# Provincial Discretion and National Power:

# Investment Policy in Guangdong and Shanghai, 1978-1993*


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***Note:***

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Central-provincial relations have been an old issue plaguing successive Chinese leaderships both before and after 1949. Indeed the spatial dimension, with its ramifications regarding power distribution and the complications around policy formulation and implementation, has been a perennial issue of concern in comparative politics. This old interest has been, in the recent years, intensified by incessant central-provincial conflicts since reform, to the extent that the integration of the Chinese state has been called into question.[1] Against this background the conventional wisdom has been to portray provincial leaders as caught between the competing roles of central agents and local spokesmen, and central-provincial relations as being an endless cycle of centralization-decentralization. The Centre and the provinces are perceived to be locked into a power relationship of, basically, a zero-sum nature.[2]

This paper argues for an alternative conception of the nature of central-provincial relations. Mutual power between the Centre and the provinces necessitates compromise on both sides, and makes changes in the relationship possible.[3] Making use of provincial implementation data on investment, the paper highlights that both provincial discretion and central policy take place within the contextual constraints imposed by one another. The concept of provincial discretion refers to action and inaction taken by provincial governments without the formal endorsement of the Centre, which involves written affirmation by the Centre through formal central documents. Whilst in the reform period provinces have acquired substantial resources and thus leverage *vis-a-vis* the Centre, as a result of the cumulative effect of previous decentralization measures,[4] what appears as provincial non-compliance is, this paper argues, partly also the product of central policy

influence. Specific strategies and courses of action are chosen by provincial leaders within the constraints imposed by central policies. Likewise, central policy is also subject to the influence of provincial discretion. The apparent simplicity of investment statistics, and especially those of "excess investment",[5] has only served to obscure the complexity and subtlety of the interactive relations between the Centre and the provinces.

These arguments are based on observations drawn from two provincial-level units, Guangdong and Shanghai. Both provinces belong to the richer category of provinces along the coast, and questions arise as to the relevance of the ostensibly "atypical" findings to the general picture. Part of the answer takes issue with the appropriateness of the concept of "typicality" itself. The question is: what do we mean by "typicality"? Does "typicality" refer to the median, the mode, or the average? Whatever the case differences are averaged out so that the use of a "typical" measure may be justified only if we are certain that those differences erased from analysis are irrelevant or unimportant. More often, however, a certain measure is used under a state of ignorance: we do not know whether or not the differences are relevant, or we find the differences altogether incomprehensible. The generalizability of an apparently typical case is, under these circumstances, merely assumed. This problem is compounded in the study of China by the sheer range of differences among Chinese provinces, in view of the "continental" nature of the Chinese state.[6] Against this background, the apparent unrepresentativeness of Guangdong and Shanghai has the desirable effect of requiring the analyst to confront squarely the wider implications of the case studies, and to explicate what is otherwise merely assumed.

Picking two resourceful areas along the coast, rather than one rich and one poor, or one coastal and one inland, allows us to minimize the number of independent variables and focus on the variable of central policies. More importantly, the choice highlights the conflict between the constraints posed by the Centre on the one hand, and the opportunities for discretion allowed by provincial socio-economic conditions on the other. The larger resource base the Guangdong and Shanghai leaderships had at their disposal, relative to other poorer interior provinces, is indicative of the extent of *choice* of provincial leaders. By ruling out the possibility that provinces comply because they have no other choice as a result of absolute deprivation, the Guangdong-Shanghai comparison allows us to ask: *would provincial leaders comply with central policies if they had the means not so to do***?**[7] In other words, their richer endowment highlights the possibility of provincial choice, and thus facilitates a focus on the analysis of the circumstances whereby specific choices are made.

So what may a comparison of Guangdong and Shanghai illuminate? The two had experiences at opposite extremes during most of the time in the first reform decade. From the beginning Guangdong was exempted from implementation of some national policies, as well as given a new set of custom-made policies allowing a large degree of provincial discretion. On the other hand Shanghai's resource base continued to be tightly controlled by the Centre, the level of extraction remaining continuously high. Their extreme treatment by the Centre posits them as two poles of a continuum in terms of the possible impact of central policy on provincial discretion, between which the position of other

provinces is likely to fall. The question asked here is: given the theoretical possibility of provincial choice in a resourceful setting, how are provincial choices actually made in light of differential central policy? In other words, whilst *similarities* of Guangdong and Shanghai, namely their large resource base, point to the possibility of provincial choice, *differences* over central policy as applied to the two direct attention to the influence of central policies on such choice.

*Unresolved Questions*[8]

Studies on China's post-1949 central-provincial relations have moved progressively towards recognition of the existence of provincial power. New data surfaced, from time to time, and required new approaches for adequate explanation and description. In this way the image of the provinces, and their leaders, has moved from one of the loyal agents of the Centre in the totalitarian literature of the 1950s and 1960s,[9] to that of responsive but coerced entities during the Cultural Revolution [10] and, subsequently since the 1980s, to an image of the powerful if unequal bargaining partners of the Centre.[11] The unfolding of events within China led analysts to recognize that provinces did, in fact, wield power *vis-à-vis* the Centre.

Upon closer examination, however, the nature of provincial power that previous analyses have documented remains highly unclear. There is the need to reconcile the co-existence of apparently contradictory phenomena. On the one hand, there were the multiple successes of provincial leaders in their manoeuvring with central policies.

Central-provincial relations were pictured as involving intense inter-agency bargaining, with a heavy bias towards the provinces who controlled the bulk of policy implementation.[12] On the other hand, the power of the Centre over the provinces was too real to be ignored, as demonstrated by the vigour of occasional recentralization measures. This has, in fact, led some analysts to conclude that the apparent decline of central control and the rise of provincial power in the 1980s was but the result of voluntary self-restraint by the Centre.[13]

It is, however, unconvincing to attribute the power of provinces entirely to the decision of the central leadership not to impose its will, or to the weakness of the Centre as a result of internal fightings amongs its own ranks. An explanation resorting to the Centre's choice immediately begs the question: why did the central leaders make this choice which they themselves were heard to be complaining about its consequences, and not act sooner to correct it? A conclusion arguing for continued central predominance also edges towards being a tautology, other than in the extreme case of secessionist movements and the break-up of China as a unified nation. The unresolved question is: what does the increased occurrence of provincial discretion since reform mean in terms of central-provincial relations? Even if one contends that the Centre did continue to wield its power over provinces, as it had during the earlier decades, and thus there has been much continuity in the relationship despite the phenomenal increase in provincial discretion, it is still necessary to state precisely what differences discretion does make.

A related issue is the failure to account for change in the central-provincial relationship. Conceiving power as zero-sum the literature infers a corresponding loss of central power whenever provincial power is noted. What is often assumed is a linear model of provincial power, in which provincial power accumulates incrementally over time at the expense of central power.[14] The simplicity of a linear model is disturbing, however, because it suggests, implicitly at least, that as the power of provinces accumulates, the power of the Centre will *in due course* be overwhelmed. Total fragmentation and the disintegration of China as a unified nation will thus result. The contradiction between this picture of provincial power and the observation of continued central predominance *despite* provincial power is obvious. On the one hand, there is an scenario of increasing provincial power of which the logical conclusion is total collapse of central power. On the other hand, the rise and fall of provincial power is regarded as merely a product of central decisions.

The contradiction has precluded us from recognizing changes in the central-provincial relationship other than unilinear moves towards fragmentation or centralization. Intuitively, analysts have talked about the likelihood of having "qualitative" changes. Their analytical framework could lead them, however, no further than to wish for the arrival of "enlightened" central and provincial leaders wise enough to make the breakthrough.[15] A zero-sum conception of central-provincial power cannot envisage circumstances whereby the rules of the game might be changed, except through *ad hoc* and idiosyncratic factors.[16] The Chinese system, it would seem, has been stuck in

its historical tradition of authoritarianism and in endless cycles of decentralization and centralization.

*Guangdong and Shanghai: A More Complicated Picture*

Instances of discretion exercised by both Guangdong and Shanghai governments regarding investment policies in the 1980s would appear to validate the argument of an increase in provincial power and decline in central control. Upon closer scrutiny, however, these instances of provincial discretion were no less the product of central policy influence than the result of independent provincial choice. In other words, the picture is not simply one of provincial non-compliance *vis-a-vis* central control. Provincial non-compliance itself reflects the impact of central policies on the province concerned *as well as* the exercise of choice by provincial leaders. Instances of provincial discretion are at one time a function of both central influence and of provincial power.

