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## Center-Local Relations: Hu's in Charge Here?

*The mountains are high, the Emperor is far away.*

— Chinese proverb

Many in the United States believe that China's one-party system gives Beijing total power and control over all levels of government. The image, perhaps left over from the Maoist cult of personality era, of a single leader or core group of leaders responsible for and in command of all aspects of Chinese society still pervades the American imagination. This perception of absolute authority has led US policymakers and industry groups to focus on securing top-down commitments from Chinese leaders to resolve bilateral economic and other issues. That the leaders sometimes do not fulfill these commitments endlessly frustrates the Americans who have sought them, who view this as negligence on the part of Chinese leaders, lack of political will, or even outright malfeasance.

Beijing's ability to unilaterally impose its will throughout China is, however, highly limited. For a variety of reasons discussed in this chapter, China's authoritarian regime lacks the capacity to implement many of its decisions throughout the polity, a limitation that has important implications for policymaking in Beijing. The leadership has to gauge carefully what it can and cannot get away with vis-à-vis local authorities; how much political capital will be required to enact controversial policies at local levels; and how much discretion to allow local authorities in policies set at the national level—recognizing that the center has no capacity to enforce absolute obedience to its edicts. The policy process can frequently result in vague national policy pronouncements that look less like hard and fast rules than abstract guiding principles—exhortations to local authorities to “do the right thing” that leave considerable latitude for local recalcitrance. Even when Beijing issues more categorical commands, local compliance is far from certain.

The central government's ability to make good on its policies and assurances is of great importance to the United States, particularly when key US trade, consumer safety, and environmental interests are involved. It may seem counterintuitive for the United States to be concerned about a *lack of control* by an authoritarian regime such as China's, but it has some fairly fundamental reasons to be concerned about the Chinese central government's capability to implement policies.

If Beijing cannot effectively implement its policies at home, its international agreements on trade and environment issues are of little use. A commitment from Beijing to abide by global intellectual property norms, no matter how well-intentioned, is of scant value if Beijing has only modest authority to actually enforce it within China. Thus, weighing the fairness of China's trade practices can be difficult: One can envision a scenario in which Beijing is penalized by the international community for unfair trade practices but is unable to make significant changes because those practices are beyond its effective control.

America's legal tradition has conditioned Americans to view the passage of a law or rule by the main government authority as binding. In managing trade disputes with China, much of US economic diplomacy is directed toward pressing Beijing to change its laws or regulations that otherwise appear to tolerate disputed behavior. It may be premature for American trade negotiators to declare victory at the passage of a new law without accounting for the center-local disconnect. A more successful US strategy may require Americans to build longer-term benchmarks and a process to verify implementation at all layers of government. That, in turn, may require the US government to deepen its reach into Chinese provinces and spend time cultivating political relationships outside China's bigger cities.

## From Decentralization to Recentralization

### Decentralization in the 1980s

In 1978 a radical program of decentralization was introduced in China to jumpstart economic development. The program introduced the "fiscal contracting system" (the so-called *fen zao chi fan* or "eating in separate kitchens" policy), which gave each level of government a separate revenue base and required them to balance their own expenditures.<sup>1</sup> In practice, this meant that tax collection became a provincial, rather than central, task, with the center and local governments negotiating the division of tax revenues.<sup>2</sup> Local governments developed their own sources of income, making them less dependent on the central purse.<sup>3</sup> With the central government no longer directly overseeing services provided in local areas, local officials gained significant autonomy from Beijing.<sup>4</sup>

Though decentralization successfully kickstarted China's economy, it also engendered institutional conflict between the central and local governments. Local governments face the dilemma of choosing between following the orders of the central government, which may harm local interests, and focusing on local interests, which may deviate from central plans and objectives.<sup>5</sup>

Decentralization has also fostered endemic corruption in China. Given the broad discretionary power officials have over regulatory issues with little effective oversight, opportunities for self-dealing are great, with potential rewards dramatically outweighing the risks of punishment.<sup>6</sup>

Decentralization has also limited the central government's capacity to use fiscal policy to manage the economy as a whole.<sup>7</sup> Recalcitrant local officials routinely ignore central policies intended to manage boom-bust cycles or otherwise direct economic growth. Beijing's efforts to balance regional growth have been particularly challenging, and its efforts to reduce the widening income disparities between regions and provinces have thus far proven ineffective.<sup>8</sup>

