



ECONOMIC TRANSFORMATION AND ITS POLITICAL DISCONTENTS IN CHINA: Authoritarianism, Unequal Growth, and the Dilemmas of Political Development

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■ **Abstract** China's economic growth and transition pose fascinating questions for social scientists. In the economic realm, proponents of the market-preserving federalism (MPF) model appear to have gone too far. In reality, China's central leadership has retained the prerogative to appoint top provincial officials as well as the power to reconfigure central-provincial fiscal relations, thus defying predictions of the MPF model. In the social realm, rapid growth has propelled the expansion of the middle class, but the large increase in inequality has sharpened social cleavages and class conflicts. The uncertainties of market transition and rising social conflicts pose major challenges for the ruling elite and for China's political development.

INTRODUCTION

Since at least the breakup of the Soviet Union, democratization has been the major theme of comparative politics research in political science. The People's Republic of China, however, has been conspicuously absent from the growing list of new democracies. Not surprisingly, the political science scholarship on China, with the exception of studies on the politics of Taiwan, has contributed relatively little to the burgeoning literature on democratization. Along the rich vein of democratization, social scientists working on China have been digging far afield, devoting much insightful attention to the introduction and popularization of elections in villages, which are not part of the formal state apparatus. For the Chinese leadership, having recently left behind the ravages of Mao's charisma and evil genius and survived the traumatic state-society confrontation

of 1989, democratization at the national level has not been a priority. Instead, in the face of the multiple challenges of industrialization, urbanization, marketization, and globalization, the foremost concern for China's leaders has been the maintenance of political order and the promotion of effective governance (Yang 2004).

Although China has apparently moved slowly at best in political democratization, it has made major headway in economic transformation. Many countries are poor, and only a small number of underdeveloped economies, notably in East Asia, have managed to move up the ladder of economic success in the past half century. Seen in this context, China's sustained economic ascent over the past quarter century, occurring on the heels of decades of civil wars and Maoist misrule, is remarkable.

To be sure, the Chinese growth trajectory has followed earlier East Asian economic successes and there is thus no miracle. Moreover, even after a quarter century of rapid growth, nominal per capita GDP in China remains quite low and only puts China into the ranks of lower-middle-income countries as defined by the World Bank. Nonetheless, there is little doubt that China, in aggregate terms, has become one of the world's economic powerhouses and a major engine for global growth. China's economic transformation has begun to reshape the global economic order in significant ways.

The combination of massive aggregates and yet modest per capita figures underscores the challenges for China's governance and further integration into the global system. It is one of a list of such combinations or contrasts that have catapulted China into its own orbit for political science analysis. Unlike most economies in the former Soviet Union and East Europe, China has largely made the transition from central planning to the market without some sort of shock therapy. Furthermore, while much attention in political science has focused on explicating the causes and dynamics of democratization, China is conspicuous by its absence. Thus, the China difference potentially has much to contribute to the comparative analyses of reforms, economic transitions, state-building, and a range of other topics that have fascinated students of postsocialist economies and societies (Laitin 2000).

The focus of this review is on the sources and consequences of China's hypergrowth. One of the most prominent explanations of China's growth has been that China has evolved into some sort of market-preserving federalism. The first part of the paper reviews this argument and examines whether the market-preserving federalism (MPF) model's predictions have been borne out. The rest of the paper looks at the consequences of China's rapid growth, which include rising income inequality and growing social cleavages. Such inequality and the sharpening of social cleavages and class conflicts have major implications for China's governance and political development. I suggest that the growing literature on these issues offers interesting insights into the prospects for the rule of law and democratization in China.

**THE INSTITUTIONAL SOURCES OF CHINA'S SUCCESS:
DECENTRALIZATION, DE FACTO FEDERALISM,
OR CHINA INC.?**

The causes and dynamics of China's reform and rapid growth have naturally attracted much scholarly attention. Beginning in the late 1970s and until the early 1990s, the central government signed fiscal contracts with local authorities that essentially made the local authorities the residual claimants of the revenue stream. This fiscal decentralization coupled with the gradual introduction of market prices through the dual-track pricing mechanism encouraged investments and stimulated growth. Much of the literature has emphasized the importance of the fiscal decentralization in providing incentives for local authorities and firms to benefit from the growth they could generate, thereby encouraging more efficient deployment of capital and stimulating economic growth (see, e.g., Lin & Liu 2000; Oi 1992, 1999; Shirk 1993; Wong 1992; for contrary findings, see Zhang & Zou 1998).

Some scholars, notably Qian, Weingast, and colleagues (Montinola et al. 1995), have gone much farther in their theoretical claims. They suggest that the Chinese economy has come under the thrall of a market-preserving federalism with Chinese characteristics. Under such a market-preserving federalist system, there is a clear division of authority between central and local governments, with the local authorities assuming primary responsibility and control over their economies. Equally important, such a division of power and responsibility ought to be durable, such that the decentralization is not at the discretion of the central government. While recognizing that the Chinese-style federalism differs "considerably from federalisms in the developed West," Montinola et al. (1995) claim that it "provides considerable political protection for China's reforms, including limits on the central government" (p. 52).