Since the 1980s the central government has issued annual control figures *(gui-mo)* prescribing the ceiling of total investment (comprising investment in both the state and non-state sectors) to be spent within the geographical area of a province.[17] The provincial government was responsible for ensuring that the actual amount of investment spent within the province in a particular year did not exceed the ceiling. This was an unwelcome task which provincial governments, eager to expand investment and thus develop the provincial economy, were loathe to perform. Tables 1 and 2 show that both

the Guangdong and Shanghai governments had consistently failed to observe central control on their investment level.

Table 1

Differentials between Central Plans and Provincial Performance

Guangdong (Yuan Billion)

| Year | Control Figures[1] | Actual Total Investment[2] | Excess Investment[3] (%) |
|---|---|---|---|
| 1985 | 5.5 | 15.6 | 184 |
| 1988 | 12.8 | 35.4 | 140 |
| 1989 | 14.0 | 30.0 | 114 |
| 1990 | 20.7 | 31.5 | 52 |
| 1991 | 23.6 | 41.3 | 75 |
| 1992 | 34.5 | 82.5 | 139 |

Notes: (1) Figures for 1985 and 1988 are control figures announced at the beginning of the years. Adjusted figures towards the end of the years, which are usually larger, are not available. Figures for the other years are year-end adjusted figures.

(2) Actual total investment here do not include central investment in the province in order to remove one major source of incomparability between the investment statistics and the control figures, which have multiple exclusion categories including central investment.[18]

(3) Excess investment refers to the differential between the central control figures and the actual provincial investment in a year.

Source: Author's interviews.

Table 2

Differentials between Central Plans and Provincial Performance

Shanghai (Yuan Billion)

| Year | Control Figures | Actual Total Investment[4] | Excess Investment (%) |
|---|---|---|---|
| 1988 | 13.0[1] | 25.4 | 95 |
| 1991 | 14.2[2] | 19.2 | 35 |
| 1992 | 22.0[3] | 29.8 | 45 |

Sources: (1) *China Capital Construction*, No.5 (1989), p.4.

(2) calculated from *Shanghai Statistics*, No.5 (1992) , pp.2-5.

(3) *Shanghai Jihua Jingji Tansuo*, No.1 (1992), p.2.

(4) *Shanghai Statistical Yearbooks, 1989, 1992, 1993*. As in Table 1 central investment is not included.

Table 1 shows that during the 1980s control figures prescribed by the central government were consistently and substantially surpassed in Guangdong. Moreover, it appears that the retrenchment campaign engineered by the Centre to restrict investment and cool down the economy in the years 1989-1991 had only limited effects on the level of provincial investment. Whilst the extent of "excess investment", that is, investment

spent beyond central quotas, in these three years was considerably smaller, it was nevertheless still quite substantial, ranging from a low of 52 per cent in excess to a high of over 110 per cent. The magnitude of such a "restrained" performance thus reflects, ostensibly, more the resilience of provincial determination to increase investment than the success of central control. Meanwhile, Table 2 shows that total investment in Shanghai had similarly surpassed the central ceiling, though the extent, as it appeared, was relatively modest when compared to that of Guangdong.[19]

Given such *prima facie* evidence of provincial non-compliance with central control measures, the question is: what does it tell us in terms of central-provincial relations? What are the processes and dynamics behind?

Five broad types of provincial discretion were identified in the case of Shanghai and Guangdong in their attempts to increase investment (Fig. 2 and 3). Given the wide differences in their operating environments in terms of central policy, the occurrence of the same types of discretionary behaviour is worth noting. As this paper will argue later, such similarity suggests the limits of central influence on provincial discretion.

Figure 1 classifies the five types of discretion according to their differing degree of central dependence. The "x" or horizontal axis classifies provincial discretion in terms of the degree of involvement of central government actors. Provincial discretion involving a high degree of central participation signals a higher degree of central dependency, while discretion involving a low degree of central participation signals a

state of provincial autarchy and lower degree of central dependency. The "y" or vertical axis classifies discretion in terms of the relevance of the central plan or central policies to the discretion, as against provincial plans, policies or market forces. This dimension tells us further about the configuration, and loci, of provincial discretion---whether the discretion is primarily targeted at central government plans and policies, or whether the provinces are more preoccupied with setting out their own development plans or with the pull of market forces.

Before proceeding further a brief description of the five broad types of discretion is in order. The first type is *bargaining with the Centre for more favourable policies* through which the provincial government sought to obtain greater autonomy in investment implementation and policies. Given the high degree of centralization in the traditional planning system, the relaxation of central control was often instrumental in enabling a provincial government a freer hand and a more hospitable environment in which to expand investment. The second is *bargaining with the Centre for more direct central support*, in the form of injection of central resources, such as budgetary or extrabudgetary fiscal resources, bank finance, and larger investment quotas. This differs from the first type of discretion in that no changes in policy are involved. The central government is merely persuaded to assign a larger amount of resources under the existing policies to a particular province. The third type of discretion is *flexible implementation of central policies*---provinces using feigned compliance as the "cover" whilst engaging in various creative interpretations of central policies in order to attain provincial objectives. The fourth type is *developing the "new horizon" of investment expansion.* In this type of

discretionary behaviour provincial goverments move beyond the state budget and the conventional state sector, which are more closely monitored by the Centre, towards the burgeoning market in their pursuit of investment expansion. Finally, the fifth type of discretion may be described as *internationalization*. This refers to the strategy to attract additional investment resources from beyond the national borders, and the skilful manoeuvres by provincial leaders to bargain for greater autonomy and resources from the Centre *as a result* of the increased participation of foreign resources in the provincial economy. When classified in the typology of Figure 1, these five types of discretion fall into four quadrants, from A to D.

Figure 1

Provincial Discretion: A Typology Relevance of Degree of Participation by Central Government Actors Central/Provincial Plans

| | Provincial Autarchy | Central Dependency |
|---|---|---|
| Central Plans or Policies | - Flexible implementation of central policies **(A)** | - Bargaining for more favourable central policies - Bargaining for direct central support (e.g. budgetary resources, larger investment control figures) **(B)** |
| Provincial Plans or Markets | - Develop "new horizon" beyond the budget: expansion into the market - Internationalization **(C)** | - Bargaining for direct central support (e.g., extrabudgetary resources of central ministries) **(D)** |

As seen in Figure 1 discretionary behaviour in quadrant (C) has the highest degree of provincial independence: where central government participation and the relevance of central plan/policies are both low. At the opposite end is quadrant (B), which includes discretionary behaviour which is heavily directed towards the central government and involves central plans/policies. Bargaining with the Centre for more favourable central policies and central resources involves a high degree of participation by central officials as well as having central plans and/or policies as the focal point of the entire exercise. At the intermediate range of provincial independence are acts of discretion in quadrants (A) and (D). In the case of quadrant (A), one famous type of provincial discretion, and in particular in Guangdong, is that of flexible implementation of central policies. Such discretion requires a considerable degree of critical analysis as to the applicability of central policies in local circumstances, as well as careful judgement regarding the limits of manoeuvres as the boundary of central tolerance changes over time. On the other hand flexible implementation is nevertheless focused on the manipulation of central policies, and nothwithstanding the autarchic character of this behaviour the shadow of the Centre looms large. In the case of quadrant (D), central actors are involved but not central plans or policies. This is the situation, for instance, when provinces seek investment capital from the extrabudgetary resources of various central units. Unlike the case of budgetary resources, the rule of the game is determined more by market forces and the economic strength of the provinces concerned.

As shown in Figures 2 and 3, discretion exercised by Guangdong and Shanghai governments displays both similarities and differences.[20] On the one hand, all five types

of discretion were witnessed in both cases. On the other hand, discretion in Guangdong and Shanghai had very different configurations and orders of importance. Whilst both Guangdong and Shanghai governments started in the late 1970s with a high occurrence of centrally dependent discretionary behaviour (Line B), such behaviour became much less dominant in Guangdong than in Shanghai over the decade of the 1980s. Discretionary behaviour of the quadrant (C), the type of discretion with the highest degree of provincial independence, increased rapidly from a low base in Guangdong, whilst its level of occurrence in Shanghai remained low until the late 1980s, when it surged rapidly. The development of discretion of the intermediate range of provincial independence (Lines A and D) was more steady in both provinces. The relative importance of discretion of quadrants (A) and (D), however, differs, as Line A lies above Line D in the case of Guangdong, and the reverse is true in the case of Shanghai. This reflects that, relatively speaking, the Guangdong government was more active in engaging in flexible implementation of central policies, whilst its Shanghai counterpart spent more effort in the attraction of central resources, regardless of whether these were within or without the central budget.

