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Reflections on China's Political Economy Model and Sustainable Development

China is arguably the most successful authoritarian state in terms of economic growth in the twenty-first century, but the stability and sustainability of the Chinese model of political economy is questionable. Through a study of state–business relations in China, this book uncovers the politicization of business as a deeply rooted challenge to the Chinese state's efforts to attract and retain private investment and its commitment to sustainable development.

While it is an authoritarian state, the Chinese government has developed high governance capacity, but it has neither solved the inconsistency problem in incentive management for its officials nor advanced its political institutions sufficiently to guarantee autonomy for its economic actors. These unresolved issues create substantial obstacles for China to provide a stable investment environment and to break from a model of economic growth at all costs to one of sustainable development. Moreover, because these issues are deeply embedded in authoritarianism, they will be difficult to resolve. In this concluding chapter, I reflect on how authoritarianism leads to politicization of business, which distorts and discounts the country's efforts in investment attraction and sustainable development.

AUTHORITARIANISM, "SOMEWHAT CREDIBLE" COMMITMENT, AND PRIVATE INVESTMENT

Politicization of business, as described in this book, is the outcome of two conflicting goals of the authoritarian system in China. The first conflict of goals arises from the classic competence–loyalty trade-off that authoritarian leaders face. The second conflict of goals arises from the need to promote investment and growth without politically empowering capitalists and entrepreneurs.

The first conflict of goals lies in choosing between competent and loyal government officials. Dictators need to have competent subordinates to better run the country. However, these competent individuals also pose a greater risk of being able to replace or overthrow the dictator, or they may be more likely to receive invitations to work for the dictator's opponents and potential successors. As a result, dictators often have to choose between the competent and the loyal (Egorov and Sonin 2011; Zakharov 2016). In China, the CCP faces the same trade-off and endeavors to strike a balance by assessing local officials based on both loyalty and competence. The demand for competence brought about a comprehensive and rigid quantitative evaluation system based on objective standards, and the demand for loyalty created a vague and flexible top-down evaluation system based on subjective standards. But this attempt to evaluate both qualities does not mean the CCP has resolved the competence-loyalty trade-off. Instead, as explained in Chapter 2, these two systems end up reflecting the trade-off and producing often contradictory recommendations on promotion, undermining the effectiveness of the evaluation system and causing anxiety among evaluated government officials.

This anxiety of being evaluated by two conflicting qualities – competence and loyalty – thus creates the sufficient condition for Chinese government officials to politicize firms. Those government officials eager for promotion, for example, seek opportunities to demonstrate both competence and loyalty, often creating visibility projects for this purpose. Competence is demonstrated through the large scale and impressive appearance of these "innovative" projects. Loyalty is demonstrated by initiating visibility projects in response to the CCP's latest policy directions and funding them in a prudent manner. Often, this involves engaging companies in the process rather than relying solely on the government's fiscal budget to avoid misusing public funds. This produces the first political service of firms described in the book – to bear the costs of individual officials' self-promotion for the benefit of their political careers. Similarly, when dealing with social conflicts, officials need to show loyalty to the CCP by not giving in to societal actors' challenge to the Party's rule, but also to show competence by carefully containing conflicts without sabotaging the legitimacy of the Party-state. This need creates the second political service of firms depicted in this book – to be allies of or scapegoats for the state, thus distancing societal grievances from the Party-state.

The second conflict of goals in China's authoritarian system provides the necessary condition for politicizing business. This conflict arises from the necessity to promote investment and growth but not to empower capitalists and entrepreneurs. The Party-state needs private investment to achieve its economic goals and to obtain performance legitimacy by fostering growth. However, the Party-state also needs to prevent resourceful economic actors, such as entrepreneurs or private investors, from coalescing into an organized opposition that could challenge the CCP's rule. On one hand, encouraging private investment requires the Party-state to rein in its officials from abusing power and exploiting business. On the other hand, not empowering private entrepreneurs requires the Party-state to grant local officials the power to monitor and control businesspeople when deemed necessary. These goals, once again, are conflicting in nature. They lead the Chinese state to tie its own hands to a certain degree to reduce government expropriation of business, but not to the degree that would prevent the government from controlling business when deemed politically necessary. This leaves open the possibility for government officials to conscript firms for political services.