### **Effort to Recentralize in the Early to Mid-1990s**

To address the ill effects of decentralization, the Chinese government began a program of recentralization in the early to mid-1990s.<sup>9</sup> The most significant dimension of recentralization was the creation of the tax division system in 1994, which transferred the role of tax collection back to the central government.<sup>10</sup> The tax division system dramatically increased central government revenue and reduced provincial economic autonomy. The center's share of total government revenue went from only 22 percent in 1993 to nearly 50 percent just three years later.<sup>11</sup>

At the same time that recentralization and the tax division system allowed the center to largely achieve its goal of increased fiscal power,<sup>12</sup> they created unique incentives for local governments to disregard central policies. Before the reforms, local governments' share of total revenue stood at 78 percent.<sup>13</sup> By 2004, however, local governments garnered just 45 percent of total government revenue yet were responsible for 72 percent of total government spending.<sup>14</sup> Beijing continues to devolve responsibility for social welfare programs to local governments but has not transferred significant new funding to them to compensate for the revenue lost from the tax division system.<sup>15</sup> In the face of revenue pressures, many local officials have little recourse but to ignore central directives on such issues as growth planning and resource management.<sup>16</sup> The financial pressure on local governments, coupled with a "growth at any cost" mandate, is responsible for many of China's policy implementation shortcomings.

## Current Factors Causing Center-Local Friction

### Growth at Any Cost

Local officials are unwilling to follow central government laws primarily because of the intense focus on “growth at any cost” since the early 1990s.<sup>17</sup> Promotion of local officials is largely based on their economic growth record, and the surest way up the ladder is to focus on “growth at any cost.”<sup>18</sup> Beijing has instituted metrics for promoting officials based on the attention they pay to environmental health and even intellectual property rights (IPR) protection, but local officials would rather focus on promoting growth.<sup>19</sup> This focus on growth is reinforced by the autonomy—strengthened by the devolution of responsibility to localities during China’s post-Mao reforms—that local officials have enjoyed for most of China’s history.

Even though the central government is increasingly aware of China’s environmental problems, “growth at any cost” has left environmental laws particularly vulnerable. Local officials often see environmental policies and continued growth as opposing choices and almost always opt for economic growth.<sup>20</sup> They gain more from promoting rapid industrialization than from promoting steady, sustainable development, an approach that generally carries considerable environmental costs.<sup>21</sup>

At the root of many local officials’ desire to maintain growth in their provinces and localities is a desire to maintain stability and prevent social unrest, particularly since promotions can also depend on an official’s ability to suppress social unrest.<sup>22</sup> Factories engaging in counterfeiting or violating product safety rules are often the cornerstones of local economies, providing jobs and revenue. Thus, when local officials uncover environmental, IPR, or consumer safety violations, they often turn a blind eye to avoid facing the dangers from job losses and decreased revenue, including social unrest, destabilization, and possible demotion.

### Institutional Weaknesses

China’s bureaucratic structure and institutional weaknesses contribute significantly to the gap between central policy and local implementation.

For example, consumer and product safety suffers as a result of nearly a dozen government organizations dealing with various aspects of food safety, including the Ministries of Health and Commerce, and a hodgepodge of laws that cover various aspects of food safety. Local governments often find it difficult to follow ministerial orders and implement laws, even if they are inclined to do so.<sup>23</sup>

The center’s structural weaknesses have also led to poor implementation of IPR policies. For example, local governments are responsible for appointing local officials and judges and for their salaries, benefits, and

housing.<sup>24</sup> The significant control that the local government exerts over these officials and judges means that they are more loyal to the local than to the central government. This translates into much less severe penalties for counterfeiters.<sup>25</sup>

To enforce its policies at the local level, the central government relies on its local bureaus, which are often ineffective because of their excessive dependence on local governments. In the case of environmental protection, for instance, the center relies on local environmental protection bureaus (EPBs) to implement environmental policies at the provincial and municipal levels down to the district/county level. For their funding, EPBs depend on local governments, which also approve promotions and allocate resources and personnel.<sup>26</sup> This dependence leaves EPBs financially vulnerable and under intense pressure from growth-driven local officials.<sup>27</sup> These EPBs are, therefore, often cash-strapped and understaffed (or with staff that lacks adequate training).<sup>28</sup>

### **Local and Personal Income Gains**

As discussed earlier, the fiscal revenue share of local governments has plummeted since the tax reform of 1994, while their share of spending on social programs has increased.<sup>29</sup> This shortfall in revenue has led to widespread corruption at the local level. In the case of the environment, local governments ignore polluting companies and pressure local EPBs to do the same in order to maintain the local government's tax revenue stream and prevent social unrest<sup>30</sup> and at the same time be able to continue to collect pollution-related fines.<sup>31</sup>