Figure 2

Provincial Discretion in Guangdong over Investment:

Trends of Development

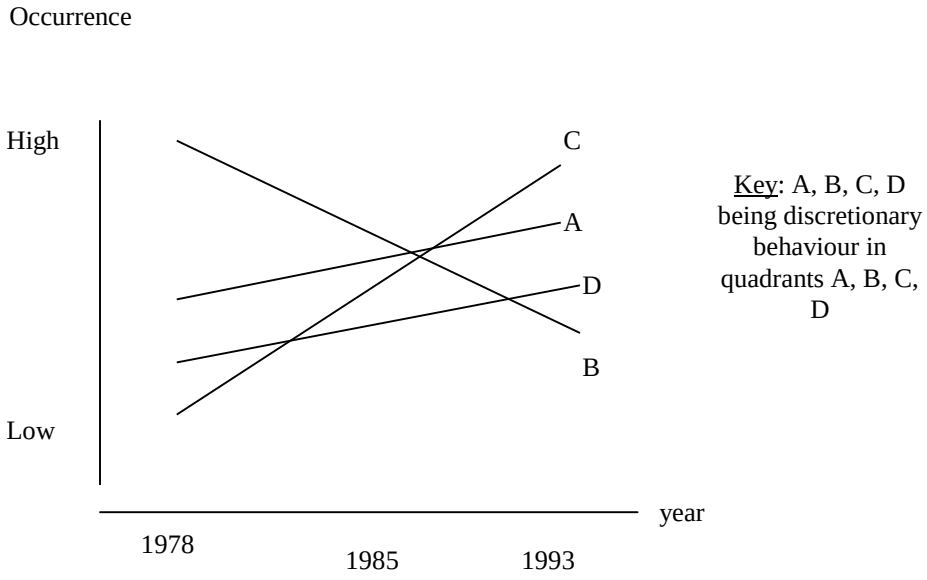
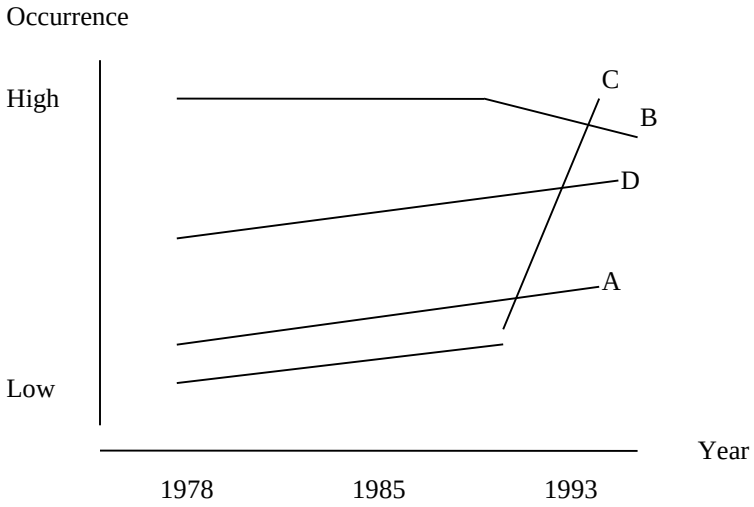



Figure 3

Provincial Discretion in Shanghai over Investment:

Trends of Development



*Impact of Central Policies on Provincial Discretion*

The differences between discretionary action taken by Guangdong and Shanghai governments to expand investment suggest the impact of differential central policies on the two provinces.[21] The fact is: while provincial discretion embodied choice by provincial leaders, these choices nevertheless took place within a context in the making of which central policies played a major part. A major difference between Guangdong and Shanghai in the 1980s was their different national roles. Being a relatively peripheral province and accounting for a mere 2.7 per cent of total national fiscal revenue between 1953 and 1980, Guangdong was allowed to experiment boldly in reform. On the other hand, Shanghai being the largest industrial and commercial centre of China and accounting for 14 per cent of the total national fiscal revenue for the 1953-1980 period, was considered too important to take risks.[22] Guangdong also benefited from its geographical proximity to Hong Kong, a source of external investment and trade which had seen quick recovery of activities once the first sign of political change occurred in the early 1970s.[23] Guangdong's smaller state sector made the provincial economy more flexible and adaptable to change; the predominance of light industry also fitted in the new national export strategy which saw light industrial goods as a major earner for foreign exchange.[24] The dominance of the state sector economy in Shanghai, meanwhile, made Shanghai's industry relatively difficult to change track. The municipality was, therefore, expected to continue the traditional system and provide backup to the costly business of reform experiments in the south.

The result was two sets of widely different policies in the two provinces. Guangdong won with relative ease a set of preferential policies, described as the "Special Policy and Flexible Measures" (hereinafter the Special Policy), in the early years of the 1980 decade. The Special Policy gave the Guangdong government very favourable terms regarding fiscal autonomy, as well as greatly enhanced power in broadly defined policy areas. Moreover, it also conferred on Guangdong, as the pioneer of reform, the discretionary authority not to follow existing central policies and regulations whenever these measures were considered to contravene the requirements of reform.[25] On the other hand, Shanghai was required to play the role of "rearguard" of reform. The policy of "horizontal integration" encouraged Shanghai to support, through the transfer of technological knowhow and capital, the development of its poorer neighbours. Shanghai's financial obligation to the Centre in terms of fiscal remittances and *ad hoc* "contributions" remained at a very high level in the 1980s.[26] Tables 3 and 4 show the gap in fiscal burden as shouldered by Guangdong and Shanghai governments during the 1980s.

Table 3

Fiscal Remittances of Guangdong*

(Billion Yuan)

| Year | Total Remittances | Total Local Fiscal Revenue[4] | Remittance Rates (%) | "Extra-Contract" Remittances out of Total (%)[3] |
|---|---|---|---|---|
| 1980-1987 | 12.2[1] | 44.2 | 27.4 | 39.9 |
| of which, 1987 | 2.3[1] | 9.3 | 25.0 | 66.5 |
| 1988-1991 | 19.3[2] | 59.3 | 32.6 | 63.5 |
| of which, 1991 | 7.0[2] | 17.7 | 39.4 | 71.4 |
| 1980-1991 | 31.5 | 103.5 | 30.5 | 54.4 |

Notes: * Fiscal remittances include both "contractual" remittances forwarded in accordance with the fiscal remittance arrangement agreed upon in advance between the provincial government and the Centre, as well as *ad hoc*, "extra-contractual", payments in the form of "contributions", "central borrowings", etc.

Sources: (1) Dangdai Zhongguo Congsu Bianju Bu (ed.), *Dangdai Zhongguo de Guangdong* (Guangdong in Contemporary China), Vol.1, (Beijing: Dangdai Zhongguo chubanshe, 1991), pp.686-87. (2) Guangdong Provincial Party Committee Secretariat (ed.), *Guangdong Gaige Kaifang Qishi Lu* (A Record of Insights of Opening and Reforms in Guangdong) (Beijing: Renim chubanshe, 1993), pp.43, 59. (3) Calculated from Source (1), p.59, and Source (2) above. (4) Guangdong Statistical Bureau (ed.),

*Guangdongsheng Guomin Jingji he Shehui Fazhan Touzi Ziliao, 1949-1988, Pingheng Touzi Bufen* (Guangdong National Economic and Social Development Statistics and Information, 1949-1988. Part on General Statistics.) (Guangdong: Neibu, 1989), p.74; *Guangdong Statistical Yearbook 1993*, p.383.

Table 4

Fiscal Remittances of Shanghai (Billion Yuan)

| Year | Local Fiscal Revenue | Local Fiscal Expenditure | Remittance Rates (%) |
|---|---|---|---|
| 1980-1984 | 82.3 | 9.9 | 88.0 |
| 1985-1987 | 52.2 | 14.8 | 71.6 |
| 1988-1992 | 83.6 | 37.3 | 55.4 |
| 1980-1992 | 218.1 | 62.0 | 71.6 |

Source*: Shanghai Statistical Yearbook, 1993*, p.55.

It is clear that the Guangdong and Shanghai governments had operated under widely different fiscal environments in the 1980s. Despite phenomenal growth in the provincial economy during the 1980s, Guangdong's remittances to the Centre during the entire 1980 decade amounted to only a minor fraction of Shanghai's remittances. Guangdong has been able to resist pressure for substantially increasing its remittances by means of the fiscal *dabaogan* system, a central feature of the Special Policy, which guaranteed a fixed amount of remittances within a specified period, set initially in 1979 to last for five years. Whilst remittances did increase substantially in the later years of the

decade, largely due to the imposition of "extra-contractual" remittances, they were still relatively modest when compared to those of Shanghai. In the case of Shanghai, where the traditional system remained in place during 1980-1984, nearly 90 per cent of Shanghai's fiscal revenue went to the central coffers. A series of fiscal crises during 1981-1983 caused alarm amongst the Shanghai and central leaderships, but the resultant relaxation was marginal, as remittance rates during 1985-1987 still exceeded 70 per cent. Conditions finally improved after the adoption of a variant of the *dabaogan* fiscal system in 1988, and remittance rate for 1988-1992 dropped to 55 per cent. This significant improvement for Shanghai paled, however, when compared with the remittance rates of Guangdong around the same period.

