

Explaining the Sources of *de facto* Federalism in Reform China: Intergovernmental Decentralization, Globalization, and Central–Local Relations*

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Abstract

China does not have a federalist system of government. Nevertheless, with deepening reform and openness, China's political system in terms of central–local relations is functioning more and more like federalism. Federalism as a functioning system in China has been understudied. This paper defines the political system existing in China as *de facto* federalism, and attempts to explore the sources and dynamics of this *de facto* federalism. China's *de facto* federalism was mainly driven by two related factors, i.e. decentralization and globalization. This paper argues that while economic decentralization in the 1980s led to the formation of *de facto* federalism, globalization since the 1990s has accelerated this process and generated increasingly high pressure on the Chinese leadership to institutionalize existing *de facto* federalism.

China does not have a federalist system of government – it has neither constitutional division of power between the different levels of government nor separation of power within the branches of government. Nevertheless, with deepening reform and openness, China's political system in terms of central–local relations is functioning more and more like federalism. The growth of socio-economic infrastructure favorable for federalism has led China scholars, especially Chinese dissident scholars, to use the term of federalism when they refer to China's central–local relations. Nonetheless, federalism as a functioning system in China has been understudied. This paper defines the political system existing in China as *de facto* federalism, and attempts to explore the sources and dynamics of this *de facto* federalism in the era of reform and openness.

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Defining federalism: formal institutional versus behavioral

In academic circles, federalism is usually defined in two ways. First, it can be defined from a formal institutional perspective. In this context, federalism is often regarded as a form of government that differs from unitary forms of government in terms of the distribution of power between central and sub-national governments, the separation of powers within the government, and the division of legislative powers between national and regional representatives. In this sense, a true federation has both a distribution of political power specified in the constitution and a direct relationship between political power and the individual citizen.

Only a few countries fit an ideal type of federalism. For example, K. C. Wheare (1964) regards the United States, Canada, and Switzerland as federal countries, while Malaysia and India only as 'quasi-federal'. This is so because states and local governments in the United States, Canada, and Switzerland are not totally dependent on their central government for matters that are local in nature, while in Malaysia and India they depend heavily upon their national government, despite the fact that these nations possess a federal structure.

Federalism presents itself in various forms of institutional arrangement. There are lesser forms of federalism, and those forms can be divided into parliamentary federalism (for example, Canada and Germany), and presidential federalism (for instance, the Latin American countries). A new form of federalism – executive federalism – is also emerging where major constitutional issues are decided by executives instead of by legislatures.

Needless to say, federalism works better in some countries than some others, and the performance of federalism is often subject to local historical trajectories and institutional arrangements. Germany is an example where federalism works well. This is due to several important historical characteristics that preceded the founding of the Federal Republic in 1949, including a socially and culturally homogeneous population, a tradition of federalism going back several centuries, a strong sense of nationalism, and institutional experience with federal processes. World War II accentuated strong regionalism and resulted in a social leveling stemming from massive movement of the German population. The war experience also provided strong incentives for the creation of a system of checks and balances to prevent the rise of dictatorships in the future.

Constitutionally, Germany is a parliamentary state that is a fusion between the functions of the executive and legislative branches, and a cooperative and interwoven distribution of executive, legislative, and judicial powers among three branches of government. There is a fixed revenue-sharing system specified in the Constitution and a true multiparty system that makes gridlock a distinct possibility on contentious issues. At the same time, the size and scope of German entitlement programs has led to executive federalism on some issues. The 1990 reunification created financial strain because of the large resource requirements of the former East Germany, and the membership of Germany in the European Union may create additional federalist

issues, since some of the provisions of the EU actually contradict specifications of the German Constitution.

In the developing world, federalism has worked less satisfactorily. For example, in Brazil, many of the difficulties stem from several key elements of the federalist system that constrain presidential initiative and contribute to policy gridlock: a symmetric bicameralism in which the strong Brazilian senate forces the president to explicitly consider a regional balance of partisan forces, severe regional disparities in the legislature, a Constitution that embeds many policies and procedures that other countries treat via ordinary law, a very high share of fiscal resources that remain with the sub-national governments, very strong gubernatorial positions coupled with strong propensities for political leaders to seek gubernatorial vice national careers, and an extremely poor nationalized party system. This form of federalism has seriously constrained reform efforts by the national government. Given the strength of state interests within the national congress, the balance of forces in terms of intergovernmental relations in Brazil is unlikely to change in the near future.

Among the post-communist countries, Russia is evolving into a federal state. Historically, Russia was a 'tribute' state, with a strong impulse toward centralization. Moscow dominates Russia in a way that no other central government dominates its regions, and the party lists guarantee that Muscovites will get elected. The president has too much power, and it will be important to obtain a functioning system of checks and balances in the face of a strong impulse toward centralization. Possibilities of countervailing forces in Russia will include competitive elections, a functioning central state that can distribute revenue, and a functioning court and legal system to define and enforce a process for dealing with conflict. As a form of transition, Russia is developing a federal state structure. Nonetheless, Russia today does not fit well into any existing category of federalism.

Apparently, federalism is a concept in flex, and presents itself in various forms of political arrangement. If the Chinese state is defined in terms of formal institutions, it cannot be considered federal. The country has constitutionally remained a unitary state whereby all local governments are subordinate to the central government. The principle of territorial distribution of power has not been changed since 1949 when the People's Republic was established. According to China's Constitution, all provincial governments are local state administrative organs, they must accept the unified leadership by the State Council, implement administrative measures, regulations and decisions by the State Council, and be responsible and report to the State Council (Pu Xingzu *et al.*, 1995: 223). On the other hand, the State Council can define the specific functions and powers of the local governments, nullify their decisions, impose martial law in the localities, and direct its auditing agencies to conduct inspections of financial discipline.

Similarly, while provincial people's congresses have the right to make local laws, the Standing Committee of the National People's Congress can annul this legislation if it conflicts with national laws. There is also no clear demarcation regarding the scope

and content of the respective legislative authority between the central and provincial congresses.¹

Nevertheless, this should not prevent us from classifying China as *de facto* federalism. Formal institutions alone cannot guarantee the powers of local governments *vis-à-vis* the national governments. Constitutional federalism guarantees the power of local governments such as in Australia, Canada, and the US, where local governments have a considerable amount of legal authority to determine their governmental form as well as legislative power to make and revise their own laws (Nathan and Balmaceda, 1990). In many other countries with constitutional federalism, especially developing countries, local governments do not have such authority. For example, in India and Brazil, constitutions assign extensive powers to the national government, which has the right to veto state legislation and take over the administration of states under emergency conditions. In Brazil, the federal constitution explicitly specifies how the internal political institutions of the states are to be organized. In India, state powers are constrained by the fact that the governors of the states are appointed by the country's president on the recommendation of the Prime Minister (*ibid.*). This is also true in the former Soviet Union. Even though there was a federal political structure, little autonomy was granted to local officials, and the central government retained virtually all authority over major economic and political decisions.

