

Governing for Growth and the Resilience of the Chinese Communist Party

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Meritocratic promotions based on local economic achievements have enabled the Chinese Communist Party (CCP) to achieve not only economic growth, but also improvements in local governance, as local governments have implemented institutional reforms in pursuit of GDP growth. However, not all regions of the country have adopted GDP growth as the key priority; those that have instead prioritized social stability have experienced not only slower growth, but also worse local governance outcomes. These findings have important implications for the adaptability and resilience of the CCP.

Politically and economically, China may be reaching an inflection point. Debt has risen to record highs as GDP growth and consumer confidence have fallen to record lows. On the political front, leading experts express concerns of a return to Mao-era policies, de-institutionalization, and the likelihood of a “coming Chinese crackup.” According to popular wisdom, a new model of political economy is required: a hierarchical cadre management system focused on achieving high rates of economic growth has produced rapid investment-led growth, but this growth has come at high social and environmental costs. The current model is seen as incapable of responding proactively to citizen preferences and creating environments that are conducive to the development of high value added services, as opposed to low-skilled manufacturing. Contrary to this wisdom, I argue that a cadre management system that prioritizes economic growth is capable of overcoming many of the economic and governance challenges that China now faces.

The CCP’s cadre management system is often cited as a cause of both China’s successes and its failures. As a solution to the principal-agent problem, the CCP’s personnel management system rewards cadres for behavior that is aligned with central priorities. In particular, prioritizing economic growth has been a key institutional cause for China’s economic success, as it has incentivized local officials to invest in their localities rather than becoming “stationary bandits.” Yet such economic one-mindedness has also led to a host of negative spillovers and side-effects, including excessive peasant burdens, under-provision of social welfare provision, poor environmental outcomes due to lax regulation and enforcement, lower revenue due to “race to the bottom” tax policies in combination with interjurisdictional competition, over-investment at the expense of consumption, and excessive debt. Many of these unintended consequences are now the key issues threatening China’s continued economic growth and political stability.

However, a closer analysis reveals the counterintuitive finding that not only has China achieved rapid economic growth through the incentives enshrined in the cadre management system, but this system has also yielded unexpected (and unintended) positive impacts on local governance and institutional reform in localities that have been most focused on growth. Many local reforms identified as most innovative and citizen-focused have indeed been implemented with the goal of achieving higher levels of economic growth; citizen accountability and clean government have been means rather than ends in their own right.

CONTRASTING INCENTIVES: LET SOME GET RICH(ER) FIRST

An understanding of the effects of the growth incentive on local governance begins from analyzing a more basic question: what explains persistent differences in governance and economic development across regions in China? Local governments intervene frequently in local economies, with rampant opportunities for rent-seeking and inefficient obstruction of markets. Many local governments have nevertheless played roles associated with successful developmental states, benefiting local businesses and helping to produce local growth. Other local governments have instead preyed upon local residents and businesses, and in doing so have stunted economic development. Such variation in both governance and economic outcomes has not been random, but has instead been relatively persistent within, but not across, regions and provinces. In particular, provinces in coastal China have grown much faster than provinces in central and western China and have also been at the forefront of local governance reforms. Provincial institutions, rather than simply geography, explain this variation, as identified by “thick” borders: counties bordering each other across provincial lines have experienced diverging development paths.

Re-considering the “growth at all costs” incentives faced by local officials enables a better understanding of this regional developmental pattern. Significant variation in developmental orientation, and thus developmental outcomes, arises as a result of varying incentives for promotion given to local officials. Analysis of the promotion prospects of China’s county leaders from 1996–2010 shows that in coastal provinces,

economic growth strongly predicts the promotion of county leaders, whereas in central provinces there is a weak *negative* relationship between growth and promotion. Looking in depth at one central province, Anhui, reveals that maintaining stability is a more important incentive than economic growth: Anhui is more likely to promote county leaders with security work backgrounds and is more likely than coastal counterparts to strictly punish officials following “mass incidents”; and the central Organization Department is more likely to promote Anhui province-level officials who have achieved positive outcomes on stability indicators than on economic growth indicators.

In other words, the cliché of the “blind pursuit of GDP growth” at all costs is not universal; it holds in some regions but not all. The CCP appears to employ a regionally diverse strategy that concentrates growth efforts predominantly in coastal provinces with geographic and first-mover advantages, while taking a more risk-averse approach in other inland provinces. The goals of this strategy is to maintain both high rates of growth as well as social and political stability. Although not the only factor explaining varying regional economic outcomes, the incentivized behavior of local governments in response to promotion emphases explain a significant share of the divergence. Three decades after Deng’s famous aphorism to “let some get rich first,” the center is still helping some get rich faster.