Given the wide disparity between fiscal arrangements in Shanghai and Guangdong, the linkage between the fiscal condition and investment performance was far more complicated, however. The proliferation of funding channels during the 1980s, as a result of economic liberalization policies and the decentralization of investment authority, had led to a situation whereby the state budget no longer dominated the supply of investment funding. For instance, the share of state sector investment financed by state budgetary funds in Guangdong had declined from 70 per cent in 1979 to 23 per cent in 1983, and further to 1.9 per cent by 1992.[27] In Shanghai, the share in 1983 was 14 per cent and 4 per cent in 1992. This suggests that the influence of the state budget and the fiscal system on provincial investment took place in a more roundabout way than the straight-forward supply of funds.

Investment in the non-state sector in Guangdong and Shanghai during the 1980s had grown generally at a faster rate than in the state sector.[30] The fewer constraints posed by the traditional planning system in the non-state sector allowed collective and private enterprises a freer hand to make investment decisions in pursuit of profits. The most significant growth area was the collective sector, where investment growth rate in Guangdong was a double of that in Shanghai (64.3 per cent against 32.8 per cent). This more than cancelled out the impact of Shanghai's slightly higher growth rates in private sector investment (30 per cent against Guangdong's 22.7 per cent). By 1992, the proportion of non-state sector investment in Guangdong's total investment was well above the national average and nearly double that of Shanghai.[31]

The linkage between differential central fiscal policies (and thus differential provincial fiscal environments), and the choice of provincial policies regarding non-state sector development is complex. It would be surmised that, given the greater freedom provinces enjoyed over the non-state sector, both the Guangdong and Shanghai governments should have acted in a similar manner. In other words, officials in Guangdong and Shanghai, driven by a common desire to expand provincial investment, should have similarly encouraged the development of non-state-owned enterprises. This had not, however, been the case during the 1980s. The Guangdong govenment had generally adopted a lenient and encouraging approach to the fledging non-state sector. The Shanghai government, on the other hand, found itself under severe financial pressure. It became preoccupied with pedantic revenue collection, stuck to the letter of policies

whose formulation dated back to the pre-reform era, and had less time to cater for the longer-term needs of economic growth.[32] For instance, formal bank finance policies of the 1980s were very discriminatory against private enterprises. In Guangdong, the government allowed many would-be private enterprises to register instead as collective enterprises, thus facilitating their investment financing and expansion.[33] The Shanghai government, by contrast, had taken deliberate actions to uphold the official policy of strict registration and the rules regarding restrictive bank finance to the private sector.[34] In Guangdong, the lenient treatment towards the non-state sector was, in fact, part of a policy which saw the provincial government leaving a large portion of enterprise profits to the enterprises, state or non-state. The rationale was simple: given the low level of fiscal remittance required under Guangdong's fiscal arrangement with the Centre, there was no need to collect too much revenue. The accumulation of too large a fiscal surplus would simply attract central attention and the jealousy of other provinces and thus risk inviting trouble.[35] The development of non-state-owned enterprises had added value in this context, as not only were the investment plans of these enterprises historically beyond the ambit of the traditional planning system, but the fiscal management of these enterprises was also largely left to local authorities with the least central scrutiny.[36] Developing the non-state sector thus enabled Guangdong to circumvent the traditional state sector which, despite substantial decentralization and liberalization reforms, was still under the shadow of central control. By having a larger non-state sector in Guangdong the provincial government retained a larger *de facto* autonomy regarding investment planning and more financial resources to implement investment projects.

Notwithstanding the disparity in their policies towards the non-state sector during the 1980s, there was indication, interestingly, that the Shanghai government was no less eager than its Guangdong counterpart to retain more revenue locally whenever possible. An analysis of the changing composition of extrabudgetary revenue in Shanghai and Guangdong suggests that the Shanghai government, not unlike Guangdong, had attempted to maximize its security and room for manoeuvre. Data available (Table 6) shows that the share of extrabudgetary revenue retained by enterprises in Shanghai's total extrabudgetary revenue (S) declined steadily from a very large share since mid-1980s.[37] The steady and considerable decline, in comparison with the relatively stable yet smaller share in Guangdong, was in line with the earlier observation that the Shanghai government, facing a heavy fiscal remittance burden, had to be stricter on revenue collection from enterprises than Guangdong. Meanwhile, the share of extrabudgetary revenue retained by local government finance (L) and administrative units (A) had substantially increased in Shanghai, and by an even higher rate than in Guangdong. The share of extrabudgetary revenue retained by Shanghai's local finance departments was consistently about double that of the national average, surpassed that of Guangdong by 1989, and by 1992 was more than double the share in 1986.[38] In fact, while extrabudgetary funds held by local finance departments generally grew at a slower rate than the total sum, both nationally and in Guangdong, the reverse was true in Shanghai.[39]

Table 6

Composition of Extrabudgetary Revenues (%)

L: Local finance bureau

A: Administrative *(Shiye)* units

S: State enterprises & Departments-in-charge

| | Shanghai | Guangdong | National |
|---|---|---|---|
| 1986 | | | |
| L | 4.4 | 6.5 | 2.5 |
| A | 11.8 | 29.1 | 16.3 |
| S | 83.9 | 64.4 | 80.6 |
| 1987 | | | |
| L | 4.6 | 5.0 | 2.2 |
| A | 13.3 | 28.4 | 17.7 |
| S | 82.1 | 66.6 | 80.1 |
| 1988 | | | |
| L | 4.4 | 4.4 | 2.1 |
| A | 13.8 | 30.2 | 18.6 |
| S | 81.7 | 65.4 | 79.3 |
| 1989 | | | |
| L | 4.7 | 3.5 | 2.0 |
| A | 17.1 | 28.9 | 18.8 |
| S | 78.3 | 67.6 | 79.1 |

| | | | |
|---|---|---|---|
| 990 | | | |
| L | 4.8 | 4.3 | 2.2 |
| A | 19.7 | 31.3 | 21.3 |
| S | 75.5 | 64.4 | 76.5 |
| 1991 | | | |
| L | 5.3 | n/a | 2.1 |
| A | 19.8 | n/a | 21.5 |
| S | 74.9 | n/a | 76.4 |
| 1992 | | | |
| L | 9.9 | n/a | n/a |
| A | 37.2 | n/a | n/a |
| S | 52.9 | n/a | n/a |

Source: For 1986-1991, *China Finance Statistics 1950-1991*, pp. 191, 199, 204. For Shanghai data of 1991, 1992, information gathered during author's interviews.

A plausible explanation was the inclination within the Shanghai government to seek some form of financial security, in light of the pressure of its high remittance target. Funds dispersed amongst state enterprises, even though these would be local resources and would benefit the development of the enterprises, were nevertheless beyond the direct control of the municipal government. Consequently their increase would not ease the concern over security. Extrabudgetary funds of the local financial departments, on the other hand, fulfilled the dual requirements of keeping the resources at a distance from the

central government, and allowing close and direct control by the municipal government. By squeezing the enterprises' funds to fill the coffers of its local finance bureaux, the Shanghai government sought to balance the need for containing the amount of revenue exposed to possible manipulation by the central government, and to centralize as much resources as possible within the municipality for its own flexible deployment.

Despite the constraints posed by much tighter central policies, therefore, Shanghai officials in the 1980s displayed tendencies in their choice of discretion *similar* to their Guangdong counterparts.[40] Tighter central policies did not eliminate provincial discretion; they affected judgement regarding what course of action was possible or affordable. When Shanghai's fiscal environment substantially improved in the early 1990s under more relaxed central policies, the Shanghai government was, unsurprisingly, enthusiastic in promoting the development of new institutions and funding resources outside the traditional state sector and state budget.[41] The room for manoeuvre was enlarged and the structure of affordability changed. Accordingly different choices of provincial discretion were made.

*Influence of Provincial Discretion on Central Policy Formulation*

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Provincial discretion is more than a mere response to central policies. Sometimes provinces would compete with the Centre in defining the contents of central policies. Guangdong's officials, for instance, during the 1980s was not infrequently found to be competing for policy orthodoxy with interpretations from the central government

regarding what constituted the "right" approach to established national policies. In January 1989, to cite an obvious example, the Guangdong provincial leadership published a series of articles in a provincial paper to protest against the centrally-imposed austerity programme.[42] The protest was striking because it went far beyond the usual tactics used by provincial leaders enduring hardships to plead for exceptional treatment based on local circumstances. Whilst the Guangdong leadership did not drop particularistic arguments, these were used to reinforce a more fundamental challenge to the appropriateness or even "correctness" of central policy.