It is an empirical question whether the Chinese system has merely experienced decentralization at the pleasure of the Center or evolved into some sort of market-preserving federalism. Montinola et al. venture that the decentralizing arrangements in China, supported by strong regional economic powers, are durable. To support this contention, they proffer three events as indications of "the striking new power of local governments to shape decisions by the central government" (p. 69). These were the failure of the Li Peng administration to recentralize investment and financial powers between 1989 and 1991, Deng's rallying of provincial support to promote reforms during his tour to the South in 1992, and the rationalizing reforms of 1993–1994 in foreign exchange, taxation, and fiscal relations. For Montinola et al., these events suggested a redistribution of power between the central government and the localities in favor of the latter and that the configuration of power had become self-reinforcing.

This is not the place for a detailed discussion of how to interpret these three events (for different perspectives, see Yang 1999; A. Esarey, unpublished manuscript). It is useful, nonetheless, to note that the timing of the Montinola

et al. article was perfect, as it followed on the heels of the 1994 fiscal reforms that were arguably the height of federalist tendencies in China. Staring down into the abyss of fiscal enervation, China's national leadership finally pushed through much-delayed fiscal and tax reforms to replace the particularistic fiscal contracting system with a tax-assignment system (Chung 1995, Wang & Hu 2001, Yang 1994). Under the new tax and fiscal regime, different taxes were allocated to central and local authorities, respectively, or shared. While the central leadership pursued the 1994 reforms to (successfully) bolster the central government's revenue base, the reforms also served to delineate central and local fiscal revenues and authorities and led to the establishment of separate national and local tax-collection administrations. The 1994 fiscal reforms were thus indicative of an effort to institutionalize central-provincial fiscal relations.

The suggestion that China, of all places, may have evolved into any sort of federalism, let alone market-preserving federalism, is controversial. Some scholars have accepted that China has adopted fiscal federalism but contend it is not the market-preserving kind (Tsai 2004). For us, however, the first question is whether China, officially a unitary state, has come into federalism, *de jure* or *de facto*, at all.

To begin with, unlike federalist systems in the developed Western economies, what transpired in China in the 1980s and early 1990s did not rest on any form of constitutional protection or explicit binding agreement. In theory, the absence of such an agreement does not obviate the possibility of federalism; it is entirely possible that a set of practices might over time become custom and unwritten law. In the Chinese case, however, one is impelled to ask the following questions: In the absence of an enforceable guarantee and in light of the fact that the national leadership has the prerogative to appoint provincial leaders, why would the national leadership respect existing fiscal arrangements between the central government and the provinces? Have the local authorities truly acquired enough power to veto the Center?

The answer to both questions seems to be No. The provincial chiefs have clearly not gained the power to override the Center, and consumers of Chinese media quickly note that the Center moves top provincial officials around the country at will. Meanwhile, the Chinese leadership has further reasserted its control over the financial sector, the regulatory institutions, and the administrative system in general since the 1994 taxation and fiscal reforms. Advocates of the MPF model can easily account for the regulatory reforms in the banking, securities, and insurance industries and a variety of other policy arenas in terms of the public goods nature of such reforms and of the need to promote common markets. What they would have difficulty in explaining are the subsequent reconfigurations in fiscal relations between the central government and the provincial authorities, which have underscored the central government's dominance of central-provincial relations and the subordinate nature of local power. These reconfigurations include, among others, the reapportionment of stamp tax revenue, the realignment of personal income tax revenue, and the reassignment of responsibility for paying the value-added tax

rebates on exports. Again and again, local authorities are reminded that the Center calls the shots and can rewrite the rules in its own favor.

As the central government assumed regulatory authority over the securities markets in the late 1990s, it also began to take control of the revenue from the stamp tax on securities transactions. Previously, local governments were allowed to retain the bulk of the stamp tax revenue. With the central takeover of securities regulation, the Center's share of the stamp tax revenue was raised to 88%. It rose to 91% in 2000 and to 98% in 2002, leaving only 2% for the localities (Yang 2004, p. 92).

The handling of the value-added tax rebates on exports, which averaged about 15% for 1999–2003, is another area where the central government has redrawn the rules at the expense of local interests. For years the central government single-handedly shouldered the burden of paying out these rebates on the assumption that foreign trade and customs administration are the central government's prerogative and responsibility (the central government is also the sole beneficiary of the value-added tax on imports). As the volume of China's exports skyrocketed, however, so did the value of the rebates, which surpassed 200 billion yuan in 2003. Unwilling to carry this burden alone, the central government decided that local authorities should share in paying the rebates and unilaterally directed local authorities to pay for 25% of the value-added tax rebates beyond the 2003 base figure beginning in January 2004. This change soon began to induce fiscal crises in various localities. Because of the highly uneven export performances of different local economies, some subprovincial governments with a lot of export-oriented firms quickly found that their entire budget revenue was not enough to cover the value-added tax rebates due to firms located in their jurisdictions, and they began to discourage exports. To alleviate these local problems, the State Council announced in August 2005 that the rebate-sharing ratio would be adjusted to 92.5% (central) to 7.5% (provincial) beginning on January 1, 2006. In announcing the adjustment, the State Council pointedly reminded local authorities that the adjustment was made on the precondition that the central and local governments would share the costs of rebating the value-added taxes for exports [*Jingji cankao bao* (Economic Reference), August 6, 2005].