Authoritarianism, therefore, directly contributes to the sufficient and necessary conditions for the politicization of business. The nature of authoritarianism dictates that unless the rulers – in China's case, the Party-state – feel perfectly secure about their rule, they cannot fully trust their own government officials or resourceful economic actors to have autonomy. And we know that authoritarian rulers do not feel perfectly secure. In his seminal work on authoritarianism, Ronald Wintrobe (1998) framed the dictator's dilemma as follows: "The leader's dilemma is that, given that he or she has such power over the regime's subjects, how can he or she know whether they really support the regime or are merely pretending to do so while secretly plotting his or her downfall?" (1998: 16). Because the dictator does not and cannot know the answer, they will always need to maintain control over political, economic, and societal actors. China's Party-state faces this same dilemma and therefore cannot evaluate its officials based solely on competence or grant economic actors full autonomy in their economic activities. In other words, China's Party-state cannot and will not completely tie its own hands.

This observation aligns with seminal works on authoritarianism and democracy, which establish a consensus that some defining features of authoritarianism include a lack of political equality (Dahl 1991), independent judiciary, and the ruler's flexibility in interpreting laws (Linz 2000). Even when limited institutionalization occurred in authoritarian states, these fundamental features of authoritarianism effectively hinder societal actors from achieving real autonomy from the state. No matter how much these institutions may improve, authoritarian rulers always need to reserve the right to undermine them if they perceive these institutions as empowering dissenting societal actors too much, which would threaten to weaken authoritarian rule. This incompleteness of institutionalization is what makes the investment environment less stable in authoritarian states than in democracies. In other words, the Chinese authoritarian state, like other authoritarian states, does not provide fully credible commitment to capital. It only provides *somewhat* credible commitment to capital through deliberately incomplete institutionalization efforts in order to achieve the goal of economic development.

Politicization of business, as this book describes, is therefore a constant feature of China's political economy model that undermines its potential to attract and retain private investment. It is an independent risk factor in China's political economy model, separate from other better-known problems such as corruption and the dominance of state-owned enterprises (SOEs), and it creates instability in China's investment environment. The Chinese government's policies might look as if they are consistently pro-business, but the Party-state leaves open the possibility to politicize business and introduces political risks into China's economy.

But how do we reconcile this observation with the fact that China managed to attract so much investment throughout its years of rapid economic growth? To begin with, China has an extraordinary market size that makes it attractive. Equally importantly, as described in Chapter 1, China did *some* things right and the government gave *somewhat* credible commitment to capital, which is still better than no credible commitment at all. Economic liberalization to a certain degree, limited institutionalization, rule by law (albeit not rule of law), and controlled policy experiments for a period of time all contributed to China's success in attracting investment and promoting economic growth to the extent that it did. Moreover, private investment exists in practically any market environment, including those with much less protection of property rights and fewer investment-promoting policies than China. It should not be surprising that China, a large country with institutionalization efforts (though limited) would attract capital.

More importantly, we cannot assume that *because* China had an extraordinary record of growth and investment attraction, the Chinese state must have come up with a stable political economy model and overcome every major problem that could have damaged China's economic growth. Instead, so far, the rapid economic growth has obscured many problems deeply embedded in China's political economy model, such as politicization of business. When a sector is experiencing robust growth, then the additional costs imposed on business may erode profit margins but not necessarily jeopardize the viability of the business. Businesses can recoup these costs relatively quickly when the sector is doing well and are more likely to sustain the financial burden over an extended period. However, if a sector is experiencing a slowdown, these additional costs might not only erode profit margins but could eventually erase them entirely.

The urban bus sector described in Chapter 4 and 5 illustrates this dynamic. The bus sector faced intense politicization at a time when China's economy was still growing at a relatively high rate and the population decline had already begun. These two factors combined meant that fewer people were using bus services. Many members of the eventually shrinking populace, particularly from the middle class, replaced bus services with their own cars or emerging subway systems. This shift left private bus companies with few options but to resist the draining political services, particularly the visibility projects that are in nature closer to "regulation" in this sector, which were threatening their survival. Their resistance to the state led to the most drastic form of state encroachment, deprivatization.

Politicization of business is thus a key challenge to China's efforts in maintaining the confidence of private investors. Unlike corruption, which, ironically, is a more predictable and stable risk factor for business, politicization of business has the feature of unpredictability in both its occurrence and its costs, as described in Chapter 1. As politicization stems from some of the fundamental authoritarian logics, it is also less likely for the state to address the issue of politicization. Consequently, it is more difficult to reassure investors and entrepreneurs that politicization will not occur.