The argument went as follows: the fundamental central policy since the 1978 Third Plenum had been that of modernization and economic development. Productivity was thus the major, if not the only, criterion against which the work of Guangdong, assigned as the pioneer of reform, should be judged. As the pioneer, Guangdong should not be governed by any of the preexisting central rules formed during the pre-reform period. Nor, it was argued, should Guangdong be automatically bound by national rules formulated thereafter for national application. Its role as a pioneer precluded such a blanket treatment. Constraining Guangdong's ability to experiment with reform measures, through the unnecessary application of national rules, was commensurate to sabotaging central policy of the highest order through pedantic regulations. Therefore, it was argued, unless the Centre changed its fundamental policy of reform and modernization, or unless Guangdong's experiments failed to bear fruit, those national rules and policies which obstructed Guangdong's work should give way.

This example shows how far the Guangdong leadership had dared to go in articulating its position. Whilst it was unlikely that the Centre, as a result of this challenge, would formally renounce its national retrenchment policy or exclude Guangdong from its application, there were nevertheless indications that Guangdong's arguments had had some effect in the actual application of retrenchment policy in the province. Guangdong was able, for instance, to have its centrallly imposed investment ceiling in 1989 considerably increased, using the pretext of an increase in foreign investment.[43] As a result the impact of retrenchment policy on investment in Guangdong was substantially temporized.[44]

It is worth noting that despite the public debate with the Centre about its policies in 1989, in most cases the Guangdong leadership had adopted an "implementation" approach, or a combination of implementation and advocacy, in its attempts in influencing central policies. One instance concerned the central policy regarding the management of bank loans, which since 1979 had segregated loans for working capital and loans for investment, assigning separate quotas for each. Guangdong's officials argued openly that the policy, which they had not followed, had become outdated, being grounded in rationales of an earlier period, and was thus obstructing economic development and reform.[45] The "segregation policy" arose from a traditional concern to control loans for investment, it was argued, which the central government treated as *de facto* grants and did not expect to be repaid. As economic reforms went further, however, enterprises were, at least in theory, required to repay all kinds of bank loans. While some enterprises might be unable to repay their loans in practice, it was argued, this was not the

reason to arbitrarily impose administrative quotas, which had had the effect of displacing the independent professional judgement of local banks with administrative interference, and thus was against the spirit of bank reform. By ignoring central rules on loan segregation, Guangdong's officials argued, they were in fact advancing economic reform, a task the Centre had assigned them.

The influence of Guangdong's arguments on central policy was obvious in a report by the State Planning Commission in 1993 on infrastructural investment in the provinces.[46] The report noted that by "flexibly handling" the segregation rules, Guangdong's authorities had successfully developed infrastructural facilities in the province, whilst other provinces and the central government had found it difficult to finance infrastructural investment. The report suggested that, in light of Guangdong's experience, the Centre should consider changing the existing policy to accommodate the new investment situation, rather than merely tolerating Guangdong's "illegal manoeuvres" in the existing system.[47]

These examples of Guangdong suggested that the more successful acts of provincial discretion were, in terms of producing results which were cherished by the Centre, the more likely were such acts to make an impact on central policies. Impressive economic growth and achievements in infrastructural investment had enabled the Guangdong government to convince the central government of the need for exceptional treatment at a time of national retrenchment, and of the necessity to revise a central policy in line with Guangdong's "experiments".

Provincial influence may be exerted through different routes. In the case of Shanghai, provincial influence derived more from Shanghai's established status as the "eldest son" of the Centre. Historically successive Shanghai leaderships had had a close relationship with the Centre, with many of its leaders subsequently becoming central leaders.[48] It is likely, therefore, that more conventional means of policy advocacy *prior to* the formulation of a policy may carry a greater weight in the case of Shanghai than Guangdong. In other words, we may conceive of two possible scenarios of provincial participation processes in central policy formulation during the reform period, as depicted in Figure 4.

Figure 4

Processes of Provincial Participation in the Formulation of Central Policies

Guangdong

(Central Policy) ---> Flexible Provincial Implementation of Central Policies ---> *De facto* Amendments to Central Policies within the province ---> *Post hoc* Advocacy/Justification ---> Official Amendments to Central Policies

Shanghai

Advocacy at Provincial Level ---> Participation in Policy Deliberations with Central Officials ---> (Central Policy Adopted) ---> Recommending Details to Smoothen Policy Implementation

An example of Shanghai's attempt to influence central policy formulation was the fiscal reform of 1994. There was a strong affinity between opinions held by Shanghai finance officials as early as in the mid-1980s regarding a proper central-provincial fiscal system and the rationale behind the institution of the new tax-sharing fiscal system in 1994.[49] Shanghai's finance officials had for long expressed their preference for a tax-sharing system. The new tax-sharing system of 1994 assigned different types of tax revenues to the central and provincial coffers respectively. Whilst some categories of tax revenues would be shared between the Centre and the provinces, the percentage shares would be determined in advance and fixed for subsequent years, and be uniform across provinces. This arrangement was designed to instill a greater degree of institutionalization and certainty to the central-provincial fiscal relationship, and thus enhance the autonomy of both the central and provincial governments in their respective fiscal management. The disparity between provinces under the previous contractual system, whereby different provinces negotiated different terms with the Centre, would also disappear as the categorization of central and provincial taxes and the percentage shares of shared taxes would be uniform between provinces under the new system.[50] If fully implemented the new system was especially favourable to Shanghai, since Shanghai's "contract" with the Centre under the pre-1994 contractual system had not been particularly attractive when compared to those of other provinces.[51]

Officials and scholars from Shanghai had participated extensively with central government officials in the extended search for a new fiscal system to replace the contractual system. A research project on fiscal reform coordinated by the Research

Institute for Fiscal Science of the Ministry of Finance during the latter half of the (1986-1990) Seventh Five-Year Plan period, for instance, included as participants a number of scholars from the Shanghai Academy of Social Sciences. The final report advised against the continued adoption of the contractual fiscal system in the 1990s and suggested instead a tax-sharing system.[52] The continuity with Shanghai's earlier position was apparent.

Shanghai's officials also attempted, as their Guangdong counterparts did, to exert influence on central policies after their promulgation. However, whilst Guangdong might simply make the necessary "adaptations", and only later justify its local adaptations when their desirability in a national context became self-evident, in Shanghai advocacy often came much earlier. Upon its implementation in 1994 the new fiscal system was still very crude on details. The early months of 1994 saw numerous expositions from Shanghai on how the new system should and could operate.[53] It was as if the Shanghai officials were acting as *de facto* drafters of new central regulations.

*Conclusion: Interactive Central-Provincial Relationship*

This paper argues that central-provincial relations are not merely about compliance and control, but are characterized by mutual influence and choice. Both parties---the Centre and the provinces---exert influence on one another, and both exercise choice within and despite such influence by the other. The governments of Guangdong and Shanghai operated under the contextual constraints of widely different central policies, which had an impact upon their choice of strategies in pursuit of investment

expansion. What often appeared as provincial non-compliance was, therefore, also partly the product of central policy.

On the other hand, the power of the Centre on provinces is not without limits. Provincial discretion in Shanghai and Guangdong showed a surprisingly similar structure, and Shanghai officials displayed the same tendency as Guangdong towards revenue maximization whenever circumstances permitted, *despite* obvious differences in their operating environments. Likewise, provincial acts of discretion exerted their influence on central policies, so that the central policy context which would constrain the next round of provincial choice was partly the product of previous provincial choices. What has been going on between the Centre and the provinces is an interactive process, and power from either side is not without limits.

One important question arising from this study is how the observations drawn from rich provinces mean for less resourceful provinces. The contention is that what differs is more one of degree than one of kind. The interactive relations and existence of mutual power between the Centre and the provinces should apply for rich as well as poorer provinces, though the relationship may be more assymmetrical in the favour of the Centre in some provinces than the others. Each and every province has different resource endowments as well as different perceptions of their national roles, and the Centre's treatment of the province and its own choice of discretion will differ accordingly. Without the special status of reform pioneer of Guangdong, or of the Centre's "eldest son" and "right-hand-man" status of Shanghai, many provinces may find themselves with

fewer bargaining chips in hand in their dealing with the Centre. The important message drawn from this study is, however, that the flow of power between the Centre and provinces is mutual, and that assymmetry does not preclude the exercise of substantial influence, at times, by the weaker party on the stronger.

