of building a comprehensive social service system that is centrally integrated, standardized and state-centric (China Development Research Foundation 2011). One informant referred to China's efforts to establish a universal welfare system as "Social Democracy (in the German or Scandinavian style) with Chinese Characteristics" (Anonymous 7). China's social service sector reforms are starting from a difficult base. Since many services have been partially privatized and thoroughly decentralized, management has become unwieldy and fragmented across programmes, space and people (World Bank and Development Research Center of the State Council 2012: 47; World Bank 2010: 18). For example, China's healthcare system has been chaotic, inefficient and riddled with conflicts of interest (World Bank and Development Research Center of the State Council 2012: 48). As Li Ling asserts, it has actually:

> deteriorated in many aspects, both in rural and urban areas. In terms of quality, efficiency, and equity, China's health care system is far behind the current level of economic development and the demands of the people. Briefly summarized, the tottering system is in a state of low accessibility and high prices (Li 2010).

Beginning in the 1980s, most hospitals had to resort to self-financing and functioned basically as for-profit organizations. Healthcare provision thus focused on expensive and profitable procedures. Expenditures grew rapidly, resulting in fewer people being able to afford health coverage. Even in urban areas, health coverage remained highly uneven and coverage portability across municipal and provincial boundaries was very limited, since many urban residents continued to be insured with only local or limited coverage. As a result, even those fully covered in urban areas via their workplaces faced an inconvenient and unwieldy system.

Li Ling states that these problems "are mainly due to government failure" (Li 2010). To address them, the government will not stage a retreat but will rather reinsert itself more forcefully into the healthcare system. China's healthcare reform plan was publicized on 6 April 2009 by the State Council. It envisages a universal healthcare system by 2020 for all Chinese, which will tackle the issues of financing, delivery, public health, regulation and access to essential drugs. It is comprehensive in its remit and state-centric in philosophy (Li 2010).

One of the main elements is to replace the uneven urban insurance system with a unified framework and expand coverage. The state aims to subsidize every Chinese citizen to join basic health insurance systems. The healthcare plan also aims to build a three-tier health service delivery system with an emphasis on providing basic care. In addition, public hospitals are to be recentralized in their administration and regulation to reverse distortions in their profit-oriented incentive systems, making them into real public hospitals. Similarly, the pharmaceutical industry is undergoing reform to build a basic/ essential drug system that is independent of hospitals and based on inexpensive generic drugs. Again, a state-centric solution is being pursued, since the state aims to exercise close supervision and regulation over the pharmaceuticals sector and directly organize procurement, production, distribution and utilization standards of basic/ essential drugs.

Evidently, the state is refurbishing itself to exercise more control and guidance. Government bureaucracies in charge of the healthcare sector are now in the process of undergoing reforms to diminish conflicts of interest, communication problems and a murky division of labour. The goal is not liberalization or deregulation, but rather to strengthen the power of the state's health administrative capacity to establish a low-cost, efficient and universal healthcare system.

A similar pattern emerges in the equally complex task of reforming the urban housing system. When asked about the development of China's urban real estate sector, the mayor of Shanghai, Han Zheng, noted, "The market system alone is not sufficient" (*Wall Street Journal* 2010). In China, a partially market-driven system with state involvement has caused dizzying real-estate prices, unsustainable investment patterns and inefficient use of scarce land resources (World Bank and Development Research Center of the State Council 2012: 56). As a result, Chinese localities are attempting to build an integrated state urban housing programme to address these imbalances.

It is perhaps here that China's state capitalist approach to rebalancing becomes most apparent. Rather than utilizing solely market and tax tools, as a limited liberal state might endeavour, the Chinese state is undertaking a massive public housing programme to create the conditions for sustained urbanization and consumption-driven growth. Under the twelfth Five-Year Plan, China intends to construct 36 million units of affordable homes with the goal of starting construction on over seven million units in 2012 alone (*Xinhua* 2012). On the one hand, stepped up public housing construction is likely to serve as a means to sustain housing investment as a major driver of growth, especially in the short term. On the other hand, the policy seeks to generate a new class of home-owners and thus consumers, while bringing under control the sky-high property prices that have caused resentment among ordinary Chinese people. The policy thus aims to ensure ongoing urbanization and sows the seeds for greater consumption since it frees up pent-up demand among poorer households.