Nowhere is the power of the central government more arbitrary than in the reapportionment of personal income tax revenue. Under the 1994 fiscal reforms, all personal income tax revenue, which had been quite modest, was assigned to the local authorities. Since 1994, this revenue category has been one of the fastest growing and thus a boon to local government budgets. Watching this growth, the central government decided it could no longer abide by the 1994 deal. As the central leadership called for more balanced regional development, especially of the Western Region, the Ministry of Finance argued that the central government needed more revenue to support such development and came up with a plan for reallocating the personal (and corporate) income tax revenue between the central government and the provinces. In 2001, the central government made the personal income tax—and the corporate income tax—a shared tax between central and

provincial governments, beginning in 2002. Personal income tax revenue above the 2001 base amount is split between central and local governments. The ratio was set at 50:50 for 2002 and 60% for the central government in 2003 (Yang 2004, pp. 78–81). In effecting this shift, the central authorities also indicated that these ratios would be further adjusted in the future as needed. In addition, the National Tax Administration decreed that it would collect the taxes on newly established firms and any new tax categories (Hu 2003).

The ease with which the Chinese central leadership has been able to restructure central-provincial fiscal relations in its favor since the latter half of the 1990s underscores the Center's leverage over the localities. The income tax story illustrates how far these relations are from being durable and how capricious the Center's actions may have appeared to local leaders. In interviews conducted after the reapportionment of personal and corporate income taxes, local officials complained of the "unpredictability of central policies." In their view, "local authorities don't know what policies the central government will come up with now or in the future and what the impact of these policies will be on the localities" (quoted in Zhao & Li 2003). A decade after the introduction of the 1994 fiscal reforms, the claim that local authorities had become strong enough to push back the Center's attempts at recentralization has largely disappeared. With the reapportionment of taxes in favor of the central government, one wonders today why the central and local governments still need to retain separate tax administrations.

Because the MPF model attaches great importance to the durability of institutional arrangements that limit the discretion of the central government, the important shifts in central-provincial fiscal relations since the mid 1990s expose a huge gulf between Chinese practice and the model proposed by Montinola et al. (1995). Even though local authorities have been allowed considerable room to promote local development, the Chinese central government has called the shots in restructuring central-provincial fiscal relations and has undertaken substantial recentralization in various areas. These changes have repeatedly underscored the reality that China's Communist Party-ruled authoritarian system is nowhere close to federalism, *de facto* or *de jure*. As Qiao Xiaoyang, a deputy secretary-general of the National People's Congress Standing Committee, reminded his audience in reference to the central government's relationship to the Hong Kong Special Administrative Region, China "implements a unitary system, not a federal system. Local regions of a unitary state have no inherent power, and local power is granted by the central authorities." Qiao went on to contrast China's unitary system with the federal system of the United States: "The power of a federal system is actually granted to the federation by the states, which retain other powers. The powers that are not granted to the federation remain in the various states. A unitary system is just the opposite. Local regions have no power of their own. Local power is granted by the central authorities. This is a fundamental difference" (Qiao 2004).

Nonetheless, despite the central government's initiatives to take revenue from the provinces, China has continued to reform and grow. Because China has

sustained its rapid growth—in fact, growth accelerated in the first half of the 2000s—even as central-provincial relations defied the predictions of the “Chinese-style federalism” model, it is apparent that neither economic growth nor economic reform in China can be attributed to such federalism.

One must therefore seek explanations of China's economic prowess elsewhere. One possibility is that China's authoritarian leadership, either because of its own commitment or because it was forced by circumstances such as the Asian financial crisis, has leveraged its power and resources to promote market-oriented governance reforms, including policies designed to limit the power of local authorities (Yang 2004). Meanwhile, decentralization and the ensuing interjurisdictional competition, one component of the Chinese-style federalism model, has also been seen as a major factor driving the spread of market reforms and economic growth (Yang 1997, Wedeman 2003; cf. Young 2000). The combination of authoritarian, albeit stable and improving, governance coupled with space for local and private initiative appears to have created an environment conducive to investment and thus growth, as had been the case in earlier growth stories in East Asia. Unlike other East Asian countries, however, China has been especially attractive to investors because they could take advantage of preferential tax treatment (Huang 2003). Indeed, a quick look at the list of domiciles where China's foreign direct investment originates suggests much of this investment is actually Chinese money masquerading as foreign investment.

Montinola et al. (1995, p. 81) concluded with a warning about the “problems from a central government that is too strong, and this is the danger of recentralization per se. Without further institutional constraints, a financially independent central government would pose potential dangers to the reform's progress over the past fifteen years, especially if run by leaders far less favorable to the reforms than Deng Xiaoping.” Much recentralization has indeed occurred, and the central government has become dominant vis-à-vis the provinces as far as fiscal relations are concerned. Fortunately, China's national leadership has become more committed to market-oriented reforms; in some other respects, constraints on government power have begun to emerge, helping to reinforce that commitment (Yang 2004).

All in all, China's central leadership has been able to restructure central-provincial fiscal relations with much ease and no fanfare. This is true to the essence of authoritarian rule but contrary to the MPF model's predictions. Thus, although there might have been federalist tendencies in the early stages of China's reform era, proponents of the MPF model have apparently gone too far in attributing China's reform and rapid growth to a “Chinese style” market-preserving federalism. In our efforts to explain Chinese rapid growth, the MPF model appears to have limited applicability, but the application of the model to the Chinese case has nonetheless helped underscore certain aspects of China's development. There should be little doubt that students of China's political economy should continue to pay attention to institutions, incentives, and leadership commitments to market-oriented reforms.