More importantly, a formal institutional perspective can hardly help us understand China's central–local relations properly simply because of the lack of a sound legal infrastructure in the country. In the developed world, laws, regulations, and contracts often mean the end of business. Once made, they are binding and local governments have to follow. But this is hardly the case in China. China has never developed a system of rule of law. For China's local governments, laws, regulations, and contracts often mean the beginning of business. Bargaining in different forms between the center and the provinces is a must in the enforcement of laws, regulations, and contracts. Legal fragmentation is an essential part of China's political system.² Therefore, a better understanding of China's central–local relations can begin with a behavioral perspective. Such an approach will enable us to see how China has developed *de facto* federalism and how this system is actually functioning.

There is the behavioral tradition in understanding federalism. Since the 1960s, scholars have attempted to look at different political systems from a behavioral perspective. Scholars find that local governments even in unitary systems have not only a considerable degree of autonomy on matters of local policy choice and in setting local policy priorities, but they have frequently been able to influence national policy. From a behavioral point of view, they criticized the centralists, who often perceived central–local relations from a formal organizational point of view, for

¹ For a detailed institutional description of local governments, see, Diao Dingtian *et al.* (1989).

² For example, Wang Xu (2001), Zheng Yongnian and Wang Xu (2001), Martin Dimitrov (2004), and Zou Keyuan (2006).

misperceiving central–local relations in a unitary system. Douglas Ashford (1977: 491) argued that the centralist perspective does not discuss the relation of local to central power, but only central to local policy. Theo Toonen (1983: 247) also pointed out, ‘Among the community of policy or implementation analysts, there seems to be some kind of implicit and broadly accepted assumption that in unitary systems . . . policy and implementation processes are comparatively less problematic – and therefore perhaps can be considered less intriguing – than in federal systems.’

Scholars in the behavioral school also found that the *de facto* power of local government officials is often much greater than their constitutional authority. Local officials can always defend their local interests in the face of the central power through the use of various local resources such as: social identities, a shared-local-political culture, distinct economic activities and interests, the statutory powers of local authorities, and the interests of local political party organizations (Schulz, 1979: 18). Studies of local power in Europe, Latin America, Africa, and Japan have all suggested the persistence of local power and local initiative in rather centralized political systems.³

Even in the former communist countries, essential local autonomy also existed. Daniel Nelson (1980: i) argued that ‘the processes of making and implementing public policies in communist systems . . . cannot be understood unless we observe the roles in these processes which are performed by local party and state organs that constitute day-to-day government for the citizenry’. Jan F. Triska (1980: 2) also found that local governments in communist countries were not mere local extensions of superior governments. They should not be perceived as simply convenient arrangements for national governance, mere local tools of national administration.

Scholars of the behavioral school argued that even though constitutionally well defined, federalism is so broad and inchoate as a governmental arrangement that it defies close specification.⁴ M. D. Reagan and J. G. Sanzone (1981) even argued that federalism as an operational concept is almost bankrupt. Diverse approaches to federalism have led to great differences in judging which country belongs to the club of modern federalism. So when K. C. Wheare (1964) published his study on comparative federalism in 1946, he believed that the club consisted of only four or five countries. Nevertheless,

³ In Europe, see, Torrow (1977), Gourevitch (1980), Milch (1974), Ashford (1980), and Dearlove (1973). In Latin America, see, Rabinoviz and Trueblood (1973). In Africa, see, Cohen (1973). In Japan, see, Samuels (1983) and Jain (1989).

⁴ In his study of American federalism, Richard H. Leach (1970: 9–10) concluded, ‘Precisely what ‘federalism’ means is not now and never has been clear. We can only be sure that the framers of the Constitution regarded it as one of several ways to limit the power of government in the United States. Thus any attempt to argue for a particular relation between the national government and the states – in particular for a precise division of powers between them – must fall flat for lack of constitutional corroboration. Nor are clear directions given with regard to other aspects of federalism. Instead of a rigid set of principles, what the framers gave us was a flexible instrument concerned with functions and the practice of government. Federalism is thus something which is able to respond to changing needs and circumstances and is not bound by the tenets of a particular political theory.’

Daniel Elazar (1987) argued in his book that as high a proportion as 70% of the people in the world live in countries with federal state structures and federal arrangements in some ways.

However, all the above controversies have not prevented scholars from defining federalism in specific contexts. I argue here that federalism can be regarded as an instrument to resolve conflicts between governments at different levels through various measures such as interest representation and decentralization. All political systems have to confront the problem of interest representation; that is, the manner in which local interests can best be expressed and how the central government responds to them. Political systems also confront the problem of policy implementation. If the central government wants to impose its own will on society, it must have policy implementors. Whether policy implementors are bureaucracies or governments, the central government needs a mechanism of interest representation internal to itself because organizations, bureaucracies, or local governments have their own interests, which may not necessarily be synonymous with central interests. Obviously, most political systems depend upon intermediary levels of government organizations or political bodies to provide contact between citizens and the central government. How these government organizations or political bodies should be organized is another important question.

Federalism is one means for resolving interest conflicts between governments at different levels. But a key question, which involves the structure of the federal system and the division of power and authority among different levels of government, is whether we define federalism as a system of multiple centers of power in which the central and local governments have broad authority to enact policies of their own choice, or whether we define federalism as a system of decentralization in which the central and local governments essentially implement uniform national policies (Kenyon and Kincaid, 1992: 4). If we take the first interpretation, then federalism could be the outcome of bargaining or a negotiated working agreement between political actors with conflicting goals, as William Riker (1964) understood it. As a matter of fact, federalism has been widely regarded as a means for resolving conflict in a fragmented society and for reducing the burden of the central government.

Moreover, there is a dynamic aspect involved in organizations. A behavioral approach is to look at China's central–local relations in a dynamic way. It helps us understand how changes in local socio-economic environments will generate changes over the relations of the provinces to the center. China's political system is not a *status quo*. Various factors such as economic development, changes in the power distribution of different levels of government and changing expectations of different actors within the system ultimately lead to changes in the way the political system is organized. In this sense, the role of local governments in economic development must be taken into account in understanding changes in China's central–local relations.

Following the behavioral tradition, I define China's central–local relations as *de facto* or behavioral federalism. One caveat must be added here first. The term 'Federal China' is gaining popularity among Chinese dissident scholars (for example, Yan, 1992;

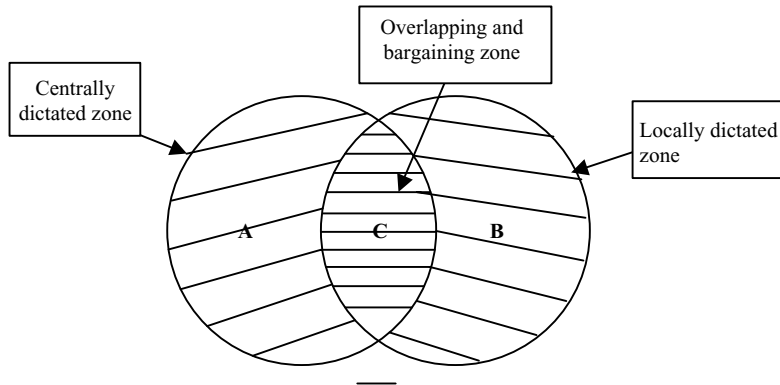


Figure 1. The division of powers between the center and the provinces

Wu, 2003, 2004). These scholars suggest that China should adopt federalism to solve the issues of national integration such as those related to Taiwan, Hong Kong, Tibet, and Xinjiang. This paper does not deal with these issues. Instead, it investigates how China actually has developed *de facto* federalism within China proper. In other words, it only looks at the issue in terms of power distribution between the center and the provinces. Other factors such as ethnicity, Hong Kong identity, and Taiwan nationalism are important in moving China towards federalism, but these factors are beyond the scope of this study.