The overall aim of China's housing policy is to create a two-tier market. Various forms of social housing are intended for lower income households, while market-priced property will be purchased mainly by higher-income households. Rosealea Yao terms this "a return to socialism" (Yao 2010). The thrust of these policy initiatives is to restructure the housing market by, first, providing modest subsidies to low-income and migrant households; second, providing some subsidies to emerging middle-class households that do not own a home and would have difficulties buying one on the market; and, finally, massively increasing the supply of units with smaller floor space (under 90 square metres) so that the average cost of a flat is kept reasonable. There are, however, limits to this form of Chinese housing "socialism", since subsidies are to be kept modest and the support for middle-class buyers is intended to enable families to move up the housing ladder to market-priced housing (Yao 2010).

The biggest question facing China's social housing policies is how to incentivize developers to build these units, especially since they tend to have low profit margins. In the past, local governments regularly failed to meet their social housing targets. But increasingly heavy-handed policy directives are changing the situation. Throughout 2011, the Chinese government rolled out measures, such as high down-payment requirements, a pilot property tax scheme for Shanghai and Chongqing and residency restrictions on who could buy property that have cooled the real estate sector and created disincentives to build market-priced housing (Yao 2011).

It is clear that the Chinese government is moving away from a relatively unrestricted, market-based system to a more heavily state-guided system. Certainly, targets for social housing have been raised rapidly. At the same time, the Chinese state is using regulatory, monetary and tax tools to curb speculative demand for luxury housing. A major pillar of sustained economic growth in China could thus move away from speculative for-market housing construction to focus instead on public housing investment (Naughton 2010b).

The two examples of reform of the health and urban housing systems in China given above show a distinct pattern: the state is not retreating, but often forcefully attempting to reinsert itself into the delivery of social services. The overall goal is to create universal and centrally standardized social welfare systems for medical care, pensions, unemployment, disability insurance, urban housing and education. Policy initiatives differ in each area, with some showing more direct state involvement (medical care) and others less (education). But the overall pattern is to create consumption-driven growth in a state-guided fashion.

A similar pattern can be seen in China's massive effort to develop rural areas. Already, since the mid-2000s, an emphasis on building a "new socialist countryside" has focused on increasing rural incomes, reducing regional inequality and improving rural social services and local governance, as well as educating local cadres and farmers. The official slogan is to create "advanced production, improved livelihood, a civilized social atmosphere, clean and tidy villages and efficient management" in China's countryside (*People's Daily* 2006). As a result of these initiatives, the central government has been funnelling public money into a rural cooperative health insurance system and rural infrastructure, as well as tax reliefs and subsidies for farmers. Several reform experiments also aim to enable more efficient rural land transfers (Chen and Gao 2011).

Hurdles remain, however, especially in the area of fiscal reform. As Christine Wong notes:

> the efficacy of these ambitious policies is threatened by China's dysfunctional fiscal system, which is unsuited to financing social expenditures in a reliable and equitable way, and is itself the root cause of the inequalities and under-provision of public services that Beijing wants to reverse (Wong 2010: 20).

One of the most challenging aspects of rebalancing China's political economy is thus to implement comprehensive fiscal reform that channels resources more effectively to where they are needed most (World Bank and Development Research Center of the State Council 2012: 56). Indeed, many rural cadres are caught between policy imposed from above and the expectations of rural citizens, with often insufficient fiscal resources, especially in poorer areas (*Oxford Analytica* 2010: 1). Certainly in this respect, the refurbishment of existing state institutions stands highest on the agenda.

Several final arenas in which the state-centric approach to rebalancing China's political economy is clearly evident encompass industrial upgrading and infrastructure development. Without doubt, the Chinese state has taken the leading role in infrastructure development, creating a nationally integrated road, rail and power transmission network to draw poorer rural and central/ western areas into the cycles of industrial upgrading occurring along the coast. In particular, high-speed rail and the establishment of a national smart grid represent state-of-the-art efforts to bridge regional development gaps.