MARKET REFORMS, INEQUALITY, AND THE REVIVAL OF CLASS CONFLICTS

Scholars have paid much attention not only to the sources of China's rapid growth but also to the implications and consequences of that growth. China's boom has engendered daunting governance challenges. The central leadership's initiatives to boost revenue extraction and strengthen regulatory institutions are but part of a quest to cope with the tensions and volatilities associated with hyper growth. The rest of this paper begins with the issue of inequality and social cleavages and then examines the implications of the rising social tensions for China's governance and its political and institutional development. In conclusion it suggests that the different social groups in China are united in using rules-based regimes to advance their divergent interests and in so doing are likely to promote the rule of law.

During the pre-reform era, Mao coupled his political witch-hunt for real and imagined enemies with a quest for economic egalitarianism. He emphasized the reduction of the three great differences—between worker and peasant, between city and countryside, and between mental and manual labor.

Unlike Mao, Deng Xiaoping privileged growth and efficiency at the expense of equity. He was willing to let some groups become wealthy first. Nonetheless, as the rising tide of economic growth lifted more and more families into the ranks of affluence, it also promised to lift the poor out of poverty (Hirschman 1981), and tens of millions have indeed left poverty behind. Moreover, for much of the 1980s and early 1990s, China's leaders were careful to promote economic reforms without hurting vested interests. Instead, vested interests were protected through the use of dual-track pricing as well as subsidies to groups that would be hurt by new reform policies. This grand bargain offered room for new entrants and approximated what economists have termed reform without (absolute) losers (Lau et al. 2000). Thus, contention over and opposition to the reforms was minimized. In fact, for years, the pragmatist Deng enjoined that certain issues should not be debated. It was fine and indeed laudable to introduce capitalist practices, but it was not permissible to openly advocate for capitalism.

Even without absolute losers, market dynamics would have sharpened disparities between urban and rural areas, among the professions, and between the coast and interior regions. In hindsight, however, it is not surprising that the market-oriented policies have over time produced absolute losers and winners as the planned part of the economy became unsustainable and crumbled. Although most Chinese have seen their living standards improve, the "market reforms in China have generated widespread suffering and life disruptions, affecting many social groups" (Hung & Chiu 2003). The working class was once the bedrock of support for the Communist Party. As state enterprises began to fail and unemployment rose, however, relations between the Party and labor became awkward and even tense. According to data from the State Statistical Bureau, total state-sector employment dropped sharply from 110.4 million at the end of 1997 to 76.4 million at the end of 2001. Even though some of the former state-sector employees found alternative

employment, there is little doubt that urban unemployment and poverty rates have risen (Murphy 2002).

Against the general background of economic prosperity, the downward mobility for much of the working class has been downright humiliating and has created a new crowd of the dispossessed in urban China (Solinger 2002, 2004). Certain population cohorts, especially the generation born between 1948 and 1957, have borne the brunt of the state-sector restructuring. This generation had received less education owing to the disruptions of the Cultural Revolution but became the first targets for furloughs and layoffs. They now represent a large proportion of the newly marginalized (Hung & Chiu 2003). Some of the company towns that were once the traditional bastions of central planning have fallen on hard times and essentially gone bust (Weston 2004).

Farmers, who had led the charge into the river of reform in the late 1970s and early 1980s, have ever since then been caught by the triple whammy of stagnant farm prices, rising input prices, and rapacious local governments (Yang 1996, Bernstein & Lü 2003). More than 100 million now seek to better their lot by working in cities and especially on the booming coast as migrant workers. But the cities are often an inhospitable foreign land (Solinger 1999). For more than a decade before 2004, wages for migrant workers toiling in factories in the Pearl River Delta hardly increased. Those who worked on construction sites were often confronted with contractors and subcontractors who paid late, if at all. The operators of privately contracted coal mines are widely known to put profits ahead of safety.

In many ways, today's Chinese would be highly sympathetic to the theme expressed by Henry George more than a century ago in *Progress and Poverty*. While China has risen magnificently from the poorhouse since Mao's time, the gap between (new) rich and poor has also become immense. The world's factory is sustained by the drudgery of tens of millions of Chinese workers making less than \$100 per month.

Economists have produced various measurements of the dark side of China's boom. Virtually all estimates have pointed to a major retreat from equality in China during the reform era (see, e.g., Khan & Riskin 2001, Riskin et al. 2001, Benjamin et al. 2005). According to data compiled by the World Bank, China started the reform era as one of the most egalitarian economies in the world, but its Gini coefficient, based on expenditure shares by percentiles of population, had risen to 44.7 by 2001. This marks China as the second most unequal, after Malaysia, among the East and Southeast Asian countries included in the World Bank database. Simply put, China's growth is significantly more unequal than that of its neighbors (World Bank 2005a, table 2.7; for trends and various forms of measurements, see World Bank 2005b).

Amid the general trend toward greater inequality is a process of immiseration for the poorest of the poor. Benjamin et al. (2005) report that in rural China, inequality worsened more quickly in the latter half of the 1990s. As a result, "as much as half of the population [was] not much better off in 1999 than 12 years earlier,

and the bottom 5% worse off” (p. 806). A report prepared for the Poverty Reduction Taskforce of the United Nations Millennium Development Project found an increase in the number of people in abject poverty; the proportion of people living on less than \$0.50 per day (measured in 1985 Purchasing Power Parity U.S. dollars) had risen from 1.8% in 1996 to 2.9% in 2002 (Woo et al. 2004). Indeed, even by the modest standards of the Chinese government, the number of farmers living in poverty rose by 800,000 in 2003. This marked the first retrogression in the government poverty figure since the start of the reform era (Watts 2004).