In a behavioral sense, China's *de facto* federalism can be defined as follows:

A relatively institutionalized pattern which involves an explicit or implicit bargain between the center and the provinces, one element in the bargain being that the provinces receive certain institutionalized or *ad hoc* benefits in return for guarantees by provincial officials that they will behave in certain ways on behalf of the center.

More concretely, China's central–local relationship can be defined as *de facto* federalism because it satisfies the following conditions:

- 1 A hierarchical political system in which the activities of government are divided between the provinces and the center in such a way that each kind of government has some activities on which it makes final decisions.
- 2 Intergovernmental decentralization is institutionalized to such a degree that it is increasingly becoming difficult, if not impossible, for the national government to unilaterally impose its discretion on the provinces and alter the distribution of authority between governments.
- 3 The provinces have primary responsibility over the economy and, to some extent, politics within their jurisdictions.

Figure 1 illustrates China's *de facto* federalism. China's Constitution does not describe such a division of power between the center and the provinces, but at a

practical and behavioral level, power is divided between the two actors. Some powers such as foreign policy, national defense, and birth planning belong exclusively to the central government, and it is very difficult for local governments to have a say on these matters. Some other matters are exclusively dictated by local governments such as local public security, road construction, and school building. Most economic matters are exclusively handled by local governments. For example, foreign direct investment (FDI) and out-flowing investment below a certain limit is decided by local governments. Other powers are shared by the center and the provinces. There are policies which are made by the center but implemented by local governments. The central government also has to consult local governments in the formulation of certain policies. Actually, there is no essential difference between China's *de facto* federalism and other forms of federalism in the world in terms of policy formation and implementation, except that China is not democratic.

Dynamics of *de facto* federalism (I): intergovernmental decentralization

In the era of reform and openness, China's *de facto* federalism has been driven by intergovernmental decentralization in the 1980s and globalization since the early 1990s. Under such a scenario, it is important to understand the changing role of local governments in local economies and the dynamics of their relations to the center. Not much has been done to discuss the impact of intergovernmental decentralization and globalization and their impacts on central–local relations. In the following sections, I will discuss how intergovernmental decentralization in the 1980s led to the rise of *de facto* federalism, and how globalization since the early 1990s has facilitated this process while generating many factors which enable China to institutionalize this *de facto* federalism.

The term 'decentralization' has been used widely by the reformist leaders in communist and post-communist countries to resolve economic and political problems resulting from over-centralization in the past. Nevertheless, different ways of decentralization engender different consequences. I summarize four major types of decentralization in Table 1. This typology is not intended to simplify the complicated processes of reforms in China. I use it here to show the linkages between intergovernmental decentralization and *de facto* federalism.

In the discussions on reforms in China and other former communist countries, much emphasis has been placed on decentralization between the state and society in the literature of comparative politics, i.e. economic decentralization in terms of state–enterprise relations and political decentralization in terms of state–society relations. As one author (Hasegawa, 1992: 62) summarizes it, 'transition from the communist system . . . involves two interrelated and interdependent processes: transition from a command economy to a market economy and transition from Communist Party dictatorship to democracy'.

Table 1. *Forms of decentralization and their consequences*

Decentralization	State–society (enterprise)	Intergovernmental
<i>Economic</i>	<i>State–enterprises</i> <i>Consequences:</i> <ul style="list-style-type: none"> ● Private property rights ● Privatization ● Marketization ● Competition among individual enterprises ● No government intervention, etc 	<i>Central–Local</i> <i>Consequences:</i> <ul style="list-style-type: none"> ● Local or regional property rights ● Jurisdictional competition ● Marketization ● Local intervention ● Local protectionism, etc
<i>Political</i>	<i>State–society</i> <i>Consequences:</i> <ul style="list-style-type: none"> ● Democratization ● Individual rights ● Political participation ● Civil society, etc. 	<i>Central–local</i> <i>Consequences:</i> <ul style="list-style-type: none"> ● “Areal democracy” ● Federalism ● Limited individual rights, etc.

Economists appreciate the economic decentralization from the state to individual enterprises because there is an important value that is enhanced by decentralization, i.e. economic efficiency. Efficiency is defined as the maximization of economic profits. In order for profits to be maximized, individual preferences have to be expressed accurately. Within a private economy, individual preferences are expressed through market mechanisms.⁵ Economic decision making should reflect as accurately as possible the aggregated preferences of consumers. Because individual preferences for economic goods differ, there will be divergence between individual preferences and the economic policies adopted by the government. Consequently, the greater the centralization of economic decision-making authority at the level of national government, the greater will be the average divergence of the individual preferences for the economic policies adopted by government. By contrast, if economic decision-making authority is decentralized to local units, each unit can adapt its economic policies to the preferences of its local residents. The greater the number of economic units to which economic decision-making authority is decentralized, the lower will be the average divergence of individual preference for economic policies. Economic efficiency is thus likely to be maximized under highly decentralized economic structures.

Economists thus emphasize decentralizing economic decision-making authority from state organizations to individual enterprises. By doing so, economic efficiency can be maximized by competition among individual enterprises. The corollary is that economic reforms in communist countries should aim at marketization and privatization. To reform their economies, the reformist leadership has to introduce

⁵ This discussion is based on Bennet (1990).

drastic changes in property relations. A legally recognized private sector has to be established. Individual enterprises have to be given a large sphere of decision-making authority with regard to production, sales, price setting, wages, etc. Although decentralizing decision-making power to local government is necessary at early stages of reforms, economic reforms are incomplete until individual enterprises gain full authority. Decentralization only transforms a planned economy to a mixed market economy. The ultimate goal of economic reforms is a laissez-faire economy where the state does not intervene in the economy.

Similarly, the literature on political transition in communist countries has focused on the decentralization from the state to society. Political transition means democratization and the decentralization of power from the state to society. The logic of political reforms follows. The communist state has to 'modify the decision-making mechanism by including a broader portion of the society in the political process, and it must modify the ideology to accommodate new economic measures. This leads to redefining and extending rights and tolerating spaces for free expression and collective action for individuals and groups in society' (Hasegawa, 1992: 63–4).

Furthermore, political transition can be divided into two major stages. Liberalization is the first stage of political transition, and democratization, the next. Liberalization refers to the process of making effective certain rights that protect both individuals and social groups from arbitrary or illegal acts committed by the state, while democratization refers to the processes whereby the rules and procedures of citizenship are applied to political institutions previously governed by other principles, expanded to include persons not previously enjoying such rights and obligations, or extended to cover issues and institutions not previously subject to citizen participation. Further, democratization is ultimately signaled by elections (for example, Di Palma, 1990; O'Donnell and Schmitter, 1986).

