

## Rising Cities and the Restructured State

Local autonomy in the name of economic development is changing China

By Xiangming Chen

**Two and a half decades of economic and administrative reform in China have meant substantial market liberalization and decentralization at the local and regional levels. The Chinese state has restructured itself and in the process reshaped its cities into increasingly autonomous actors, which in turn has dramatically changed the relationship between cities and the state.**



XIANGMING CHEN

is a professor at the School of Social Development and Public Policy at Fudan University, Shanghai, and a professor of sociology at the University of Illinois in Chicago.

Cities are not only rising in China, they have entered the world's stage. The stream of stories on cosmopolitan Beijing and Shanghai may be old news, but according to *Newsweek*, of the top 150 fastest-growing secondary and medium-sized cities in the world's emerging economies, the most by far (55) are in China. The economic boom of China's cities, especially those on the country's "gold coast," has been fueled by growing political and policymaking autonomy as a result of administrative decentralization over the last 25 years. This makes the Chinese experience highly relevant to the question that many observers today are asking: "Will cities be more important than nation states in the future?"<sup>1</sup> The growth of China's cities sheds new light on the changing relationship between cities and the nation state, and their positions in a globalizing world.

The great cities of China, such as Shanghai, Xi'an, Hangzhou, Nanjing and Guangzhou, rose and fell throughout history as political, cultural or commercial centers with some, albeit uneven, autonomy vis-à-vis the central government. While there were far fewer medium-sized and small cities in pre-1949 China that had the economic dynamism and administrative autonomy of their contemporary counter-

parts, they did, however, manage to carve out some autonomy for themselves. In fact, regionalism and localism existed in the de jure centralized but unstable system during both the long imperial years and short republican era before 1949.

In China between 1949 and 1978 cities simultaneously suffered and prospered. The large coastal cities like Shanghai, for example, were not only forced to redistribute resources by sending technical personnel and relocating factories to the interior, they also subsidized the central government heavily. Shanghai turned over 350 billion yuan (\$40 billion) in revenue to the central government during the period 1949-1985, but received only 3.5 billion yuan (\$44 million) for building municipal infrastructure.<sup>2</sup> On the other hand, many cities in general benefited from the central state's development strategy, which favored urban-based industrialization and a policy of controlling population movement through the household registration (*hukou*) system. While the cities and their residents were economically better off than the villages and their rural residents, the cities themselves existed as cell-like, largely insulated economic and administrative units in the vertical, top-down system of central planning and control.

<sup>1</sup> See forthcoming *Internationale Politik* issue 11/06 (November 2006).

<sup>2</sup> Shi Lei, Qi Ge and Yuan Min, *Shanghai Ren Da Zhihui* (The Smart Shanghainese) (World Knowledge Press, 2004), p. 6.

### An Era of Resurgence

The fortune of China's cities began to turn again in the late 1970's when the central government selected four cities (Shenzhen, Zhuhai, Shantou, Xiamen) on the southeastern coast as special economic zones. They were granted administrative autonomy in order to attract foreign investment and experiment with market measures. The success of targeting these cities as new models of decentralized development led the central government to designate 14 other cities along the entire coast, including Shanghai, as "open cities" in 1984. By doing so, the government gave them leeway and flexibility to deal with foreign investors and pursue local economic development. From the late 1980's and into the 1990's, the central government extended similar policymaking autonomy to a much larger number of interior and border cities in order to stimulate them to catch up with the fast-growing coastal cities. Since 2000, the trend toward decentralization throughout China has increased, strengthening the local autonomy of many cities even further.

Shanghai figured prominently in a dramatic turn in federal-local government relations in the early 1990's. Having contributed mightily to the national government throughout the 1980's, Shanghai requested and was granted special permission by the central government to raise capital by borrowing. It was permitted to incur debts from international sources to finance massive construction projects for physical infrastructure. The appeal of Line 1 of Shanghai's subway project was so great that Germany was willing to provide a full government loan at exceptionally low interest in order to keep all of the other bidders away. Shanghai borrowed in total \$3.2 bil-

lion from foreign governments and banks at favorable interest rates. In the late 1980's and early 1990's, the central government also allowed Shanghai to be one of the few Chinese cities to experiment with selling the user rights of state-owned land for a period of up to 70 years to foreign investors. This reflected the Chinese state's new and practical approach to the socialist principle and practice of public land ownership, which became both the hallmark and essential element of administrative and financial autonomy for municipal governments. By 2000, Shanghai had raised over \$13 billion from leasing local land for the construction of infrastructure and urban development. Shanghai's former mayor observed at the time that if Shanghai depended on the central government for traditional budget allocation instead of raising funds through land lease, the urban renewal projects completed from 1990 to 2000 would have taken 100 years.<sup>3</sup> Fortunately that was not necessary since Shanghai has attracted over \$100 billion in foreign investment since 1992.