This non-zero-sum, interactive model of central-provincial relations allows us to explain and anticipate the circumstances for change in the relationship. The mutuality of power precludes an indefinite expansion of power along an unilinear direction, whether in favour of the Centre or the provinces. The Guangdong government had, for instance, been fairly successful in maximizing the fiscal resources retained within the province during the 1980s. Such a remarkable performance, however, did not give Guangdong total victory over the Centre. The impact of central policies on Guangdong's strategies was apparent, and when the Centre decided to replace the fiscal contractual system with the new tax-sharing system in late 1993, the most the Guangdong leadership could do was to attempt to contain "damage" and negotiate the best possible deal with the Centre on the basis of the *new* system.[54] On the other hand, the Centre was similarly constrained in its push for the new system which, from its perspective, would improve its control over the distribution of fiscal resources and enlarge its share of total revenue. Its proposal would not, however, have been able to obtain the support of some important provinces, most notably Shanghai, if it had not also promised a better institutionalization of such distribution, thus guaranteeing greater fiscal autonomy of provincial governments, under the new system. Central-provincial interactions during the formative stage of the tax-sharing fiscal system in 1993 demonstrate that both the Centre and the provinces, whilst

pushing strategies to advance their respective interests, were nevertheless forced to take into account the interests of the other party. Co-existence breeds compromise, and qualitative change results.

[*] This paper is based on the author's doctoral thesis, *Shifting Central-Provincial Relations in China: The Politics of Fixed Asset Investment in Shanghai and Guangdong, 1978-1993*, University of London, 1995. Field research on Shanghai and Guangdong was done between summer 1993 and summer 1994, during which the author stayed principally in Beijing and made trips to Guangzhou and Shanghai. Altogether 43 officials from the central government and the two provincial governments were interviewed. I am grateful to the feedback and advice given by various academics and Chinese officials in various stages of the research, whose names are too many to be cited here. David Goodman and Paul Wilding read and gave comments on an earlier draft of this paper, for which I am grateful.

[11] See for instance Maria Hsia Chang, "China's Future: Regionalism, Federation, or Disintegration", *Studes in Comparative Communism*, Vol.25, No.3 (1992), pp.211-27. For an insightful account of the long history of the discussion about the disintegration of the Chinese state, and the rationale behind such discussion, see John Fitzgerald, "'Reports of my death have been greatly exaggerated': the history of the death of China", in David S. G. Goodman and Gerald Segal, eds., *China Deconstructs: Politics, Trade and Regionalism* (London and New York: Routledge, 1994), pp.21-58.

[2] Dali L. Yang and Jae Ho Chung have come to a similar observation about previous works on central-local relations and suggested a non-zero-sum view be adopted. See Dali L. Yang, "Reform and the restructuring of central-local relations", in Goodman and Segal, *China Deconstructs*, p. 73, and Jae Ho Chung, "Studies of central-provincial relations in the People's Republic of China: a mid-term appraisal", *China Quarterly*, No.142 (June 1995), pp. 487-508.

[3]A fuller treatment of the argument against a zero-sum view of power is made in Linda Chelan Li, "Towards a non-zero-sum interactive framework of spatial politics: the case of contemporary China", *Political Studies*, Vo.45, No.1 (March 1997).

[4] The inertia of decentralized powers and resources is noted in Carl Riskin, "Neither plan nor market: Mao's political economy", in William A. Joseph, Christine P. W. Wong and David Zweig (eds.), *New Perspectives on the Cultural Revolution* (U.S: Harvard University, The Council on East Asian Studies, 1991), pp.132-52.

A similar observation is made in the context of the Open (door) policy in Jude Howell, *China Opens Its Door: The Politics of Economic Transition* (Hertfordshire: Harvester Wheatsheaf, 1993), pp.5-6.

[5] "Excess investment" refers to the amount of investment value completed within a province in a year over and above the ceiling prescribed by the central government.

[6] For a note on the Chinese state as a continental system, stressing the diversities within the territory and the subsequent implication on understanding Chinese politics, see David S. G. Goodman, "Future paths for China: nation-state perspectives on a continental system", paper presented at Conference on "The Contest for 'Asia'", University of Hong Kong, December 1995.

[7]In David S. G. Goodman, *Centre and Province in the People's Republic of China: Sichuan and Guizhou, 1955-65* (Cambridge: Harvard University Press, 1986), it is concluded that both provincial conditions and national policies determined provincial discretion. While this must be true, what the case of Guizhou, an extremely poor province, illuminates is at best indeterminate. The extremely deprived conditions in a province might have literally deprived the provincial leaders' ability to follow central policies, as Goodman has concluded. Alternatively, however, the difficult provincial conditions might have the effect of increasing bottom-up pressure on the provincial leaders to stand up against inappropriate central policies. The "unsatisfactory" performance of the provincial government, from the Centre's point of view, and which had caused its leader sacked, might thus be attributed to entirely different reasons. The implication is that the case of a poor province would not be able to highlight the difficult choices provincial leaders had to make between their agency role for the Centre and the representative role for the province.

[8]A more detailed discussion on this topic and a review of the previous literature on China's central-provincial relations is found in Li, "Towards a non-zero-sum interactive framework".

[9] Major works giving this interpretation to central-provincial relations include A. D. Barnett, *Cadres, Bureaucracy, and Political Power in Communist China* (New York and London: Columbia University Press, 1967); F.Schurmann, *Ideology and Organization in Communist China* New, enlarged edition (Berkeley: University of California Press, 1968); and F. Teiwes, "The purge of provincial leaders, 1957-1958", *China Quarterly*, No.27 (1966), pp.14-32.

[10] See for instance David S. G. Goodman ed., *Groups and Politics in the People's Republic of China* (Armonk, New York: M. E. Sharpe, 1984); Goodman, *Centre and Province in the People's Republic of China*; Victor C. Falkenheim ed., *Citizens and Groups in Contemporary China* (Ann Arbor: Centre for Chinese Studies, University of Michigan, 1987); Falkenheim, "Continuing central predominance", *Problems of* Communism Vol.21, No.4 (1972), pp.67-75; Lucian Pye, *The Dynamics of Chinese Politics* (Cambridge, Mass.: Oelgeschlager, Gunn and Hain, 1981); Parris H. Chang, "Provincial party leaders' strategies for survival during the Cultural Revolution", in Robert A. Scalapino, ed., *Elites in the People's Republic of China* (Seattle & London: University of Washington Press, 1972), pp.501-39; F. Teiwes, "Provincial politics in China: themes and variations", in John M. H. Lindbeck, ed., *China: Management of a Revolutionary Society* (London: George Allen & Unwin, 1972). See also Audrey Donnithorne, "Central economic control in China", in Ruth Adams, ed., *Contemporary China* (London: Peter Owen, 1969); Donnithorne, "Comment: centralization and decentralization in China's fiscal management", *China Quarterly*, No. 66 (1976) pp.328-40; Nicholas Lardy, "Centralization and decentralization in China's fiscal management", *China Quarterly*, No.61(1975), pp.25-60; Lardy, "Reply", *China Quarterly*, No.66 (1976), pp.340-54.

[11] Major works projecting this image of provinces as bargaining partner include: D. M. Lampton, "Chinese Politics: The Bargaining Treadmill", *Issues and Studies*, Vol.23, No.3 (1987), pp.11-41; Lampton, ed., *Policy Implementation in Post-Mao China*, (Berkeley: University of California Press, 1987); K. Lieberthal and M. Oksenberg, *Policy Making in China: Leaders, Structures, and Processes*, (Princeton, New Jersey: Princeton University Press, 1988); Zhao Suisheng, "The feeble political capacity of a strong one-party regime---an institutional approach toward the formulation and implementation of economic policy in post-Mao mainland China", *Issues and Studies*, Parts I & II, Vol.26, Nos.1-2 (1990), pp. 47-80, 35-74; Lieberthal and Lampton, eds., *Bureaucracy, Politics and Decision-Making in Post-Mao China*, (Berkeley: University of California Press, 1992); and S. Shirk, *The Political Logic of Economic Reform in China*, (Berkeley: University of California Press, 1993). The vitality of provincial bargaining has led researchers to talk about the resurgence of 'regionalism' and the decline of central state capacity. See, for instance, Goodman and Segal, eds., *China Deconstructs*; Jia Hao and Lin Zhimin, eds., *Changing Central-Local*

*Relations in China: Reform and State Capacity* (Boulder: Westwiew Press, 1994); and Dali Yang, "Reforms, resources and regional cleavages: the political economy of coast-interior relations in mainland China", *Issues and Studies*, Vol.27, No.9 (September 1991), pp.43-69.

[12] Barry Naughton describes the existence of a strong "implementation bias" in favour of the provinces and David Bachman notes the rule of the "iron law of autarky" in tax collection in their contributions to Lampton ed., *Policy Implementation in Post-Mao China*.