The importance of intergovernmental decentralization in China has not been fully appreciated. In effect, intergovernmental decentralization was significant not only for local–central relations but also for state–society (enterprises) relations. With intergovernmental economic decentralization, the center decentralized economic decision-making authority to local governments. Even though the reformist leadership aimed to give individual enterprises more authority over economic decision making, the previous economic structure made it virtually impossible for governments at different levels to withdraw completely from individual enterprises for a long period of time. It was also difficult for individual enterprises to make economic decisions according to markets because there were no such markets. At early stages of reforms, individual enterprises still relied heavily on the state for protection. Consequently, instead of privatization, with intergovernmental economic decentralization, property rights were decentralized to local governments rather than to individual enterprises or individual entrepreneurs. Local governments became *de facto* owners of state enterprises.

Thus, even though the center gradually withdrew from economic affairs of individual enterprises, local governments became highly interventionist. Intergovernmental

decentralization actually created an institutional setting and legitimacy for local governments to intervene in economic activities under their jurisdictions. Nonetheless, intergovernmental decentralization does not mean that marketization becomes unlikely. Instead, marketization was highly encouraged. This was not only because the reformist leadership was market oriented. More important, it was because intense competition existed between different jurisdictions and between enterprises with different forms of ownership. Local protectionism existed at early stages of economic reforms, but with the deepening of decentralization, it was constrained.

With intergovernmental political decentralization, even though the political space for free expression and collective action for individuals and social groups were extended and the communist regime turned to consultative authoritarianism, political participation was very limited. The focus of intergovernmental political decentralization was power shifts not between the state and society, but between the center and the provinces. The reformist leadership did not want to decentralize political power to society. Instead, it believed that political participation should be constrained and mass mobilization could not help the transition to an efficient government.

But with the deepening of economic reforms, great changes occurred in the power bases of local governments. Central–local relations became highly interdependent. While previously the center still held great power over local governments, cooperation from the provinces now became essential in governing the country. Furthermore, the decentralization of power was increasingly not merely at the discretion of the central government; indeed, it became irreversible. As a result, while the provinces developed and strengthened their own power basis, the center also adjusted its relations with the provinces. The center recognized *de facto* independent power of the provinces on the one hand, and made efforts to develop its own independent power to constrain local behavior on the other hand. Mutual adjustment in the relations between the center and the provinces resulted in changes in the state structure. Areal democracy⁶ took place and the provinces began to have an important say in decision making at the national level. The provinces had not only the authority to deal with local affairs but also to influence decision making at the national level. Democracy in terms of state–society relations may emerge, but vary in different regions. Political participation was very limited and depended on local factors such as the levels of economic development, local political cultures, the attitude of the local leadership toward democracy, and the measures of political reforms introduced locally.⁷

Intergovernmental political decentralization was significant for economic reforms, since economic decentralization did not in itself generate a momentum toward

⁶ For a discussion of the concept ‘areal democracy’, see articles in Maass (1959).

⁷ A good example is the development of the grass-roots election system in the countryside. For discussions of the uneven progress of the system, see, Shi (1999), and Thurston (1998).

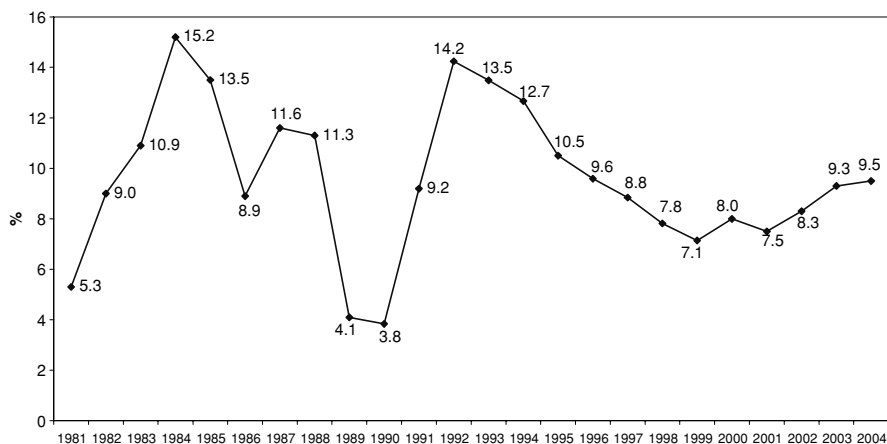


Figure 2. China's Economic Growth, 1981–2004

Sources: China Statistics Yearbook 2004; Website of National Bureau of Statistics of China, February 2005, <http://www.stats.gov.cn>.

marketization and had to be implemented by an authoritarian regime, as one scholar (Hasegawa, 1992: 69) has already pointed out:

It seems almost impossible for pockets of privatized economic entities or decentralized economic decisions to develop spontaneously into a market economy. The roots of a command economy are so resilient that they are bound to stifle such incipient, fragile development from below. Thus, strong leadership from above is necessary for decentralization to lead to marketization. And yet strong leadership, buttressed by strong machinery to implement its decision, can be created only by the Communist Party apparatus, which is the greatest impediment to political transition.

Intergovernmental political decentralization alleviated this contradiction between economic and political reforms. Decentralizing political decision-making power to the provinces strengthened local power in initiating economic reforms and creating a counter-power to central bureaucracies which often served as a major impediment to economic reforms in communist countries. Moreover, political decentralization itself was an important aspect of democratic changes in China. Powerful provinces exerted a serious constraint on the power of the center and protected local societies from central arbitrary power even though local governments were often reluctant to share political power with society.

De facto federalism as an unexpected consequence

Decentralization in the 1980s was very successful in economic terms. It provided local governments with greater economic incentives to promote economic growth and improve people's living standards. Figure 2 shows rapid economic growth between 1981 and 1988 (before the 1989 pro-democracy movement).

Nevertheless, excessive decentralization had its costs. Power shifted from the national government to local governments at different levels. Even though rapid decentralization did not lead to the breakup of the country as the Soviet Union did, with no effective institutional constraints, localism or regionalism often became uncontrollable and posed a serious challenge to central power.

One sign of the crisis of central power was the decline of the fiscal and financial power of the central state. After the reform began in 1978, central revenue declined continuously until the 1994 taxation reform. Initially, the national government decentralized fiscal power to local governments in order to motivate local economic initiatives. Central officials, however, found that once power was decentralized, it became rather difficult to collect fiscal revenue from the provinces, especially from the booming coastal areas. For example, the percentage share of the central government in total expenditure shrank from 51 in 1979 to 28 in 1993 (Figure 3). The provinces even began to resist new fiscal policies initiated by the central government. When the national government asked rich provinces to pay more taxes, resistance from them was very strong due to their wealth generated by decentralization.

Further, economic decentralization widened diversities among the provinces and regions. In coastal areas such as Guangdong, Zhejiang, Jiangsu, and Shandong, local officials developed very strong non-state sectors including collectives, private economies, and joint ventures, each of which became very profitable and was beyond the control of the national government. In inland provinces, owing to the lack of financial resources and skilled personnel, local governments had difficulty pushing local growth, let alone adjusting the local industrial structure. Consequently, some provincial governments achieved a high capacity to lead local development and improve local residents' living standards, while others did not. Due to local diversity, the national government often failed to implement unified policies to lead and constrain local governments, and local officials could easily nullify central policies. The national government was thus unable to bring local governments in line with the national interest.