Both the government and business realize this, and both worry about the future of attracting investment in China. In a conversation at the end of 2018, a provincial level official told me about all the efforts by the provincial government to calm private investors, whose confidence had dropped after a series of state–business conflicts, including the national government taking over the Anbang Group, one of the largest insurance and finance companies in China, and Jack Ma announcing his retirement from Alibaba's board. This government official said:

"Secretary Xi said we would always support private entrepreneurs, and so our provincial government had several panel discussions with the largest private companies [in the province]. We told them [the entrepreneurs] that we care about them, and we will always support them."

"How did they receive that?"

"They completely freaked out."

"Why is that?"

"Well, it's like the wife that just got beat up by the husband. And then the husband knelt on the ground asking for forgiveness and tried to take care of the wife. Do you think the wife would feel happy or more scared?"[1]

This concern is resonated by private entrepreneurs. A private bus company owner who was forced out of the sector lamented after a series of visibility projects in his sector led to deprivatization of private bus companies,

They [the city government] now want us [private bus companies] back, once they realized how much it costs to maintain a bus system in the city. I told them, "If you think you can lead me by the nose again, you've got another think coming."[2]

Another private entrepreneur in the medical appliance sector said:

We [private firms] are like hens. It all depends on if the local government wants to keep getting eggs from us or also wants to have us for chicken soup. I worry every day about what they might do to us the next day. It would be fine if I just wanted to make some quick money, but my industry is not one for quick money. All I can depend on is the protection from my business partner's dad [a high-level official in the locality], but he is retiring soon.[3]

A Chinese machinery company who supplied equipment to European companies in China's water sector expressed the same concern,

They [the European partner companies] asked us, "Why is it that every time there is a new leader in the city, policies have to change?" We told them this is the way it works, but they didn't want to deal with that anymore, they left with a grudge.[4]

To private entrepreneurs, politicization of business exposes a fundamental disadvantage of theirs: They are more subject to hard budget

[1] Interview 2018110939492.
[2] Interview 20160306203.
[3] Interview 201903a87.
[4] Interview 20160413b.

constraints and they have less political capital compared to SOEs, who can therefore withstand politicization better. As explained in Chapter 3, the political capital of private business is volatile, constantly changing, and individual-based. This disadvantage is particularly obvious when private firms have to compete with SOEs not only in the economic realm but also in providing political services. Unless China can restrict government officials from politicizing firms and level the playing field for companies of different ownership types and therefore different levels of political capital, the process of building a market economy will unavoidably be distorted. These necessary changes would mean fundamental institutional reforms, which will be difficult to achieve. Therefore, politicization of business will most likely persist in China's current political economy model, reducing the credibility of the Chinese government's promises to private investors.

THE INSTITUTIONAL CHALLENGE TO SUSTAINABLE DEVELOPMENT

This book also generates implications for China's prospects for sustainable development. By studying infrastructure and projects that aim to alleviate environmental degradation, this book highlights a mismatch between China's goal of sustainable development and its means. This mismatch goes beyond the information problem and corruption that plague authoritarian countries, as well as the common bureaucratic coordination issues that affect large nations.

To have sustainable development, China needs long-term investments that are often not attractive to local officials. Take the goal of having clean water, for example. Some key infrastructure includes in-ground stormwater collection systems, networks of sewage pipes, infiltration basins, and canals to restore groundwater. Most of these long-term projects are invisible, not economically profitable, and require a large sum of up-front investment, with returns accrued over a long time-horizon and often only in the form of reduced negative externalities. Therefore, compared with many other government projects, sustainability-oriented projects are not inherently appealing undertakings for local government officials.

Knowing the tendency of local government officials to eschew such projects that do not bring in political or economic benefits within a short time frame, the Chinese Party-state attempted to incentivize local government officials using two strategies from its collection of tools, both of which had been used to facilitate economic growth: aligning incentives for local officials and implementing market reforms in relevant sectors.

Central to the first strategy of aligning the incentives of government officials is payoff management and induced competition among local leaders to outperform each other. The key institution to create these incentives is the cadre evaluation system that ties every local leader's career prospects and bonuses to their performance. By incorporating quantitative policy goals such as gross domestic product (GDP) growth and income per capita into this system, China had successfully motivated local officials to promote their local economies.