[13] This is the view of, for instance, Barry Naughton in his discussion of the decline of central control over investment. See Barry Naughton, "Decline of central control over investment in post-Mao China", in Lampton ed., *Policy Implementation in Post-Mao China*, p.78.

[14] See S. M. Goldstein, "Reforming socialist systems: some lessons of the Chinese experience", *Studies in Comparative Communism* Vol.21, No.2 (Summer 1988), p.231; Lieberthal, "Introduction: the 'fragmented authoritarianism' model", in Lieberthal and Lampton, eds., *Bureaucracy, Politics and Decision-Making in Post-Mao China*, p.12.

[15] Jia and Lin, eds., *Changing Central-Local Relations in China*, p.10.

[16] The unanswered question is obviously: how is the emergence of these "enlightened" leaders possible? Given the randomness of intelligence distribution over time and space, it is hard to believe that the difficulty posed by institutional contradictions which all previous generations of leaders had failed to break through can be resolved by the emergence of a few "specially enlightened" leaders.

[17]As a central control measure the control figure has evolved out of the state investment plan during the 1980s. Before reform the state, and of which the central government, had more or less monopolized investment, meaning that the state investment plan by and large encompassed all investment in the economy. This ended with decentralization during reform and the proliferation of investment agents. The central control figure for annual investment ceiling in a province, which started as merely the sum total of investment specified in the state investment plan for a province, evolved gradually to cover also investment outside the state investment plan, and was increasingly relied upon by the Centre as a control instrument.

[18] Apart from central investment, major exclusion categories in the control figures are: foreign investment, two groups of pre-specified investment categories excluded as a result of deliberate central policy to

encourage investment in these areas. In 1982 and 1985, eleven and five categories of investment were specified as excluded from coverage respectively. They include the repair of existing equipment, building of roads, schools, hospitals, museums, staff hostels, etc. See Dangdai Zhongguo Congshu Bianji Bu ed., *Dangdai Zhongguo de Jingji Guanli* (The Economic Management of Contemporary China) (Beijing: Zhongguo Shehui Kexue chubanshe, 1985), p.237.

[19] Shanghai's relatively modest excess investment reflected partly a genuinely lower level of investment activity in Shanghai when compared to Guangdong, and partly a higher level of under-reporting and manipulation of investment statistics by Shanghai officials so as to maintain Shanghai's image of a rule-abiding city. Author's interviews, January 1994. For more discussion see Linda Chelan Li, *Centre and Provinces: China, 1978-93. Power as Non-zero-sum* (Oxford: Oxford University Press, forthcoming), Chapter 4.

[20] Figures 2 and 3 are based on impressions gained through field interviews as well as documentary research on the provincial discretion of the two provinces, and are intended to show the general *trend* and relativities, rather than the precise level or frequency of occurrence of a particular behaviour, which is in any case difficult to quantify in a meaningful manner. The figures had been presented to knowledgeable respondents for cross-checking purpose.

[21] A similar observation on the impact of central policies on localities is made in Dorothy Solinger, "Despite decentralization: disadvantages, dependence and ongoing central power in the inland---the case of Wuhan", *China Quarterly*, No.145 (March 1996), pp.1-34.

[22] Calculated from Shanghai Statistical Bureau (ed.) *Xin Shanghai Sishi Nian* (Forty Years of New Shanghai) (Beijing: Zhongguo Tongji chubanshe, 1989), p.78; *Shanghai Statistical Yearbook 1993*, p.14; Guangdong Statistical Bureau (ed.), *Guangdongsheng Guomin Jingji he Shehui Fazhan Touzi Ziliao, 1949-1988, Pingheng Touzi Bufen* (Guangdong National Economic and Social Development Statistics and Information, 1949-1988. Part on General Statistics.) (Guangdong: Neibu, 1989), p.74; and *Statistical Yearbook of China 1993*, p.229.

[23] China began to turn to the outside world and normalize relations with the Western countries in 1970, after the border clashes with the Soviets in 1969. Soon the international trade fair in Guangzhou resumed, in

which many Hong Kong businesspeople participated. For the close relationship between Guangdong and Hong Kong, see Ezra F. Vogel, *One Step Ahead in China: Guangdong under Reform* (Cambridge, Mass.: Harvard University Press, 1989), Chapters 2 & 13.

[24] See Daniel Kelliher, *Peasant Power in China* (New Haven and London: Yale University Press, 1992), p.48, for the new national export strategy.

[25] For a full discussion of the evolving contents of the "Special Policy" of Guangdong, and the process of its development, see Li, *Centre and Provinces*, Chapter 5; and Peter T. Y. Cheung, "Relations between the central government and Guangdong", in Y. M. Yeung and David K. Y. Chu (eds.), *Guangdong: Survey of a Province Undergoing Rapid Change* (Hong Kong: The Chinese University of Hong Kong Press, 1994), pp.25-37.

[26] See Lynn T. White III, *Shanghai Shanghaied? Uneven Taxes in Reform China* (Hong Kong: University of Hong Kong Press, 1989) for a description of Shanghai's plight. See also Li, *Centre and Provinces*, Chapters 4 & 6.

[27] See Guangdong Statistical Bureau (ed.), *Guangdongsheng guomin jingji he shehui fazhan touzi ziliao, 1949-1988, guding zichan touzi bufen* (Guangdong National Economic and Social Development Statistics and Information, 1949-1988. Part on Fixed Asset Investment) (Guangdong: Neibu, 1989), pp.88-89; *Guangdong Statistical Yearbook 1993,* p.237.

[28] Author's interviews with Guangdong officials, 1993.

[29] See Lin Ruo, "Looking Back and Rethink: The Track of Reform and Opening of Guangdong", in Zhang Hanqing (ed.), *Gaige kaifeng zai Guangdong* (Reform and Opening in Guangdong: Implementation and Thoughts on the One Step Ahead Policy) (Guangzhou: Guangdong Higher Education Press, 1992), p.18. Lin was the Provincial Party Secretary of Guangdong during 1986-1990. Since then he has been the Director of Guangdong's Provincial People's Congress Standing Committee.

[30] Average Annual Growth Rates of Investment: A Comparison (1981-1992) (%)

| Sector | Guangdong | Shanghai |
|---|---|---|
| Total (Non-State and State) | 31.5 | 19.6 |
| State | 32.0 | 17.7 |

| | | |
|---|---|---|
| Non-State | 36.2 | 30.9 |
| of which: | | |
| Collective | 64.3 | 32.8 |
| Private | 22.7 | 30.0 |

Source: *Guangdong Statistical Yearbook 1993*, p.236; *Shanghai Statistical Yearbook 1993*, p.244.

[31] Proportion Share of Non-State Sector Investment in Total Investment (1992) (%)

| Sector | National | Guangdong | Shanghai |
|---|---|---|---|
| State | 67.1 | 59.2 | 77.1 |
| Non-State | 32.9 | 40.8 | 22.9 |
| of which: | | | |
| Collective | 17.3 | 22.7 | 18.0 |
| Private | 15.6 | 18.1 | 4.9 |

Source: *Statistical Yearbook of China 1993*, p.145*; Guangdong Statistical Yearbook 1993*, p.236; *Shanghai Statistical Yearbook 1993*, p.244.

[32] Apart from the influence of fiscal environment, the choice of different policies regarding the non-state sector might also be attributed to the fact that the non-state sector historically occupied a more important place in the pre-reform economy of Guangdong than Shanghai, where state-owned enterprises accounted for over 90% of total industrial output as of 1978, against a more modest 68% in Guangdong..

[33] According to an article written by officials from Guangdong's Industry and Commerce Bureau, in Guangdong it was estimated that there were 800000 to 900000 private enterprises in 1989. The number of private enterprises in the official register was, however, less than 6000. The vast majority (99.3%) of private enterprises had been registered as collectives with the tacit connivance of the Guangdong authorities. See "The Present Status and Future Development Strategies of Private Enterprises in Guangdong", in Lok Chaopei and Zheng Yanchao (ed.), *Guangdong siying jingji yanjiu* (A Study of Guangdong's Private Sector Economy) (Beijing: Zhongguo Jingji chubanshe ), pp.257-58.

[34] The Shanghai government issued a notice in 1985 reiterating the old (pre-reform) rule of a total ban on bank loans to the private sector. In so doing it ignored the changing economic situation since the commencement of economic reform. See Shanghai Government Notice No.112 (1985), December 13, 1985, "Some Regulations of The People's Bank of China (Shanghai Branch) on the Financing and Capital Brokerage of Enterprises", printed in Shanghai Economic System Reform Leading Group, *Shanghaishi jingji tizhi gaige wenjian huibian* (A Compendium of Economic System Reform Documents of Shanghai), Part 4, (Shanghai; Qiye Guanli Xuehui, 1986), pp.109-13. In addition, the Shanghai government launched a campaign in as late as 1989 to stamp out "pseudo collectives", that is, private enterprises disguised and registered as collective enterprises. Many such "collectives" were thus re-registered as private enterprises or "private individuals", and were made to pay higher taxes applicable to these ownership categories. See *Shanghai Economy 1990*, p. 460.