Indeed, uneven development among regions became a major issue on China's political agenda. Local officials in poor areas called for recentralization and asked the national government to pay more attention to their areas. Obviously, local officials felt great pressure from local residents arising from increasing diversities among regions. According to a survey among government officials at the provincial and prefectural levels in 1994, 84% of government officials believed that great regional income disparities would cause social instability, and 16% contended that they would lead to national disintegration, especially in minority areas. The same survey also showed that nearly 64% of local government officials believed that reducing regional disparities should be the most important political agenda for the national government (Hu Angang, 1994: 88–90).

The decline of central power and authority gave rise to local protectionism and the national government was no longer able to coordinate local economic activities

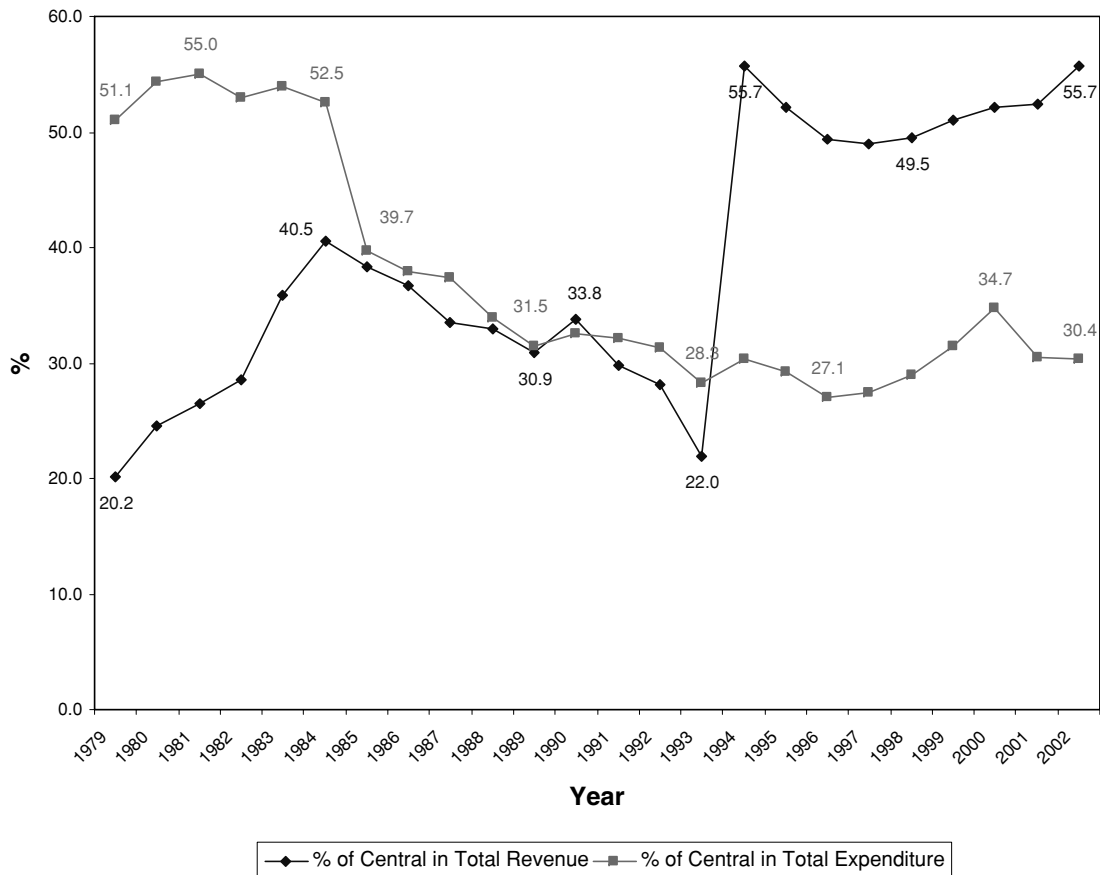


Figure 3. % of Central Government in Total Revenue and Expenditure
Sources: The Ministry of Finance, *Finance Yearbook of China*, various issues.

effectively. Rich provinces were reluctant to cooperate with one another when they could design local development independently. Even below the provincial level, coordination was also very poor: one study (Taylor, 1990) suggested the fragmentation and lack of coordination in the well-developed Pearl River Delta region of Guangdong province; another study by Chinese scholars (Ding Jinhong and Luo Zude, 1993) indicated very poor coordination among the three richest areas within the Jiangsu province, i.e. Suzhou, Wuxi, and Changzhou.

Poor and rich provinces were also reluctant to cooperate. Besides the presence of a similar industrial structure, the psychology of the local officials in poor provinces was important. For instance, local officials in Anhui province did not cooperate with neighboring Shanghai because they believed that they had been victimized by Shanghai, and they regarded it as a colonial center. Hunan was unwilling to cooperate with Guangdong because of a similar psychology of being victimized, and its leaders once blocked grain shipments to Guangdong. Local governments competed with one another for local development and used all possible administrative methods to protect local industries (Wedeman, 2003).

Economic decentralization also resulted in a relatively greater increase in interdependence between the Chinese provinces and the outside world, and a surprising decrease in inter-provincial interdependence. According to the World Bank, as of the early 1990s, internal trade as a percentage of gross domestic product among Chinese provinces was 22%, which was lower than the then European Community's 28% and the 27% among the republics of the former Soviet Union before the union was dissolved. The World Bank thus warned that individual provinces had the tendency to behave like independent countries, with an increase in external (overseas) trade and a relative decline in trade flows with each other (Kumar, 1994).

Summarily, rapid decentralization in the 1980s led to the provinces' relative independence from the central government on the one hand, and being independent from each other on the other hand. As two well-known Chinese economists Shen Liren and Dai Yuanchen (1990: 12) argued in the early 1990s, rapid local economic development was associated with the rise of various dukedoms:

Economic circles describe the result of economic decentralization during the economic reform as a new economic phenomenon – an 'economy of dukedom'. That means, thirty provinces, autonomous regions and municipalities (Beijing, Tianjin and Shanghai) are big dukes, three hundred prefectures and cities are medium dukes, and two thousand counties are small dukes. These dukes have their own domains and political regimes, and seek to develop independently.

Dynamics of *de facto* federalism (II): globalization

The progress toward *de facto* federalism almost came to a halt in the aftermath of the crackdown of the pro-democracy movement in 1989. The conservative leadership tried to re-centralize economic and political powers via various forms of coercive means.