Central to the second strategy is to put forth market-friendly policies and invite private investors into the relevant sectors. China has successfully used this strategy to mobilize private capital to provide public goods and services that the state lacks the financial or technological capacity to offer. For example, since the beginning of marketization in the health care sector in 2009, there are now at least twice as many private hospitals as state-owned ones at the end of 2020.[5] Similarly, the number of private retirement homes has quickly grown to exceed state-owned retirement homes since marketization of the sector began in 2016.[6] Private investment became an important contributor to China's development in infrastructure, public transportation, telecommunications, energy, education, and many other sectors that play key roles in the pursuit of broad-based economic development. After observing how private investment allowed these traditionally state-directed sectors to expand quickly, the Chinese state appears to have drawn the conclusion that the same strategies would be equally successful in developing sectors key to environmental sustainability, such as nature preservation, water management, drainage systems, and waste and wastewater treatment.

The Chinese state has thus attempted to use these two strategies to protect the environment and promote sustainable development. To incentivize local officials, the CCP gradually added environmental targets into the target responsibility system from 2013,[7] thereby tying the

[5] "2009 Guowuyuan guanyu shenhua yiyao weisheng tizhi gaige de yijian," The State Council, Chinese government, 2020-12-31, www.nhc.gov.cn/mohwsbwstjxxzx/s7967/202012/36cdc5cc143148dd8d61303c6c1d4b35.shtml.

[6] "Guowuyuan bangong ting guanyu quanmian fangkai yanglao fuwu shichang tisheng yanglao fuwu zhiliang de ruogan yijian," The State Council, Chinese government, 2016-12-23, www.gov.cn/zhengce/content/2016-12/23/content_5151747.htm.

[7] "Guanyu gaijin difang dangzheng lingdao banzi he lingdao ganbu zhengji kaohe gongzuo de tongzhi," *Xinhua News*, 2013-12-09, www.gov.cn/jrzg/2013-12/09/content_2545183.htm.

career outcomes of local leaders to quantifiable environmental outcomes. These targets vary across provinces but often include forest and grassland coverage, wetland protection, waste treatment rate, wastewater treatment rate, water quality, and PM2.5 level.[8] To encourage private investment into these sectors, the CCP continued to issue policy directives to increase incentives and reduce risks for private investors beginning in 2005. These directives cover issues from preferential tax rates and land pricing to access to loans for private firms in a sector, stressing policy stability, and ordering local officials to respect public–private partnership contracts. On top of the 1999 Contract Law, the central government issued new guidance in 2016 to stress that contracts made by previous administrations must be respected, and that local governments should not arbitrarily change contract terms after they come into effect.[9]

At first glance, these two strategies seem to have been working wonders in promoting environmental sustainability. The speed and scale of China's development of sustainability projects are as remarkable as China's economic growth in its early stages. For example, since the central government called for sanitary waste treatment and recycling in 2008, the number of waste incineration plants has increased from 100 to 514 in 2020.[10] After the central government encouraged "sponge city" infrastructure projects in 2014 to alleviate urban flooding plaguing many Chinese cities,[11] thirty cities completed the transformation by 2016, and more than 400 cities and towns are in the process of doing so or planning to become sponge cities.[12] Public projects responding to sustainable development mushroomed everywhere, from urban bus systems and sanitary husbandry farms to forests in the desert and wetland parks in cities. Wherever the central government's attention focused, local officials have been quick to respond, and private firms have

[8] PM2.5 stands for the concentration of particles with a diameter of 2.5 micrometers or less. These particles can be inhaled and cause serious health concerns. It is a common indicator for air pollution. The higher the PM2.5, the worse the air quality.

[9] "Zhonggong zhongyang guowuyuan guanyu wanshan chanquan baohu zhidu yifa baohu chanquan de yijian," *Xinhua News*, 2016-11-04, http://gzw.gd.gov.cn/zcjd/content/post_1336990.html.

[10] Author's data collection from Chinese City Yearbooks.

[11] A sponge city is an urban design concept aimed at preventing urban flooding. Its key features include more open green spaces, water reservoirs and catch basins, and porous road surfaces to allow water to drain away rather than accumulating on the ground.

[12] "Haimian chengshi jianshe ruhe dailai "huihuxi" de shenghuo?," *Xinhua News*, 2021-05-11, www.xinhuanet.com/fortune/2021-05/11/c_1127433503.htm.

promptly entered the sector. Together, they seem to be transforming these sectors at an extraordinary speed.