Many developing economies have experienced rising inequality. In his famous 1955 article, Kuznets argued that inequality tends to follow an inverted-U curve; it can rise in the early stages of development before declining in the later stages (Kuznets 1955). In the Chinese case, the Maoist state was able to keep inequality at bay by draconian means but, in light of China’s level of development, the deterioration in the measures of inequality is to be expected once China moves onto the market-oriented path.

The whipsawing between Maoist egalitarianism and Dengist capitalism with Chinese characteristics, coupled with dramatic upward and downward socioeconomic mobility, has accentuated the popular sense of unfair income distribution and sharpened sociopolitical cleavages. Among the former state-sector employees, there is a widespread sense that the government has broken an implicit social contract. Among rural residents, surveys have found that most respondents, particularly in poorer villagers, favor periodic land distribution on a per capita basis so that all members of the village collective would be assured of some income, even though such redistributions go against national policies for hardening land tenure (Kung 1995, Vermeer 2004). The rapid rise in Chinese inequality would have been a significant challenge to any government. To the extent that the current ruling elite in China still spouts a socialist rhetoric, the sharply increased inequality is especially disconcerting to large segments of the population and demanding for the ruling elite.

In fact, the combination of escalating inequality and popular discontent has helped fuel numerous protests. Between 1993 and 2004, the number of “mass incidents,” i.e., mass protests and riots, rose from ~10,000 to ~74,000 and the number of participants in these “incidents” rose from 730,000 to 3.8 million. In 2004, the State Bureau for Letters and Calls received 11.7% more petition and complaint letters than a year earlier, and the number of petitioning visitors (including returning visitors) to the Bureau increased by 53% (*Nanfang ribao* [Southern Daily], July 8, 2005; *South China Morning Post*, June 8, 2004; French 2005).

Most of the protests are small and localized. Some seek redress for unpaid pensions and wages or inadequate severance payments. Others arise from disputes over land and mineral rights and disagreements over housing compensation for relocations. Both categories of protests may be fused with perceptions of cadre corruption. There have also been protests spurred by environmental pollution.

The first category of protests may involve (former) state-sector workers or migrant workers toiling on assembly lines or on construction sites. The protests

by former state-sector workers in company towns such as Daqing, Fushun, and Liaoyang in the Northeast have received special attention (Lee 2000, Human Rights Watch 2002, Hurst & O'Brien 2002). These former state-sector workers joined the labor force under an implicit social contract between the working class and the socialist state: In exchange for their acceptance of low wages, the workers received housing, education, and welfare benefits from cradle to grave. With the layoffs and early retirements, these workers were deprived of their jobs and of various services and welfare provisions and thus felt betrayed (Hung & Chiu 2003, F. Chen 2003). Cut off from the state enterprises that once tethered them to the government, these former employees have few qualms about protesting (Weston 2004).

In the second category, the contentions and protests over land, mineral, and housing rights remind one of the legal (and oftentimes not so legal) disputes in the American West during the Gold Rush in the last half of the nineteenth century (Libecap 1996). As the Chinese economy has boomed and asset values have shot up, the struggle for property rights has, not surprisingly, intensified.

Besides the struggles over entitlements and property rights, it appears that the popular discontent with rising inequality, unfair income distribution, and rampant corruption has made parts of Chinese society volatile cesspools of potential instability. In recent years, minor scuffles and traffic incidents have touched off major protests and even riots against local authorities in Wanzhou (Chongqing), Chizhou (Anhui), and other interior localities. Boom towns such as Dongguan and Shenzhen in Guangdong have seen their own protests, which reflect rising class tensions. Dongyang and Changxing of prosperous Zhejiang Province have witnessed eruptions of protests against environmental degradation (Chan 2004, Kahn 2004). Some of the new rich have become victims of violent crimes. In many ways, these confrontations are signs of class warfare between capital and labor.

RISING SOCIAL TENSIONS AND POPULIST AUTHORITARIANISM

Unlike in the immediate post-Tiananmen years, China's leaders have grudgingly come to accept that mass protests and riots are inevitable in a society torn by divergent interests. They have concluded that societies with per capita GDP in the US\$1000–3000 range are at a critical juncture and especially likely to face growing popular demands (Ren 2004, Hu 2005). Many local authorities have become inured to the daily presence of petitioners. As technocrats, China's ruling elite see their mission as coping with conflicts through reforms, institutional development, and crackdowns where needed without jeopardizing the continued rule of the Chinese Communist Party. The Party would, on this account, play the paternal role of looking after the interests of the people. The "harmonious society" that Hu Jintao has espoused must be steered by the Communist Party.

The apparent harmony relies on carrot-and-stick tactics. Authorities are especially worried about organized opposition and have brooked no attempt to register

opposition parties or mount organized political dissidence. They also worry that the combustible mass discontent might be fused with religious or quasi-religious forces such as the Falun Gong, much like the extremely destructive Taiping Rebellion. Authorities have launched a relentless crackdown on the Falun Gong and similar groups (Chang 2004). However, authorities have been willing to placate bereft workers/pensioners demanding their overdue benefits while picking out “ringleaders” (Cai 2002).