Growth and land policies are also vulnerable to corruption because of the profits local officials can make, as they control both land and building projects. Local officials often seize collectively owned farmland, providing little or no compensation to the displaced, and sell the land at a significant profit. This system gives local officials a powerful incentive to ignore central land management directives.<sup>32</sup>

In addition, local officials often have a personal stake in a province's major enterprises, and when these enterprises are the target of a suit or mediation regarding pollution or labor violations, local officials are quick to become involved and able to sway the court to rule in the favor of the enterprises.<sup>33</sup>

All these weaknesses plague nearly all policy areas of interest to the United States. The next section shows how local governments blatantly ignore central rules and regulations in key areas and why the United States should care. The last sections discuss the steps the center is taking to improve local implementation of its policies in key areas and recommend that the United States, in addition to seeking top-down commitments, should build interest coalitions at the local level.

## How Center-Local Relations Affect Key Policies (and Why the United States Should Care)

### Environmental Policies

China is on the cusp of environmental catastrophe. According to the World Bank, just 1 percent of China's urban population of 560 million people breathes safe air;<sup>34</sup> 300 million people in China have no access to clean water. Pollution is said to be responsible for 710,000 to 760,000 deaths a year,<sup>35</sup> and official Chinese estimates peg the economic cost of pollution at 8 to 12 percent of China's annual GDP. Environment- and pollution-related protests have increased nearly 30 percent per year since 2000.<sup>36</sup> China's nascent environmental movement has the potential to galvanize nationwide support, cutting across regional and socioeconomic boundaries, and presenting the organized opposition the Chinese Communist Party so fears.<sup>37</sup> Clearly, environmental degradation is upping the ante on China's economic development and social stability considerations (see chapters 6 and 7).

Beijing has attempted to rally support for environmental awareness. The Beijing Olympics in 2008 is being marketed as the "Green Olympics," and stringent environmental standards for a range of new investment projects have been passed.

Despite the tough talk, however, local authorities have thwarted the center's environmental policy at every turn. Local government corruption, cover-ups, misreporting, and lax enforcement have been the rule, rather than the exception, with respect to environmental regulation. Central-government inspections in October 2006 revealed that local governments had checked just 30 percent of projects for compliance before approval, and nearly half of the projects checked did not implement the required pollution controls.<sup>38</sup> In December 2006, the State Environmental Protection Agency (SEPA) noted that national targets to reduce particular pollutants (such as sulfur dioxide) had not been met and that levels had actually risen despite the fact that local governments had broadly reported having hit their targets.<sup>39</sup>

### Intellectual Property Policies

The US economy increasingly relies on intellectual property as a fundamental value, and in the fight for global IPR protection today, China is a key battleground.

Despite the central government's efforts to reduce the level of counterfeiting and trademark infringement, IPRs remain fluid throughout much of China. US industry groups variously estimate the problem in the tens of billions of dollars, but any estimate is impracticable. Although IPR protec-

tion and enforcement is improving, the problem is outstripping the ability of Chinese authorities to manage or contain it. It is no longer simply a problem for the domestic Chinese market: Chinese products made up 79 percent of the counterfeit goods seized by the European Union in 2006<sup>40</sup> and 81 percent of the total domestic value of US mid-year FY2007 seizures.<sup>41</sup>

Although Beijing has stepped up efforts to combat IPR violations through campaigns and legislation,<sup>42</sup> local officials, with much at stake in preserving IPR-infringing enterprises, have proved a significant obstacle (see earlier section). Raids and seizures take place occasionally, but for the pirates, the profits they can earn far outweigh the risk of punishment. In 2000, average fines in administrative IPR cases were \$792, average compensation in those cases for brand owners was \$19, and criminal prosecution proceedings were carried out in just 1 in 500 cases<sup>43</sup>—with this record, legal action is hardly a deterrent.

### Consumer/Product Safety Policies

Be it adulterated cooking oil, toxic toothpaste, counterfeit medicines, poisonous dog food, or lead-tainted toys, China's record on product safety is a matter of grave concern to consumers in China and throughout the world. With some 80 percent of toys sold in the United States made in China, import safety issues have become a hot topic. In March 2006, Mega Brands, Inc. recalled 3.8 million magnetic building sets made in China, and in August 2007, Mattel recalled 10.5 million Chinese-made toys.<sup>44</sup>

Farm-raised seafood imports from China have also caused a great deal of concern. Chinese exports of agricultural and seafood products to the United States quadrupled from 1996 to 2006, making China the second leading exporter of seafood to the United States. However, between October 2006 and May 2007, the US Food and Drug Administration (FDA) found Chinese seafood contaminated with banned antimicrobial agents such as carcinogens malachite green, nitrofurans, and gentian violet.<sup>45</sup>

Consumer/product safety is of significant concern in Beijing, not only because it threatens China's export juggernaut but also because China's domestic consumers are themselves increasingly restive about the issue. While the central government has acknowledged the problem and taken steps to correct it, local governments continue to ignore it.