But that is if we only examine the speed of growth in the early stages of development. Upon closer examination of the quality and efficiency of these projects and observing how these developments evolve over time – from project selection to public–private cooperation – the effectiveness of these strategies becomes questionable. The phenomena depicted in this book spread across these sectors. Instead of developmental projects, visibility projects occur, and local governments permit companies to cut corners and compromise quality, especially when asking them to provide societal control services. The strategies that China used to promote economic growth do not guarantee success in promoting sustainable development, for two reasons.

The Difference in the Chinese State's Role in Promoting Growth and Sustainability

Economic growth and sustainable development require different degrees and nature of state intervention. The success of China's economic growth, reexamined in multiple scholarly works, largely depended on the government, both central and local, clearing the way for the private sector and assuming a more passive role. Some scholars argue that China's successful reform happened not because of government intervention, but because of *reduced* government intervention. The high growth era in China corresponded with economic liberalization that occurred as the planning state retreated (Naughton 1995; Pei 2006; Huang 2008; Kennedy 2010; Wang 2024), and growth mostly occurred where the state was constrained from overreaching, such as imposing predatory taxation or bailing out SOEs (Steinfeld 1998). When the Chinese state did assume more active roles by adopting a statist approach to development, such efforts often backfired. In the 1990s, when the state expanded its role in industrial policies, the growth of income per capita slowed down, household savings stagnated, and inequality between urban and rural areas, as well as between different regions, was exacerbated (Chen and Fleisher 1996; Yao 1999; Huang 2008; 2011). Revisiting the role of local Chinese governments in the 1990s, they appear to resemble more of a clientelist state mired in corruption than a developmental state (Ong 2012), and China's tax reform did not benefit public goods and service provision in rural China (Takeuchi 2014). What's more, after a series of industrial policies that promoted SOEs at the expense of private firms, China's economic growth ended up even more dependent on private companies (Lardy 2014).

Environmental sustainability, to a much greater extent than GDP growth, is a process that requires the state to assume a more active role in planning, funding, and regulation.[13] This is because companies are primarily focused on maximizing their bottom-line profits rather than prioritizing environmental goals, thus leaving the government as a more significant leader in promoting sustainability. But as the observations here suggest, the Chinese state has yet to show its ability to mobilize its government officials to take on active and constructive roles in promoting environmental sustainability.

In other policy areas concerning sustainability, such as strengthening the social safety net and reducing poverty, research indicates that progress was primarily a trickle-down effect of economic growth rather than being a result of active policy choices. Economic growth brought in more government revenues and therefore increased the absolute amount of social spending, and even then, the state's role remained minimal and welfare provision largely depended on informal social networks (Saich 2008). Similarly, poverty alleviation in China largely benefited from economic growth itself, and local governments have seriously underinvested in education and healthcare, creating a large population of structurally unemployable labor, which will eventually hurt China's continued growth (Rozelle and Hell 2020). While this does not suggest that the Party-state has done nothing to improve human capital, it does raise a serious question about the Chinese government's ability to play both an active and constructive role in promoting economic sustainability. China's potential to pursue environmental sustainability will rely to a much larger extent on this yet-to-be-demonstrated ability of the Chinese government.

And as this book shows, when the Chinese government, both central and local, takes on an active role in pursuing environmental sustainability, the process becomes vulnerable to politicization, particularly in the form of visibility projects. This is compounded by the nature of environmental protection and preservation, which, unlike economic growth, makes it more difficult for the central government to detect questionable policy choices, creating a second challenge to pursuing environmental sustainability.

[13] Most researchers and practitioners agree that successful sustainable development requires collaboration between the state, firms, and the public (e.g. Hopwood, Mellor, and O'Brien 2005).

The Challenge of Incentivizing Local Officials to Pursue Long-Term Environmental Sustainability

The second reason that China's economic growth strategies fall short in the domain of environmental sustainability lies in the method of incentive alignment of local officials: to include quantitative targets measuring environmental outcomes in China's cadre evaluation system. This approach might have been effective in promoting economic growth because GDP growth is an immediate, localized outcome that can be attributed to specific policy outputs such as tax breaks, subsidies, and preferential land prices. It also worked because local officials' incentives to promote GDP growth align with the profit motives of private entrepreneurs. However, when it comes to environmental outcomes, the dynamics are not exactly the same.