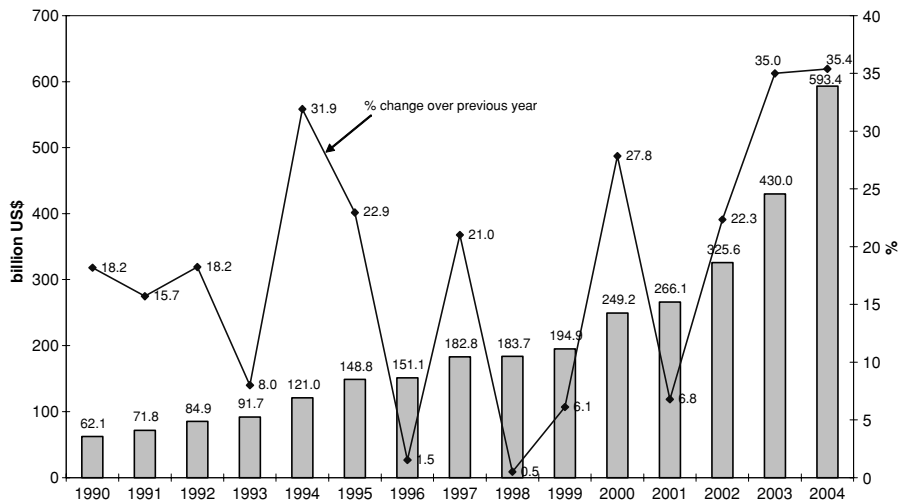


Figure 4. China's exports, 1990–2004

Sources: China Statistics Yearbook 2004, China Statistics Press; Website of Ministry of Commerce of China, <http://www.mofcom.gov.cn>, February 2005.

Nevertheless, recentralization came at a high cost. Economic development slowed down (Figure 2), and enormous socio-economic problems surfaced.

To save the Chinese communist regime, Deng Xiaoping called for even more radical decentralization during his southern China tour in early 1992. A new wave of decentralization closely associated with 'openness' – globalization – followed. Reform and 'openness' has generated rapid economic growth since then (Figure 2). The most convincing economic effect of openness has been the explosive growth of China's exports (Figure 4). Another indicator is foreign direct investment (FDI) that flowed into China after 1992 (Figure 5). China has become the most favored destination among all developing countries for FDI.

Rapid globalization has facilitated the transformation of China's *de facto* federalism. China scholars have debated whether various measures of recentralization in the 1990s have enabled the center to reverse decentralization and thus constrained *de facto* federalism. I would argue that, while economic decentralization in the 1980s led to the formation of *de facto* federalism, globalization since the 1990s has accelerated this process and generated increasingly high pressure on the Chinese leadership to institutionalize existing *de facto* federalism.

Like elsewhere, globalization has weakened the power of the national government over localities in many areas, while creating an opportunity for state transformation. Globalization has affected China's central–local relations with the creation of two opposite forces, i.e. decentralization and centralization. On the one hand, globalization has decentralized economic activities further to local governments and other local organizations, making it increasingly difficult for the center to access local economic

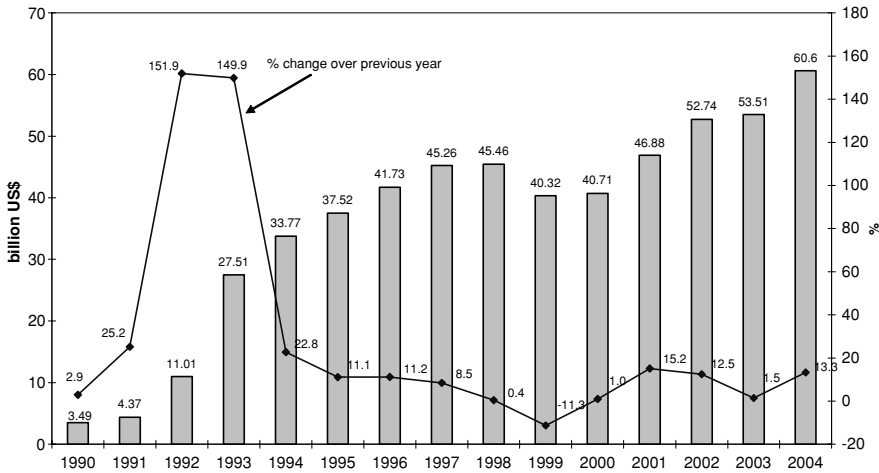


Figure 5. China's FDI Inflows, 1990–2004

Sources: *China Statistics Yearbook 2003*, China Statistics Press; *Foreign Investment Statistics*, Ministry of Commerce of China, February 2005, <http://www.mofcom.gov.cn>.

resources. On the other hand, globalization requires the center to regulate the national economy in order to accommodate external economic forces resulting from globalization. Centralization is thus a prerequisite for the national government to establish a national regulatory system. For China, the two opposite forces have created great political tension between the national government and local governments. In responding to globalization and its consequences, the Chinese leadership has implemented a strategy of what I called 'selective re-centralization' since the mid 1990s to reconcile the imperatives of decentralization and re-centralization. With selective re-centralization measures, *de facto* federalism is gradually being institutionalized.

Selective economic centralization

Selective centralization has concentrated on two major reform initiatives, i.e. taxation reform and central banking system reform, among others. In 1994, the central government began to implement a new taxation system, i.e. the tax-division system or a federal style taxation system. Before this system, the center did not have its own institutions to collect taxes. All taxes from the provinces were collected by provincial governments first and then were divided between the center and the provinces through bargaining between the center and individual provinces. Provincial governments were regarded only as a part or an extension of central power, rather than institutions with their own power base. The new taxation system changed the institutional base of the old system and thus the interaction between the center and the provinces.

First of all, under the new taxation system, taxes are divided into three categories, namely, central, local, and shared. Central taxes would go to the central coffer, local

taxes would go to local budgets, and shared taxes were to be divided between the center and the provinces according to separately negotiated agreements.

Second, tax administration is centralized. Instead of authorizing local tax offices to collect virtually all taxes, the center now collects taxes by its own institutions independent of the provinces, meaning that the center has established its own revenue collection agency—the national tax service. Nevertheless, the new system also recognizes independent provincial power, i.e. provincial authorities can collect several types of taxes without central interference. In other words, there are now two parallel and independent systems for tax administration, i.e. a national system for central taxes and a local one for local taxes. Shared taxes were collected by the central government first, and then divided between the center and the provinces.

Similar efforts have been made to reform China's central banking system. In terms of central–local relations, China's central banking system was highly decentralized before the 1998 reform. The central bank, People's Bank, established branches in every province and assumed that all provincial branches would take orders from the center, since they theoretically were a part or extension of the central bank. But, in reality, local branches were often exposed to the political influence from local government, since the personnel of local branches were arranged and their welfare was provided by local governments. This frequently led to local branches ignoring orders from the central bank and subordinating themselves to local influences. Indeed, local branches of the central bank often became an effective instrument for local governments to promote local economic growth. But rapid local growth was achieved at the expense of the stability of the national economy.⁸

As of the end of the 1980s, the central government introduced some changes into the central banking system and decided that all directors of local branches should be appointed by the central bank rather than by provincial governments. In doing so, the central government expected that all local branches would act in accordance with central directive and be independent from local political influence. However, the reform did not lead to the expected results. Local branches developed their own independent institutional interests, and preferred to use their resources to develop local economies since they could benefit greatly from local growth. This eventually led to the crisis of macro-economic management in the mid 1990s. After Zhu Rongji became China's new premier and a new government was established in March 1998, the central government declared a bold measure to reform China's financial system: All provincial branches of the central bank were eliminated and nine cross-provincial or regional branches established over a short period of time (Bian Ji, 1998).⁹ The reform attempted to

⁸ For discussions of the central banking system reform, see, Bowles and White (1993) and Chen Yuan (1994).