Similarly, China is using a variety of state-guided industrial policy tools to foster industrial upgrading. For China to establish a consumption-oriented economy, labour's low share of the national economic pie must be increased. The key to this is to support higher value-added activities that pay higher wages in cutting-edge industries and the service sector (World Bank and Development Research Center of the State Council 2012: 61). China, therefore, will focus under the twelfth Five-Year Plan on developing "emerging strategic industries" to foster innovation and form a new backbone of economic growth (National People's Congress of the PRC 2011). The central government intends to spend more than 4 trillion CNY (609 billion USD) on industries including alternative energy, biotechnology, new-generation information technology, high-end equipment manufacturing, advanced materials and alternative fuel cars, as well as energy-saving and environmental protection technologies (Jackson 2011). These new strategic industries' value-added output should account for 8 per cent of GDP by 2015 (*China Daily* 2011b).

Industrial upgrading also focuses on moving manufacturers and processors inland to rebalance regional economies. In this manner, the Chinese government hopes to create a virtuous cycle by which lower value-added and labour-intensive activities move inland, while manufacturers along the coast upgrade. In fact, industrial upgrading, industrial relocation inland and growing wages throughout the country are seen as part of a comprehensive effort to utilize domestic demand and innovation, rather than exports, as future catalysts for growth.

The policy areas included in the foregoing analysis did not address several important initiatives aimed at rebalancing China's political economy. In particular, efforts to improve the environmental sustainability of China's growth model have not been covered. Other policy arenas only touched upon include comprehensive efforts to integrate urban and rural areas, strengthen the service sector, continue state sector and financial reforms, and various taxation and fiscal reform policies (on financial sector reforms and labour system reforms see the contributions by Lüthje, Buttolo and Gruin in this topical issue). Each of these arenas incorporates different initial conditions and dynamics. Overall, though, the major policy thrust of China's efforts to rebalance the political economy is quite clear. The Chinese state under the CCP is for the most part not liberalizing economic governance in favour of market-based dynamics, but rather aiming to refurbish itself to more effectively guide a socially inclusive political economy. The goal is more effective state control, not less.

Concluding Remarks: Refurbishing State Capitalism in China

There are pessimists and optimists among those observing China's renewed efforts to rebalance its political economy (see also the contribution by ten Brink in this topical issue). Some think that the CCP leadership will face strong resistance from local governments and powerful state-owned companies that are keen to protect their own interests. They look back at recent history and conclude that China's powerful state-owned enterprises are highly unlikely to jettison their habit of amassing large profits, implying that state-led investment will remain a crucial driver of economic growth.

Others though see that, to maintain social stability and the CCP's political legitimacy, the party-state has little choice. Several informants noted that the CCP has no alternative but to rebalance the political economy effectively, otherwise it could be faced with a slackening of economic growth and social unrest (Anonymous 3, 2, 6). Ideally, the rebalancing policies examined above would create a virtuous cycle whereby household spending supports sufficient domestic consumption to undergird sustained economic growth.

Whatever view one takes, the policy initiatives discussed here make clear that there is an emphasis on statist solutions to rebalance China's political economy. In some areas, China's state capitalism will have to "clip its own wings" to deliver more equitable, sustainable and domestically oriented growth. However, this constitutes efforts to revamp, restructure, and, ultimately, strengthen China's form of state capitalism; a process of "authoritarian upgrading" in Sebastian Heilmann's (2010) words.

As with other forms of modern state capitalism in Brazil, India and Russia, China's state capitalism encompasses a strong belief in the potential benefits of state power (McNally 2013). Therefore, while having adopted capitalist practices and pursued liberalization measures in a variety of policy arenas, China continues its aim to retain state control over the direction and stability of the economy. The foregoing analysis has shown that the Chinese leadership intends to pursue policies that can centralize, standardize and better regulate the political economy under state guidance. In Barry Naughton's words:

> Central government leaders have concluded that they must exert more detailed and differentiated control over economic decision-making […] The Chinese government is laying out a future path in which economic growth is to be steered by a strong and intrusive government (Naughton 2010b).

The Chinese state under the CCP is thus unlikely to give up its leading role in the economy. Industrial policy to spur innovation, public housing programmes to facilitate urbanization and the development of a state-centric social welfare system and national infrastructure are all state-guided elements that are intended to rebalance China's political economy. In this regard, the Chinese government is taking a rather different approach to that of most Western governments. Although Western governments' role in the economy has increased in the aftermath of the 2008 financial crisis, there has been a considerable backlash, most evident in the United States and the United Kingdom. China, however, is looking to the government to do more in a more effective and concentrated manner.