GROWTH INCENTIVES FOR GOOD GOVERNANCE

Regionally-diverse developmental emphases not only result in faster economic growth in coastal regions, which already have geographic and historic advantages, but lead to better governance outcomes in these regions as well, as I learned during six months interviewing officials and businesses in a border region in Jiangsu Province and Anhui Province, and particularly three pairs of bordering counties. Although Jiangsu is one of China’s richest provinces and Anhui is one of its poorest, the counties selected for analysis had similar development levels until the mid-1990s, after which the Jiangsu counties attracted much more investment and grew much more rapidly; although the Jiangsu counties were on average slightly poorer than the Anhui counterparts in 1994, by 2007 they were over 60 percent wealthier. Matching across initial conditions and

geography facilitated an exploration of the role of provincial institutions in determining variation in governance and growth.

Interviews in the three Jiangsu counties highlighted a causal chain running from promotion incentives for growth to governance improvements to attract investment. As well documented, growth in China has become increasingly dependent on capital accumulation. In a competitive environment, the basis for economic success has been the ability to attract mobile capital, both foreign and domestic. In this competition for mobile capital environment, the key means of success is the ability of a county to differentiate itself from competitors as a good place to invest. Considerable attention has been devoted to a discussion of development zones and preferential policies, but this discussion misses a key fact: zones tend to offer the same tax breaks and preferences, so in many ways they simply create a race-to-the-bottom equilibrium with sub-optimal levels of industrial taxation. Geography, and particularly the interaction between geography and the development of transport infrastructure, plays an important role in attracting firms, but geography cannot account for the differences observed border areas. As highlighted repeatedly in interviews, the perceived behavior of local government is a key variable in investment location decisions.

“Pro-growth governance” consists of tackling *government failures* through local efforts to combat corruption, red tape, and excessive fee collection; and ameliorating *market failures*, corresponding to the “helping hand” orientation of local governments as they take on developmental roles and act as service-oriented agents of local industry. Such pro-growth governance differs across localities, manifesting in different growth outcomes through variable degrees of investment attractiveness. Counties on the Jiangsu side of the border that face pro-growth promotion incentives have implemented successful institutional reforms for pro-growth governance, including both controlling local cadres and creating more service-oriented government. A few examples include citizen consultation on cadre appointments, restrictions on cadre drinking and banqueting, and removal of red tape through “one-stop shopping” centers. And while a growth emphasis incentivizes these governance improvements, a stability emphasis not only does not incentivize governance improvements, but actually *disincentivizes* them: counties focused on stability avoid bold institutional reforms for fear of local unrest. As one official in Anhui notes, “our leaders have no courage.”

Given the either/or nature of instability, rather than the continuous variable nature of GDP growth, promotions become less objective, leading to an enhanced role of patronage in local personnel decisions, a leading cause of corruption.

CCP RESILIENCE AND ADAPTABILITY

An understanding of the effects of promotion targets on growth and governance outcomes has important implications not only for understanding China's current regional inequality, but also for diagnosing the resilience of the CCP and the adaptability of its model of political economy. The current system has worked in an investment-led growth model, yet China may now be at an inflection point that requires greater local government responsiveness to local citizens, who studies repeatedly show have little faith in local governments and condemn procedural injustice, corruption, and environmental disregard. In addition to citizen responsiveness, China requires changes to its economic model. The growth model has been based on excessive domestic investment, and an intended switch to domestic consumption and innovation as sources of growth has thus far proved elusive.

Much discussion focuses on the need for accountability mechanisms to adapt to make local governments responsive to a growing middle class with growing demands. The question frequently boils down to whether the current upwardly accountable personnel management system can adapt sufficiently by including new targets. There have already been initial attempts to switch targets to focus on public satisfaction, including one city in Jiangsu that introduced a citizen "happiness index" as a supplementary performance measure. But moving to new *de jure* targets alone will not be sufficient: the key will be whether these targets become the *de facto* criteria for promotions. The ability to micro-manage behavior through multiple targets may be limited, as research on organizational management has shown. Indeed, the focus on stability outcomes in central regions does not imply that economic growth is not one of many included targets on performance contracts. But as one Anhui official noted in comparison to Jiangsu, "we have investment targets also, but no one cares if we don't hit them."

Instead, a de facto growth target may currently be the most effective means of responding to local preferences and citizen demands. To continue to grow, localities in more developed areas need to make livable cities that attract talented workers rather than capital-rich firms. The conditions for such “livability” are vastly different than for firm investment in a surplus labor environment, and include: social services, particularly high quality education for children; robust consumer environment; low levels of water and air pollution; low traffic; etc. These are the goals of the growing urban middle class, and meeting these goals would go a long way towards ameliorating China’s current political and economic challenges. The analysis here suggests that spreading the growth incentive throughout the country may help achieve this transition. Indeed, the same pro-growth incentive structure could lead to regionally different emphases without the need for varying sub-targets. Inland provinces would compete among themselves to attract relocating manufacturing industries; as the coastal economy switches towards services, local governments would compete over the attractiveness and “livability” of their local environment, necessitating greater degrees of citizen accountability.



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