The Party establishment has sought repeatedly to limit the circulation of potentially subversive ideas. Although China boasts the largest media and book markets in the world, certain books have been banned, including the popular *A Survey of Chinese Peasants*, which brought the plight of farmers to the attention of the elite and the reading public. From time to time, the Party’s Propaganda Department has instructed the media to tone down their coverage of certain themes, including issues of inequality, class, and social justice (for broader discussions, see Liebman 2005 and Zhao 1998). Public intellectuals who stick their necks out to advocate radical political change risk losing their state-sector jobs at universities and not getting published within China. Dissident internet posters without formal state-sector employment have faced harsher treatment, and dozens now languish in jail.

Within this authoritarian framework, the Chinese leadership has since the late 1990s launched a variety of populist initiatives to address imbalances in the economy and society. Urban authorities have stepped up their efforts to make sure wages and pensions are paid and paid on time. There has been special emphasis on helping disadvantaged groups (*ruoshi qunti*). As corporate downsizing accelerated, the central government as well as local authorities sharply raised the number of urban residents receiving minimum livelihood support and increased outlays so that anyone qualifying for such support would receive it. At the end of 2000, the number of people on such support was 4 million. This number rose to 11.7 million at the end of 2001 and 22 million as of mid 2005 (Ministry of Civil Affairs data). Some provinces, such as Zhejiang, have also extended such help to rural residents, albeit at reduced benefit levels.

In regional policy, the Jiang Zemin–Zhu Rongji team initiated a massive Western Development Program in the late 1990s to pour funds into infrastructure and the countryside in Western China (Naughton 2004; see also Yang 1997). This has since been followed up by a policy, less ambitious, to revitalize the Northeast, China’s industrial rustbelt, under Hu Jintao and Wen Jiabao. In rural policy, the Jiang-Zhu era began to rationalize the myriad burdens of taxes and fees on peasants (Yep 2004). As of 2005, the Hu-Wen administration is well on its way toward abolishing the state agricultural tax. Meanwhile, the government has introduced substantial direct subsidies to grain farmers and increased government funding for rural education and, in a limited way, for rural public health. Migrant workers from rural areas now face a more hospitable urban environment following the abolition of the “custody and repatriation” regime. The central government has also made serious efforts to help migrant workers, especially construction workers, obtain

overdue compensation. At the same time, employers, having to contend with a dearth of migrant workers since 2004, have started to offer somewhat better pay and working conditions for workers on assembly lines and in sweatshops. Altogether, it appears that China has finally begun to shift away from the previous bias against agriculture and rural residents.

Where there are disputes and protests over property rights, there have also been, as in the American West in the nineteenth century, institutional adjustments. Indeed, in some provinces such as Shaanxi, the provincial authorities were themselves involved in taking over (oil) assets that had sharply appreciated in value without offering adequate compensation. In general, however, as petitions and protests erupted over evictions and land sales, authorities adjusted the existing laws and regulations to improve the terms for farmers and for current occupants of urban housing.

Throughout the reform era, a loose group of intellectuals commonly lumped together as the New Left has warned against unbridled neoliberal policies and called for more attention to issues of social justice (Fewsmith 2001). In many ways, as China's economic restructuring became especially painful for certain social groups, China's leaders, particularly the younger Hu Jintao–Wen Jiabao team, have adopted the social justice concerns of the New Left to alleviate the pains of further liberalization, which they have continued to champion (Fewsmith 2005). Though not fully coherent as a new form of social contract, the different strands of the recent policies suggest the weaving of some sort of safety net to cushion the blows associated with the uncertainties of global markets.

SOCIAL POLARIZATION AND THE CHALLENGE TO POLITICAL DEVELOPMENT

From the perspective of democratization theory, China's sharply growing inequality bodes ill for the prospects of democratization (Boix 2003, Przeworski et al. 2000). While market forces are bringing the country together, Chinese sociologists have in recent years emphasized the increasing fragmentation of Chinese society. Besides the dualism between urban and rural areas, the sociological research has given special attention to the growing gap between the new rich and those at the bottom (Sun 2004). Meanwhile, the ruling elite have invoked the increased social tensions to justify measures aimed at more top-down control.

In this context, it is no surprise that Chinese social scientists, particularly sociologists, have devoted much effort to the search for China's newly emerging middle class and ideally, in the tradition of Moore's (1966) classic work, for a new bourgeoisie. There is a consensus in the Chinese social science community that a larger middle class would be more conducive to social stability. The results of that search, however, have been mixed at best, at least so far. Various Chinese studies have concluded that the Chinese middle class, though growing, is still very small by their standards, which include measures of profession and income

(see especially Lu 2002). Even by the most generous yardsticks, China remains far from being a society of the middle class (C. Li 2004).

It is possible that many Chinese, like their foreign counterparts, share middle-class values despite earning only modest incomes. Recently, a team at the Chinese Academy of Social Sciences (CASS) has sought to measure whether urban Chinese identify themselves as part of the middle class. The survey found that, compared with developed economies and Asian societies ranging from Japan and South Korea to India and the Philippines, a significantly smaller proportion of the Chinese sampled identify themselves as belonging to the middle stratum and much higher percentages (41%) identify themselves as belonging to the lower middle or lower stratum instead (Li et al. 2005, p. 57).