Many other cities have followed Shanghai and the earlier-developing coastal cities in taking advantage of the newly gained autonomy to lease land to accelerate local economic growth. These municipal governments have competed to lease large tracts of land to both foreign manufacturing investors for building new factories, and to domestic real estate developers for the construction of residential housing. Attracting large amounts of foreign investment and raising the GDP makes local officials look good in the eyes of higher state authorities, while raising tax revenues from both foreign investors and real estate developers makes local governments rich. By controlling land price and taxes,

Many cities have followed Shanghai in taking advantage of newly gained autonomy to accelerate local economic growth.

3) Ibid, p. 13.

local governments engage in monopolistic competition to raise as much money as possible in order to strengthen their competitive position vis-à-vis neighboring cities. The combination of local autonomy, excessive investment and inter-city competition has led to overheated economic growth, wasteful use of energy and exploitation of natural resources. China's economy, the world's fourth largest behind the United States, Japan and Germany, expanded by an annualized 10.9 percent in the first six months of 2006, boosted by massive investment especially in the provinces.<sup>4</sup> Ninety percent of all investment was approved by governments at provincial, municipal and county levels, reflecting different agendas in Beijing and elsewhere. Undesirable consequences aside, local autonomy for cities is the key factor in China's overall development success.

### The Response to Rising Cities

Local autonomy has become a double-edged sword for the Chinese state. By granting more decision-making power to provinces and municipalities, the central government has weakened itself, whether intentionally or not. Moreover, the devolution of power to localities has translated into a spatial shift of the state and its functions to the local level, turning the local governments into more dominant players in economic development. This scaling down of the state, however, does not mean a complete withdrawal—the central government is now finding it difficult to rein in local governments by means of macro regulation and intervention. According to Andy Xie, a Hong Kong-based economist for Mor-

gan Stanley, local governments can create a *fait accompli* by starting numerous projects to deter macro tightening by the central government since cutting off liquidity would keep these projects unfinished, that is, macro tightening could generate large financial risks. Second, local government leaders often have seniority over their regulators in the communist party hierarchy and, hence, have a major say in macroeconomic policy.<sup>5</sup>

While local autonomy has largely thwarted the central government's macroeconomic tightening since it began in April 2004, the central state has reasserted itself by imposing a variety of administrative directives and regulatory decrees to slow down local economic growth, especially the rapidly expanding housing sector. In June 2006, the central government rolled out a series of measures to 1) boost the minimum down payment to 30 percent (up from 20 percent) on homes larger than 90 square meters; 2) levy a tax of 5.5 percent on the entire purchase price of any property sold within five years (up from two years) to discourage rapid reselling of apartments; and 3) to ban sales of government-owned land for detached houses.<sup>6</sup> One month later, top central leaders exhorted party and government officials at the provincial and municipal levels to obey Beijing's macroeconomic directives by putting fixed-asset investment under tight control and making more efforts to lower energy consumption and improve environmental protection. Then in August, the central government ordered a half-finished power plant in inner Mongolia to be shut down and the local officials responsible for the wasteful project to turn in

The Chinese central government has weakened itself by granting more decision-making power to provinces and municipalities.

4) Asia Times Online: "Beijing cracks the whip on rogue projects," August 22, 2006.

5) Morgan Stanley Global Economic Forum, "China: Development Model and Tightening Challenges," August 8, 2006.

6) Frederik Balfour, "The starter home is a nonstarter," *Business Week*, June 19, 2006, p. 49.

reports accounting for their failings. These harsh administrative measures are intended, as a Chinese proverb goes, to “kill a chicken to scare off the monkeys,” that is, punish one badly behaving person to deter others from behaving the same way. How well have these aggressive state measures worked?

Some of the imposed directives had a temporary effect. In Shanghai, where the booming luxury housing market had pushed property prices sky high, sales of high-end townhouses have shown signs of slowdown since June 2006. It is doubtful, however, that the weakened central state can reestablish its past levels of control over affluent cities in light of the competing interests and priorities between them. Whereas the central government is concerned with macro issues such as inflation and other symptoms of overheating, local governments prioritize growth because it means more jobs and less risk of social unrest, which in turn helps local government officials advance their political careers. More importantly, the increasing inability of the Chinese state to reassert vertical sovereignty is closely tied with China’s economic development becoming increasingly driven by the local level. City govern-

ments are essentially businesses that compete among themselves to maximize their GDP.

The rise of cities, driven by a new and powerful model of local government-led economic development, challenges the national state to rebalance interests at the central, regional and local levels. While too much autonomy on the part of cities leads to runaway growth and vicious competition, likely triggering centrifugal and fragmenting tendencies that could destabilize the center, reining in the cities too far threatens to kill positive local development initiatives. Since the balance of power appears to have largely tilted toward the local side, cities in China are likely to sustain their relative autonomy in planning and implementing development initiatives, thus strengthening decentralization tendencies and weakening the national state. Complicating the new and fragile relationship between city and state is the growing forces of market activities and globalization. Even if the independence of China’s cities was limited under the centralized state, their rapid economic development and growing autonomy since the 1980’s present an intriguing case for exploring and evaluating the implications of the power of cities across diverse national contexts.

Cities in China are likely to continue strengthening decentralization tendencies and weaken the national state.