### Labor and Trade Laws

China's success in implementing labor laws is also of critical interest to the United States, both for humanitarian and economic competitiveness reasons. Chinese workers operate in unsafe conditions and earn very low wages. Despite central regulations to protect them, local government officials, in collusion with factory owners, continue to abuse the workers.<sup>46</sup>

The brick kiln scandal is an extreme example of the gap between central labor laws and local implementation. In August 2007, authorities were alerted to a massive forced labor operation in brick kilns, mines, and workshops.<sup>47</sup> A subsequent investigation discovered 67,000 kilns, mines, and workshops without licenses,<sup>48</sup> and 1,340 people were rescued from forced labor.<sup>49</sup> Reports have surfaced that local government officials, including the police force, were aware of the violations but did little to protect the workers.<sup>50</sup>

In addition to labor laws, local governments routinely violate trade laws. They are often guilty of unfair subsidies and industrial dumping, two particularly significant US concerns. Free or considerably underpriced land is a common subsidy local authorities offer investors in favored projects. Under-cost products factories make at the behest of local governments seeking simply to keep those businesses up and running—against the wishes of Beijing—is one cause of dumping.

Corrupt land transactions are another major problem, as mentioned earlier, particularly with regard to compensation. According to official central audits, local governments often pay little or no compensation to displaced people, misappropriating funds designated for land compensation to give staff bonuses or make up budget shortfalls.<sup>51</sup>

Local governments are responsible for nearly 20 percent of China's investment,<sup>52</sup> much of which is misdirected into sectors with excess capacity, such as steel,<sup>53</sup> while ignoring sectors with more long-term promise, such as labor-intensive agriculture.<sup>54</sup> In addition, to attract both foreign and domestic businesses, local governments turn a blind eye to a wide range of central government laws, allowing companies to ignore minimum wage laws,<sup>55</sup> suppressing union organizations,<sup>56</sup> and granting asylum to environmentally noncompliant businesses.<sup>57</sup>

## What It Means for Hu and Wen

President Hu's ambitious Scientific Development Concept, enshrined into Party doctrine at the 17th Party Congress, as well as the goal of a "harmonious society," effectively challenges the status quo by asserting the importance of balance and stability ahead of growth at all cost. As such, the center is on a collision course with existing tensions in center-local relations. To implement its "rebalancing" campaign, Beijing will have to exert its will on local authorities in ways that have been particularly challenging for the past few years.<sup>58</sup>

Hu has taken steps over the past few years to gain better local control, for himself and his political allies in Beijing. He devoted much of his initial five years in office to ensuring that a cadre of like-minded, trusted associates stocked key provincial positions throughout China. Now that he has made considerable headway toward this goal, he arguably has more direct provincial reach than any of his predecessors in memory. Whether

the existence of these leaders and Hu's personal authority over them will be adequate to overcome the challenges to local adherence to central policy is an open question.

## Steps the Center Is Taking

The central government has taken significant steps to strengthen the effectiveness of its policies and improve its capacity to implement them.

**Environmental Policy.** In a major move to streamline environmental policy, for example, the March 2008 National People's Congress upgraded environmental issues to the ministry level, replacing SEPA with a Ministry of Environmental Protection. The new ministry will have more staff, a larger budget, and a wider range of responsibilities, including pollution prevention and clean-up and biodiversity management.<sup>59</sup> It is as yet unknown how locally managed EPBs will be reformed, if at all. Additionally, the State Council approved the appointment of six interregional environmental inspectors to increase central government control.<sup>60</sup> One of the most promising efforts of the central government to incentivize environmental policy is its Green GDP Program, which uses "green GDP," determined by subtracting the cost of environmental damage from net GDP, to evaluate the performance of local officials.<sup>61</sup> Though the initiative remains alive, it hit a snag when green GDP was found to be almost zero in some provinces due to the severity of pollution<sup>62</sup> and local officials opposed it.<sup>63</sup> The central government has also developed a "green credit" policy, which suspends lending to polluting companies, and a "green trade" policy, which suspends a polluting company's ability to export.<sup>64</sup>