⁹ The locations of the headquarters of the nine regional branches established include: Shanghai (Shanghai, Zhejiang, and Fujian); Tianjin (Tianjin, Hebei, Shanxi, and Inner Mongolia); Shenyang (Liaoning, Jilin, and Helongjiang); Nanjing (Jiangsu and Anhui); Ji'nan (Shandong and Henan); Wuhan (Jiangxi,

model the US system of federal–state relations, aiming at getting rid of the institutional instruments of provincial governments to intervene in the central banking system.¹⁰

Strengthening the nomenklatura system

Compared to the economic side, no radical innovation has been made to institutionalize central–local political relations. Radical decentralization led to the rise of economic localism, and the provinces attempted to use their growing power to have some say in policy making at the national level. Interest representation occurred in terms of recruiting local political leaders into the central leadership. Since the early 1990s, the majority of the Central Committee members have come from the provinces, and especially from rich coastal provinces such as Guangdong, Zhejiang, Jiangsu, Shanghai, and Shandong. A more important change is that local power holders have begun to compete for national power. In the 1980s, local power holders were behind localism. Today, localism continues, but local strongmen now play an important role in the formation of the national leadership. For example, in the 16th Party Congress in 2002, the Standing Committee of the Political Bureau, China’s most powerful decision-making body, was expanded from seven to nine members. Besides factional politics, a major factor behind the expansion was that a compromise could not be reached between local strongmen and the party leaders, and, consequently, the former were all given membership.

In terms of political control, so far, the efforts of the central government have been on re-strengthening the old nomenklatura system. The central government has strengthened the cadre management (*ganbu guanli*) system. ‘Party management of cadres’ (*dang guan ganbu*) has been one of the most important organizational principles, and indeed this principle gives the central government a dominant say over personnel decisions (Burns, 1989). In 1995, the central government issued a document entitled ‘Temporary Regulations on Selection and Appointment of Party and Government Leading Cadres’. The 1995 regulations reemphasized the cadre transfer system or the cadre exchange system (*ganbu jiaoliu zhidu*), which enabled the center to tighten its control over local cadres (*People’s Daily*, 17 May 1995: 1).

A key focus of the 1995 regulations is on the transfer of leading members of Party committees and governments. According to regulations, a leading member of a local Party committee or government should be transferred, if he/she has worked in the same position for ten years. The Constitution of the Chinese Communist Party regulates that positions in Party committees at the county level and above have a term of five years. Therefore, a provincial level cadre, by the end of his second term, if he has not reached the retirement age, has to be transferred. Transfers may also result from the nature of his work, the need to broaden work experience and improve leadership, the requirement

Hubei, and Hunan); Chengdu (Sichuan, Guizhou, Yunnan, and Tibet); Xi’an (Shanxi, Gansu, Qinghai, Ningxia, and Xinjiang); and Guangzhou (Guangdong, Guangxi, and Hainan).

¹⁰ Interviews in the Development Research Center, the State Council, 6 May 1998; and Bian Ji (1998).

of the rule of avoidance, and other reasons. Whatever it is, the system of cadre transfer is an effective instrument for the center to constrain the rise of localism.

The cadre transfer system has been an effective means for the central government to control provincial leaders and solicit their compliance. The transfer of local cadres has occurred in various ways. Among others, inter-provincial transfer, province–center transfer and center–province transfer are the most common. Nevertheless, all these forms of transfer often encounter great difficulty.

The inter-provincial transfer is in effect a form of traditional control system, i.e. the system of avoidance, meaning that provincial leaders cannot serve their native provinces. This form of transfer system is contradictory to the central leaders' expectations of provincial officials. One major strength of the nomenklatura is that it enables the central government to recruit the 'right' type of cadres into the leading bodies. Since the reform began in the late 1970s, the CCP's priority has been modernization and economic growth. Actually, the decentralization of nomenklatura system was to give provincial leaders more political autonomy to promote local growth. To promote local development, provincial leaders have to collect adequate local information in order to make and implement policies suitable for local conditions. But the transfer system constrains, even undermines, provincial leaders' capability to access local information. When he/she begins to become familiar with local situations, he/she has to be transferred to another province. Frequent transfer of provincial leaders often makes it difficult for them to make and implement consistent policies.

The transfer from the center to provinces is intended to enable the central government to exercise direct control over the provinces. Nevertheless, the utility of this type of transfer is also limited. When a central official is sent to hold a top position in the provincial leadership, he/she encounters a difficult choice: either to behave on behalf of the central government or to promote local interests. The first choice will make it difficult for him/her to solicit cooperation from local officials, and thus will restrict him/her from achieving what the central government expects, i.e. to promote local development. The second choice will certainly nullify the aim of central appointment *per se*.¹¹

The transfer from provinces to the center is multifunctional. In some cases, the transfer is a promotion, but, in other cases, transfers to the center mean only that they are deprived of the political power they used to enjoy in their home provinces.¹² The transfer as a means of promotion has been used by top leaders to rejuvenate the central leadership, as in the case of Zhao Ziyang and Wan Li, who were promoted to the central leadership in the early 1980s because of their reform initiatives in their home provinces. Since the transfer also serves as a form of depriving power, provincial leaders tend not to be 'promoted', as in the case of Ye Xuanping, governor of Guangdong province, who

¹¹ For a discussion of this point, see Zheng (1998a).

¹² For a discussion of this point, see Zheng (1998b).

turned down attractive job offers in Beijing to stay in Guangdong in the late 1980s and early 1990s (Shirk, 1993: 189).

More importantly, the transfer system is incompatible with democracy, and thus has been undermined by newly developed democratic factors in China. The strengthening of People's Congress tends to weaken the cadre transfer system. Provincial congress persons prefer to vote for native cadres rather than outsiders. Furthermore, with the improvement of the provincial electoral system, provincial leaders are increasingly local interest oriented. Regardless of whether they are natives or outsiders, they all have to pay attention to local interests. Otherwise, it will be difficult for them to mobilize and harness local support. Therefore, while leaders come and go, local interests remain. Certainly, how central control and local interests should be reconciled is still an important political issue facing the Chinese leadership.

From *de facto* to *de jure* Federalism? Political Solution

The *de facto* federalism that exists in China today has not yet been formalized. This is because the leadership is not entirely convinced of the merits of moving beyond *de facto* federalism to *de jure* federalism. To be sure, the Chinese seemed to have realized the values of federalism as early as the late nineteenth century.¹³ What could China do in terms of central–local relations after the collapse of imperial hegemony? This was an important question that many revolutionary leaders including Sun Yat-sen and Liang Qichao considered. By the early years of the twentieth century, federal ideas were so pervasive that they played an important role in the constitutional reforms promulgated by the Qing between 1906 and 1911. The self-government movement reflected many leaders' belief that national strength would be based on local self-government (Fincher, 1981; Waldron, 1990). The 1911 revolution did not lead to the realization of the revolutionary leaders' federal ideal. In fact, the breakdown of the Qing dynasty led China to chaos, i.e. warlordism. During the period of warlordism, federalism was often used as a means for local officials to gain political power (Chesneaux, 1969; Schoppa, 1976 and 1977).