Because the CASS survey results are derived from a predominantly urban sample, not including the rural residents who have been left behind, one can easily imagine that the results from a fully representative sample of the Chinese population would be even more polarized. Such self-identifications and the widespread sense of being left behind have led some Chinese scholars, such as Qinghua University professor Li Qiang (2000), to worry that they may provide the basis for social instability and radicalism. Indeed, in the CASS sample, both those who reported a significant rise in their living standards over the past five years and those whose incomes had declined sharply were especially likely to report feeling that income and property distribution had become unequal, and to report rising class tensions/conflicts (Li et al. 2005, p. 115). Remarkably, around half of the respondents, when asked about their attitudes toward collective petitions and protests when their colleagues or neighbors are involved, answered that they would participate (21%) or express their sympathies (33%) (Li et al. 2005, p. 106). In short, for large percentages of Chinese respondents, rapid social change has raised serious questions about the legitimacy of the evolving sociopolitical order.

While the emerging middle class remains small, scholars seeking agents of political change have turned their attention to the various types of entrepreneurs. In the tradition of Barrington Moore, they wonder whether China's newly rich entrepreneurs might fill the role of the bourgeoisie in effecting democratic change. Despite more than a quarter century of economic reforms, the entrepreneurial class in China is weaker than expected. A major reason for this weakness is the government's policy toward foreign direct investment (FDI) and private business. In their eagerness to attract foreign investment, China's leaders have adopted preferential policies for foreign investors but discriminate against domestic businesses, especially private business. Such policies have indeed helped China become one of the most attractive destinations for FDI (Huang 2003). The huge influx of foreign capital has helped the Chinese economy move toward capitalism, but politically its impact has been more ambiguous. In various other Asian societies, notably Korea and Taiwan, economic development during the authoritarian eras led to the growth of a domestic business class whose growing autonomy would provide pressures for political change. In contrast, Gallagher (2002, 2005) contends that the huge presence of FDI has, at least in the short run, substituted for the expansion of the

private economy and stunted the growth of the domestic business class. As a result, FDI has so far helped boost the Chinese economy as well as the Chinese state and yet contributed to a delay in political liberalization. Gallagher (2002, p. 372) goes so far as to argue that "China's early embrace of foreign capital should be credited with saving the Chinese Communist Party."

Moreover, the new entrepreneurial class may not be true friends of democratic change. An Chen (2002) divides this group into small entrepreneurs or the petit bourgeoisie (part of the middle class) on the one hand and the wealthiest Chinese private entrepreneurs or bourgeoisie on the other. He further classifies the bourgeoisie into the parasitic (those who have thrived on their political connections) and the self-made. Neither type, in Chen's view, sees the democratic empowerment of the masses as being in their interest. Likewise, Dickson (2003) and Hong (2004) conclude that private entrepreneurs in China are reluctant to rock the boat and promote democratization. For its part, the Communist Party has come up with a variety of tactics to coopt private entrepreneurs, finally allowing some entrepreneurs to join the Party beginning in 2001 (see also Pearson 1997).

Yet the very process of cooptation also promises to change the Party. If the entrepreneurs are made partners of the Party-state, one could also say that the Party-state is cooperating with the entrepreneurs. In some parts of the country, private entrepreneurs already make up a very substantial proportion of the local policy elite (Lang & Guo 2005). The sociologist Ching Kwan Lee (1999, 2002) reported collusion between local officials and enterprise owners to impose some sort of despotism on labor. Indeed, An Chen (2003) goes so far as to suggest the emergence of a right-wing antidemocratic alliance between the communist state and the entrepreneurial class (and other middle classes) based on mutual dependence and a shared interest in keeping the lower classes at bay. While the state increasingly relies on the entrepreneurial class and other middle classes for revenue and employment, the wealthier strata need the state to keep them safe from the poorer strata, and many members of the entrepreneurial class profit from the government's patronage economically.

For An Chen (2003), such an alliance with the haves would serve to alienate the state from the have-nots and weaken its traditional base of social support, namely workers and peasants. Although Chen is open to other possibilities, the main scenario he projects is one of growing conflict: "As the state attempts to resort to a greater extent to naked coercion for maintaining social stability, it has intensified its confrontation with the resentful lower classes and created a potentially revolutionary situation" (p. 143). All in all, the state is constrained financially to respond effectively to demands from the poorer strata. "As the middle classes are obviously reluctant to see economic inequality reduced at their expense, so the authoritarian solution would seem to them the only option" (A. Chen 2003, p. 155).

At the time of his writing, Chen appears to have underestimated the scope of populist social policies, exemplified by the abolition of the state agricultural tax, that the Chinese leadership was about to unleash to address popular grievances. He

was probably unduly pessimistic about the fiscal prowess and institutional capacity of the Chinese state (Yang 2004). Nonetheless, he and many others are right to highlight the class chasm in contemporary China and how this chasm has made the Chinese ruling elite more hesitant about broadening political participation. For now, social scientists in China can only salivate over the benefits that a middle-class society might bring.

Nonetheless, middle-class aspirations have clearly been on the rise. The CASS study cited above found that a growing number of people spent like the middle class. A 2004 survey conducted in seven cities of South China's Guangdong Province, one of China's most affluent regions, also found that more than half of the respondents put themselves in the middle-class and upper-middle-class categories and that the trend was up from the last survey conducted in 2000 (Guangdong Survey 2005). Judging by such statistical trends, or simply by the rapidly growing numbers of cars and luxury properties and the popularity of TV programs such as *Supergirls* (modeled on *American Idol*), one can easily project many more millions of Chinese joining the ranks of the middle class. Such social transformation coupled with the openness of the Chinese economy will likely have momentous implications for the future of political China.