Perhaps somewhat ironically, the considerable political obstacles that Chinese policy-makers face in rebalancing the political economy emanate in large part from interests within the party-state, such as the large oligopolistic state conglomerates. These interests could prove to be the most wedded to the old order and have the resources to resist the central government's rebalancing policies. Precisely because of this fact, policy-makers see a more state-centric approach as necessary. Only the central party-state is perceived as having the potential clout to refurbish China's form of state capitalism by "clipping its own wings" and "re-grouping" to deliver more equitable, sustainable and domestically oriented growth.

This logic flies in the face of neoliberal policy prescriptions, such as those espoused by Huang Yasheng (2008) and, in a more measured fashion, the World Bank and Development Research Center of the State Council (2012). These prescriptions hope that the Chinese state would retreat, giving way in this process to the fundamental belief that liberal market forces are the best means to allocate goods and services. While Chinese policies undoubtedly will make use of market liberalization, a "withering away" of the state is highly unlikely.

It is in this context pertinent to understand that the trajectory of China's reforms over the period from the 1980s to the 2000s was neither purely the history of gradual economic liberalization nor that of statist domination. It is not "the market wins, the state loses" or vice versa. Rather, private sector forces, market forces and state power have actually augmented each other in concert. China's dialectic of state-led capitalism top-down, juxtaposed with entrepreneurial network capitalism bottom-up, has over time created a highly flexible political economy with global reach (McNally 2008, 2012). Put differently, the state has allowed measured steps at liberalization, while continuously seeking to refurbish its control over economic decision-making. The picture is thus rather complex, since the CCP's project of reform and opening up has been characterized by the mutual strengthening of state, society and economy (cf. Kohli and Shue 1994).

Given the crucial nature of rebalancing China's political economy for social stability and sustainable growth into the future, recent policy proposals display a sense of urgency and pay much attention to comprehensive and integrated solutions. They are logical, coherent and directly aimed at shifting the economy toward increasing household incomes and consumer spending. Doubts are thus concentrated on the political equation: can opposition be overcome to effectively implement these policies?

This question has to remain unanswered for the time being. What is clear is that the CCP party-state aims to pursue a further phase of state reconstitution, moving away from the growth fetish of the last 30 years to take a leading role in building "Social Democracy with Chinese Characteristics". Further liberalization of certain sectors of the economy will continue, such as for some service industries, parts of the financial system, the one-child policy and the *hukou* (residency) system. But this is "strategic liberalization" contained in key sectors. Overall, statist tools will be at the forefront in order to affect reforms in areas such as public housing, infrastructure, industrial policy, social welfare system reforms and, most importantly, the CCP-controlled cadre incentive system, which will have to move away from emphasizing GDP maximization to quality-of-life indices.

Evidently, all of these reforms are to a considerable extent state-designed, state-driven and state-coordinated. This is most clearly reflected in the state sector dividend policy. There is no intent whatsoever for large state firms to cede the commanding heights of the economy, and there are no clear policy propositions to introduce more competition from the private sector in key industries like telecommunications, steel and airlines. Nevertheless, the state is aiming to recentralize control over state-sector earnings, using them as a valuable resource to support greater social service spending.

In the final analysis, China's political economic background continues to foster state-centric policy solutions (McNally 2012). This poses a challenge to our understanding of what constitutes the key to successful and sustainable economic development (cf. Heilmann 2010). Could state capitalist and state-centric solutions be more amenable to the challenges created by globalization and recurring financial crises for developing economies? Could China's model of state capitalism that emphasizes the collective good (as defined by the state) challenge the Western-led neoliberal order? (cf. Nicholson 2011). Certainly, there is increasing reservation on the global level that the free market model is the best of all economic systems, especially the position that the freer it is, the more efficient its outcomes (Stiglitz 2010). Parts of global governance, for example, are gradually shifting to liberal market policies that are tempered by state regulation and state guidance (Kahler 2010). While the success of Chinese efforts to rebalance the political economy are still indeterminate, its state-centric policy approach undoubtedly provides an interesting counterpoint to the neoliberal free-market economic model.

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