[35] The major means by which the Guangdong authorities reduced their due revenue collection from the enterprises, thus hiding resources from the Centre and avoiding pressure to increase its fiscal remittances, include (1) adopting a generous tax exemption and reduction "policy", (2) being lax in tax collection, and (3) diverting budgetary revenue to extrabudgetary and other "private" accounts. For details see Li, *Centre and Provinces*, Chapter 5.

[36] The provincial government could easily manipulate the level of revenue collected from non-state enterprises by various tax exemption and reduction measures. Another category of enterprises which had similar flexibility from the provincial viewpoint and thus enthusiastically promoted by the Guangdong government during the 1980s was the so-called "extrabudgetary state enterprises". These were in fact local state enterprises usually established with local resources. Profit and tax revenues from these enterprises were often placed outside the state coffers, thus the description of "extrabudgetary" enterprises. *ibid.*, pp.262-65.

[37] The original high share was probably attributable to the large number of relatively old state enterprises in Shanghai. Technical renovation funds, the major form of investment in these enterprises, were a form of extrabudgetary revenue.

[38]The value of extrabudgetary local fiscal revenue in 1993 was estimated to reach 2 billion yuan, which was over 8% of the total fiscal revenue of the year. See "An Analysis of the Local Fiscal Revenue and Expenditure of Shanghai in 1993 and a Forecast of 1994", in Shanghai Institute of Economic Development (ed.), *Shanghai Jingji Fazhan, 1993* (Shanghai Economic Development, 1993) (Shanghai: China Business Weekly Press), p. 75. This article was reportedly written by informed sources in the municipal finance bureau.

[39] Available data shows extrabudgetary revenues grew by 55.9% (nationally), 89.2% (Guangdong), and 23.2% (Shanghai) between 1986 and 1990, whilst the part of extrabudgetary revenue retained by local finance departments grew by 40.3% (nationally), 26.4% (Guangdong), and 34.2% (Shanghai). See Ministry of Finance ed., *China Finance Statistics, 1950-1991* (Beijing: China Science Press, 1992), pp.189, 199, 204.

[40] For a similar observation on the similarities and differences of different localities in their interaction with central policy in the context of agricultural reform, see Kelliher, *Peasant Power in China*, p. 69.

[41] This is reflected by the substantial rise of the line (C) in Figure 3 since the early 1990s. One example of "non-traditional" discretion was the development of fiscal credits, which involved the local finance departments acting like *de facto* investment banks. The funds of fiscal credits were originally diverted from the local fiscal budget. This part of fiscal resource was, however, *not* included in the compilation of extrabudgetary finance statistics, thus forming a novel "third finance" of the local finance departments. (The "first finance" was the local budget; the "second finance" was those extrabudgetary resources entered in the extrabudgetary finance statistics.) It was estimated that the value of fiscal credits nationally amounted to 40-50 billion yuan by 1993/94, the amount in Shanghai increasing by at least 1 to 2 billion yuan per annum. Author's interviews, 1994.

[42] Wang Hao, "Sanshui, sanbian" (Three "Sayings", Three Defences), *Zhongguo Jinbao*, January 13, 1989, p.2. Wang was the propaganda chief of the Guangdong Provincial Party Committee.

[43] The Guangdong leadership was able to convince central planning officials inspecting the retrenchment implementation of the province of the need for a larger, not smaller, investment ceiling. One tactic was was to boost up foreign investment and increase the linkage between the traditional domestic sector and foreign

capital. Another strategy was to bargain at the specifics, emphasizing the desirability of specific investment projects and the opportunity cost of dropping them. (Author's interviews with Guangdong officials, 1993). After returning to Beijing one of those visiting central officials wrote a report highly in Guangdong's favour, apparently convinced by the persuasion of the Guangdong officials. See Sun Jian, "Guangdongsheng yasuo tousi guimo jishi" (A Report of Guangdong's Efforts to Contain Its Investment Scale), *China Construction and Investment* No.8 (August 1989), pp.17-18.

[44] The following table shows that investment in Guangdong had had a higher growth rate than Shanghai and the national average during the retrenchment period:

Growth Rates of Total Investment (%)

| Year | Guangdong | Shanghai | National |
|---|---|---|---|
| 1989 | -1.8 | -12.4 | -8.0 |
| 1990 | 7.3 | 5.7 | 7.5 |
| 1991 | 28.3 | 13.7 | 23.8 |

Source: *Guangdong Statistical Yearbook 1992, 1993,* respectively, p.145, p.236; State Statistical Bureau (ed.), *Statistics on Investment in Fixed Assets of China (1988-1989), (1990-1991)* (Beijing: Zhongguo Tongji chubanshe, 1991, 1992), respectively, p.13, p.16; *Shanghai Statistical Yearbook 1990, 1991, 1992,* respectively, p.238, p.260, p.280.

[45] See Li Chaoyung, "The Capital Problem in the Development of Externally-Oriented Economy of the Special Economic Zones", *Theory and Practice of the Special Economic Zone* No.4 (August, 1990), p.59. Li was an official of the Shenzhen Branch of the Construction Bank of China. Informed sources in Guangdong confirmed that this was not a lone voice and personal opinion of individual officials. (Author's interviews, 1993).

[46] Lou Jinfen and Guo Shuping (ed.), *Jichu chanye jianshe zijiu chouju* (Capital Mobilization for Infrastructural Construction) (Beijing: Zhongguo Fazhan chubanshe, 1993).

[47] *ibid.*, p.239.

[48] Since 1949 a good number of Shanghai leaders have led both provincial and national careers. In the early years, the second and third First Party Secretary of Shanghai after 1949, Chen Yi and Ke Qingshi,

were central government figures posted to Shanghai. During the Cultural Revolution, Zhang Chunqiao, Yao Wenyun and Wang Hongwen were promoted to the central leadership. And more recently the current Secretary General of the Party, Jiang Zemin, and two prominent vice-premiers, Zhu Rongji and Wu Bangguo, had served in Shanghai immediately before their promotion.

[49] In 1985 some Shanghai officials wrote that "to improve fundamentally the local fiscal system, the obvious choice is to have a system whereby the Centre and the local governments obtain their share of revenue according to the types of taxes...This should be the basic direction of future fiscal system reform." See Xu Riqing et al, "Wanshan Shanghaishi Difang Caizheng de Yanjiu" (A Study on How to Perfect the Local Fiscal System in Shanghai), in Chen Minzhi (ed.), *Shanghai jingji fazhan zhanlue yanjiu* (A Study of Shanghai's Economic Development Strategy) (Shanghai: Shanghai Renmin chubanshe, 1985), p.247.

[50] For an outline of the content of the 1994 fiscal system reform, see State Council Notice No.85 (1993), December 15, 1993, "State Council's Decision on Implementing the Tax-Sharing Fiscal Management System", printed in *Caizheng* No.2 (1994), pp.18-20.

[51] In practice the system implemented in 1994 was a watered down version and a combination of the principles of uniform tax rates and tax sharing under the new system and the principle of guaranteeing existing local revenues under the *dabaogan* system. See Jae Ho Chung, "Beijing confronting the provinces: the 1994 tax-sharing reform and its implications for central-provincial relations in China", *China Information* Vol.IX, Nos.2/3 (Winter 1994/95), pp.1-23.

[52] See Song Xinzhong (ed.), *Zhongguo caizheng tizhi gaige yanjiu* (A Study on the Fiscal System Reform in China) (Beijing: Zhongguo Caizheng chubanshe, 1992).

[53] See for instance Ke Tizuo, "Fenshuizhi de tansuo yu xuanze" (Probes and Choices on the Tax-Sharing System), *Shanghai Caizhui* No.2 (February 1994), pp.8-14; Gu Xingquan, "Qiantian caishui tizhi gaige" (A Preliminary Discussion on the Fiscal and Tax Reforms), *Shanghai Caishui* No.3 (March 1994), pp.10-11, 31; and Wu Jiangguo, "Dui shishi caizheng 'zhuanyi zhifuzhi' de xianshi sikao" (Pragmatic Thoughts on Implementing the Fiscal Transfer Payment System), *Shanghai Caishui* No.3 (March 1994), pp.12-14.

[54] See Li, *Centre and Provinces*, Chapter 5, for more details.