**Consumer/Product Safety.** The central government launched a four-month campaign in August 2007 to improve product quality, specifically targeting items such as farm produce, pork, drugs, and exported products linked to human health, and including such measures as a nationwide quality monitoring system.<sup>65</sup> The monitoring system is also part of a larger five-year plan announced in May 2007 and is scheduled to cover 90 percent of the country by 2010.<sup>66</sup> In August 2007, the government also announced an RMB8.8 billion pledge to improve the food and drug safety infrastructure, which will include the renovation of drug testing.<sup>67</sup> Also included in the increased efforts is a new accountability system that makes local governments responsible for the quality of food and drugs manufactured in their jurisdictions and punishes officials for substandard food and drug quality.<sup>68</sup> The government is taking the problem seriously: In July 2007, China executed Zheng Xiaoyu, head of China's State Food and Drug Administration, for taking bribes to approve a substandard antibiotic that led to the deaths of at least 10 people.<sup>69</sup>

**Land Policies.** The central government issued land policies in September 2006 to combat implementation problems associated with pro-growth policies, including a supervisory system to oversee urban land transactions,<sup>70</sup> a National Land Superintendency, and increased inspections.<sup>71</sup> The policies indicate that compliance with land use policy will be used as a performance indicator for leaders at all government levels.<sup>72</sup> Furthermore, local governments will be required to list the revenues they receive from land sales, which will help reduce corruption.<sup>73</sup> Additionally, new laws that came into effect in January 2007 put restrictions on land sales and raised compensation and land use taxes.<sup>74</sup> The central government has also stepped up punishments of local officials, punishing three local officials in August 2006 for permitting construction of an unauthorized power station<sup>75</sup> and a land official in December 2006 for approving shady land deals.<sup>76</sup>

**Labor Laws.** New labor laws that came into effect in January 2008 require written contracts for employees, limit the use of temporary laborers, make firing employees more difficult, and give unions the power to bargain with employers.<sup>77</sup> In response to the kiln scandal mentioned above, a clause was added to the law stipulating punishment of local officials who “overlook or tolerate labor rights violations.”<sup>78</sup>

**Intellectual Property Rights.** On the IPR front, China’s action plans every year are intended as multidisciplinary educational, administrative, and punitive exercises to improve IPR protection. Recent efforts to expand education to the provinces are more ambitious than in years past. In 2006, China raised the number of IPR service centers to 50 nationwide and established a national “12312” helpline. The service centers are responsible for receiving and handling complaints about IPR infringements and offering consulting services.<sup>79</sup> Most importantly for center-local considerations, the various agencies with IPR responsibility have focused on streamlining cooperation, particularly between central ministries and relevant administrative entities and law enforcement and judicial departments.

## Implications for the United States and Policy Recommendations

For the United States, managing national concerns on trade and economic issues with a national government as difficult to penetrate as China’s is a tall prospect as it is. When that government also has very limited power to control the behavior of its own citizens because local officials protect them, the difficulties become more complex. As noted earlier, local governments have traditionally maintained a strong degree of autonomy from the center. But that does not mean that they have always subverted, or will always subvert, the center’s interests. Nor should Beijing accept the center-local disconnect as an excuse for shortcomings in China’s governance.

To ensure local government compliance with central-government laws, China will have to stop venerating “growth at any cost” and increase funding of local social programs. As Richard Baum, political science professor at the University of California Los Angeles observes, in discussing how to improve enforcement of food safety regulations, for example, “until the central government fixes the fiscal starvation of local governments, who are funded by a combination of local taxes, kickbacks, and bribes, the problem . . . will remain unsolved.”<sup>80</sup>

The United States, for its part, will have to build interest coalitions in China that are not just top down but also offer a broader national consensus, including at the local level, in favor of US positions. Such interest coalition building may require more nuance, patience, and effort than most Americans are used to exercising. The current US temptation to pound away at the top, to browbeat Beijing into agreeing to “do something” about US concerns, may satisfy American lawyerly urges, but it does not take the reality of the governance dynamic in China into account. It will certainly not be effective in the long term at delivering meaningful results for US interests.

At a minimum, visiting US officials, politicians, and business groups should venture beyond Beijing and Shanghai to explore China’s lesser-known provincial capitals, establish working relationships with local-level officials, and become familiar with their respective provincial policy priorities. In this regard, expansion of US consulate presence in China’s provinces, including the posting of commercial and economic officers, should be encouraged.

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