DIVERGENT INTERESTS AND THE RULE OF LAW

Whereas the different social classes disagree sharply on political democratization, they do seem to agree on the need for more legal protection of their interests. According to Chen (2002), the entrepreneurs, especially the self-made ones, would like the rule of law to institutionalize the market order, restrain official power, and protect the fruits of their business success. In contrast, Lee (2002, p. 220) contends that "rather than the entrepreneurs or the rising middle classes, whose interests reside in evading the law rather than promoting it, it is the popular classes, e.g., workers and peasants, who champion the cause of 'bourgeois' legal rights!" Meanwhile, foreign investors have been the most vocal and consistent advocates for the rule of law. The increasing demands for legal redress in an increasingly complex economy have contributed to a dramatic rise in the number of civil cases. Some Chinese scholars, such as Beijing University professor Pan Wei, have vigorously argued for building a rule of law regime that falls short of democracy (Pan 2003).

When the parties to the lawsuits are dissatisfied with the court verdicts and administrative rulings or when the courts do not accept their lawsuits, they may appeal through the system of letters and visits (Cai 2004). Although this system of appeals is known to be far from effective, many continue to pin their last hopes on it. In fact, the Chinese public generally trust the central government much more than they do the local authorities (Yu 2005; see also L. Li 2004). The public's trust of the central government can be both a blessing and a curse. High public trust means high public expectations of central government performance. Yet such expectations can easily be deflated. According to data gathered by Yu, the percentage of petitioners

who answered that the central leadership genuinely welcomed them declined from 95% on the day of their arrival in Beijing to just 39% after they had been in Beijing for seven days; meanwhile, the percentage of those who believed that the central leadership was afraid of petitioners increased from 7% to 59% (Yu 2005, p. 214).

The high public expectations placed on the central elite are almost impossible to meet. It thus stands to reason that the Center would benefit from the existence of an institutionalized conflict-resolution system centered on the courts, so as not to involve itself in resolving all manners of conflicts. Space limits do not allow me to elaborate on this huge topic. Suffice it to say that, in practice, the Chinese leadership has chosen to go slowly on broadening local elections but has in recent years given much vigor to the arduous task of reforming the legal system and promoting the rule of law so that, ideally, in accordance with the law, crimes are punished, disputes are resolved, and rights are protected (see, e.g., Xiao 2005; see also Peerenboom 2002, Diamant et al. 2005). As of this writing, the Supreme People's Court of China has begun to promote its second five-year reform program. The 50 or so measures to be promoted under this program are designed, among other things, to improve and rationalize legal procedures and organizations, enhance the uniformity of law nationwide, and strengthen the enforcement of verdicts (<http://www.court.gov.cn>). The rule of law may remain an ideal for some time to come, but it appears to be the institutional equilibrium point to which the ruling elite as well as the major societal interests are aspiring.

SUMMARY AND CONCLUSIONS

In the aftermath of Tiananmen 1989 and the collapse of communism in the former Soviet Union and Eastern Europe, the Chinese Communist Party has defied predictions of its collapse (Goldstone 1995, Chang 2001), persevered along the path of economic reform, and presided over a quarter century of sustained economic growth. Existing explanations for the Chinese growth have given pride of place to institutional incentives for investment, and some researchers have contended that China may have evolved into some sort of market-preserving federalism despite the Communist Party's predominance. Our review of the evolution of central-provincial relations since the latter half of the 1990s, especially the central government's unilateral changes to central-provincial fiscal relations in the context of the Center's prerogative to appoint top provincial leaders, suggests the limited applicability of the MPF model.

The Chinese central government's incessant efforts to enhance its fiscal prowess, boost regulatory institutions, and strengthen its overall governing ability can be understood as part of a quest for stability in a rapidly changing external environment. Although the Chinese population enjoys better living standards and more economic and social freedom, they have also experienced rapidly increasing inequality and rising social tensions. To cope with and alleviate these tensions and

moderate class conflicts, the central government has on the one hand used its new-found fiscal power to pay for various populist social policies and on the other hand adopted various measures to forestall the emergence of an organized opposition.

The Chinese ruling elite has invoked the rising social tensions and the size and relatively low education level of the Chinese population to justify moving slowly on political reforms (Pomfret & Pan 2003); the increasing inequality, growing social cleavages, and relatively small size of the middle class also appear to make the various social strata balk at the prospect of rapid democratization for now. For the intermediate future, unless major shocks to the system occur, the institutional equilibrium desired by the ruling elite and most social strata seems to be rule of law and by extension the protection of rights.

For the past quarter century, the Chinese Communist Party has mainly relied on rapid economic growth and improvement of people's living standards to boost its legitimacy. Yet there is already a growing sentiment among the Chinese elite that China needs not only economic growth but also more concern for the environment, more support for the disadvantaged, and more attention to social justice overall. Recognizing the myriad challenges, the Chinese leadership has made some efforts to broaden its sources of legitimacy and has devoted more attention to issues of social justice and to the constitutional basis of its rule. In the absence of an alternative to the vision of liberal democracy, the authoritarian Chinese ruling elite will find it no easy task to juggle all the competing demands that come its way.

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