The Chinese Communist Party employed the appeal of federalism and democracy in its struggle for state power. At the CCP's second national congress, the Party declared its intent to establish a federal republic of China, and to unify the main provinces with Mongolia, Tibet, and Hui-Uighur regions on the basis of liberal federalism. The Party also recognized the right of minorities to complete self-determination (Yan Jiaqi, 1992). But the CCP did not bring a federal system to China. Instead, after the CCP took over political power, China became a centralized unitary country with the assignment of great autonomy only to minority areas.

People are not ruled by abstract principles. Soon after the establishment of the PRC, Chinese leaders including Mao realized that a high degree of centralization carried its

¹³ For a brief survey of the origins and development of federal thought in China, see, Yan Jiaqi (1992).

own series of problems. Two major decentralization movements were initiated during the Great Leap Forward and the Cultural Revolution. In effect, even under Mao's regime, which was often regarded as a totalitarian rule, localities enjoyed autonomy to some degree.

Central to Deng's reform was inter-governmental decentralization under which China developed a *de facto* federal system. As discussed earlier, great efforts have been made to reconstitute the economic relationship between the center and the provinces, following federal system elsewhere. Great demands for institutionalizing *de facto* political federalism also existed. Since, in practice, federalism is often not a free choice, but a function of the political power of territorial leadership when open coercion is excluded as a possible option, the central government's dependence on localities has produced new seeds for political federalism. Indeed, after the mid 1980s, federalism became a popular topic within the reform leadership and its think-tanks. In 1986, as initiated by Zhao Ziyang, the central leadership established the Group for Research on Political Institution Reforms. Seven subgroups were organized, with one assigned to focus on decentralization and institutional reforms. A major research theme of this subgroup was whether China could use federalism such as that in the United States and elsewhere to reform the existing power relations between the central and local governments (Chen Yizi, 1990).

Intergovernmental decentralization has had great political significance for central–local relations. The rise of provincial economic power has created the great possibility of the formation of a system of checks and balances in terms of local–central relations, which is pushing China to political federalism. As Chen Yizi (1990: 205), former director of the Institute of Economic System Reform, argued:

With the rise of local force, powerful localities will stand in front of the central government. A strong local economic power will create great local demands for political power. Thus, the central government's power will be constrained. . . . If the central government wants to control localities effectively, it must satisfy localities' basic political and economic demands. The existing local–central system has to be changed.

Since the early 1990s, Chinese scholars have called for the formalization of *de facto* federalism. While many have argued that only by institutionalizing *de facto* federalism can local autonomy be protected from arbitrary interference into local affairs by the central government and thus sustain the country's rapid development, many others believe that federalism indeed can strengthen central power, rather than weaken it.¹⁴ Even for the proponents of centralization, federalism seems inevitable. For example, Wang Shaoguang and Hu Angang, two Chinese scholars who have been known for their calls for recentralization, argued that power has been too decentralized and

¹⁴ For the debates between the two views, see, 'A Symposium on Formalizing the Division of Power and Institutional Transition', *Dangdai Zhongguo yanjiu* (Modern China Studies), special issues, nos. 1–2, 1995.

the central government has to recentralize its power in order to maintain national unity. Nevertheless, they do not believe that the country should go back to the old style of central control, and called for political innovations to reconstruct central–local relations.¹⁵ This view has gained popularity not only among Chinese scholars, but also among Chinese local officials. Local officials have made strong demands for institutionalizing central–local relations. Take financial power as an example. Local officials regarded it as necessary for the central government to control national finances, but they demanded their participation in decision making at the national level since they were afraid that the central government would abuse its great power. According to a survey conducted by Hu Angang in 1998, 55% of local officials argued that the power division between the center and the provinces should be institutionalized, and about 46% argued that the Financial and Economic Committee in the National People’s Congress should consist of central and provincial representatives, and a system of ‘one province, one vote’ should be implemented (Hu Angang, 1999).

Then, why is the central government reluctant to rebuild the political relationship between the center and the provinces according to federal principles? As mentioned above, it has been argued that federalism is the only best way to institutionalize central–local relations (Yan Jiaqi, 1992; Jin Ji, 1992). Nevertheless, without great political initiatives, central–local relations will remain *de facto* federalism rather than federalism. To legitimate federalism is not an easy task in China.

Ideologically, federalism is a concept contradictory to the ideology of the CCP. The history of warlordism early in this century links chaos and federalism together (Fitzgerald, 1994; Waldron, 1990). For many, federalism will result in a divided China, or a divided China will fall prey to federalism. Given the fact that federalism has been discussed in the context of Hong Kong, Taiwan, Tibet, Xinjiang, and other territorial issues, the ideological legitimacy of federalism becomes more complicated. Although these territorial factors have pulled China toward federalism, the ideological barrier is not easy to overcome. Indeed, for many within the CCP, federalism has been seen as an ideology to divide China as a sovereign state. We have seen in the West that federalism has been a strong ideological foundation for federal political system, as liberalism supports democracy. As long as federalism cannot be legitimized ideologically, a transition from *de facto* to *de jure* federalism is unlikely to take place. Therefore, when Yan Jiaqi, the then director of the Institute of Political Science of the Chinese Academy of Social Sciences, proposed a Chinese federation having a democratic system as the best hope both for reforming China’s internal politics and for resolving the problems of Hong Kong, Taiwan and Tibet, Yan was immediately denounced by his colleagues in the same institute (Xu Gongmin, 1990).

At the practical level, it seems that the timing is not ‘right’ for the legitimization of federalism. Compared to *de facto* federalism, the advantages of federalism are obvious. The institutionalization of *de facto* federalism is favorable for political stability since

¹⁵ For a discussion of the views of Wang and Hu, see, Zheng (1999), Chapter 2.

it reduces the tension between the two actors. Nevertheless, the institutionalization of *de facto* federalism is also likely to render the political system rigid. Given the fact that great diversities among the provinces exist, equal rights among them (implicit in federalism) are not likely. Rich provinces prefer a weak center, while poor provinces prefer a strong one. The recent call for recentralization by poor provinces is without any reasons. Without doubt, top leaders fear that federalism will lead to a China with great diversities and to disintegration. Also, the leadership's priority is to promote economic development rather than to divide power between the center and the provinces and among the provinces. To do so, it has to adjust continuously its relationship with the provinces and mediate the relations among the provinces in accordance with changing circumstances. The legitimization of federalism will render such continuous adjustment less likely. In contrast, *de facto* federalism has its advantage of flexibility. What the center needs is creative ambiguity implicit in *de facto* federalism. In other words, the center needs, for the time being, not a clear-cut division between the center and the provinces, but ambiguity between them. As long as the center maintains its relative power over the provinces, it will be able to adjust central–local relations. Nevertheless, in the long run, selective institutionalization of *de facto* federalism will lay an institutional foundation for China's *de jure* federalism.

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