While it is easy for the CCP to incorporate quantified environmental outcomes such as water quality and air quality into the cadre evaluation system, the Party-state cannot ensure that these quantifiable outcomes will translate into long-term investments and efforts by local officials essential for sustainable development. There are simply too many ways to either achieve or fail to achieve these environmental outcomes. Take water quality, for example. It only improves when all localities along the waterbody work together, and it can improve as a consequence of any number of actions, such as regulating polluting factories, conducting river cleaning projects, building and upgrading sewerage networks, separating sewerage and stormwater systems, and constructing wastewater treatment plants. But to a significant degree, water quality is also influenced by natural variability beyond the control of any official – such as storms, floods, droughts, ecological cycles, and so on.

This creates a disconnect between any official's policy output and policy outcome. It would be easy for local officials to show short-term improvement in quantified water quality measures by improving infrastructure, ordering polluting factories to clean up, or even employing "blunt force regulation" (van der Kamp 2023) to temporarily shut down polluting factories. It would be equally easy for local officials to blame less than ideal environmental quality on the insufficient actions of other involved governments or on natural factors. What this suggests is that local officials often have the opportunity to showcase impressive policy outputs, such as visibility projects, without necessarily delivering long-term environmental outcomes. Indeed, Gilley (2012) insightfully documented how China is more effective in producing policy outputs than outcomes in its efforts to counter climate change. This disconnect between outputs and outcomes incentivizes local officials to engage in the most visible actions that allows them to claim credit for short-term, quantifiable, or visible outcomes regardless of long-term improvement in the environment – thus the creation of visibility projects.

Therefore, China's cadre evaluation system is almost perfectly designed to undermine the kind of hidden, unglamorous actions and long-term efforts essential to sustainable development. This system rewards visibility over sustainability.

For these reasons, the way the Chinese Party-state pursues environmental sustainability encourages government officials to be proactive in their actions but does not and cannot hold them accountable for long-term environmental outcomes. As a result, visible actions become the focus of government officials in environmental protection and preservation, conveniently translating into visibility projects, detailed in Chapter 2, that showcase effort without guaranteeing sustainability. This is shown clearly in the bus sector in Chapters 4 and 5, where clean air initiatives lead to visibility projects that are highly wasteful and come at the costs of sustainable development. Another good example is China's failed recycling movement, where visibility, rather than sustainability, became the focus.

In 2000, China's national government started to promote solid waste recycling and offered full subsidies to cities pursuing such projects. Eight Chinese cities were chosen in 2000 as experimental sites to launch a municipal solid waste sorting and recycling system.[14] These cities all invested in the visible components such as recycling bins, recycled garbage collection sites, and public education programs, but they failed to establish the invisible yet crucial post-collection sorting system to separate solid waste into recyclable and nonrecyclable categories. This eventually upset the public, who realized their efforts to separate household garbage were sabotaged by the lack of sorting systems, and they stopped participating in the recycling movement. An official in Shenzhen's urban management department explained to the media how the effort failed: "They [residents] questioned us [government]: 'we [residents] separated the garbage and threw it into the correct garbage bins as you told us to, and then you guys [the government] mixed them up again in the [garbage] truck!' Indeed, we [the government] need to solve this problem [of

[14] These cities were Beijing, Shanghai, Nanjing, Hangzhou, Guilin, Guangzhou, Shenzhen, and Xiamen.

mixing garbage] in the collection process."[15] City governments' focus on the visible features sometimes went to such an extreme that at several of my interview sites, street garbage bins had two sides for recyclable and nonrecyclable trash, but there was no internal partition to actually keep them separate. In 2014, the national government announced that after fifteen years the effort had failed.[16]

Therefore, when promoting environmental sustainability, relying solely on strategies for promoting economic growth might not be sufficient. If the Party-state cannot come up with an incentive system that rewards invisible efforts and long-term outcomes, it will be hard to avoid politicization of the promotion of environmental sustainability. Under the current institutional setup, government officials will be incentivized to exploit the environmental agenda as an opportunity for promotion through visibility projects, which are costly and unsustainable.

ACTORS IN THIS BOOK: "PERPETRATORS" AND "VICTIMS"?

To explain the politicization of business, this book presents two pairs of political relations in China: the one between the national government and local governments, and the one between the state and business. I do not intend to leave readers with the impression that the Chinese national government is a benign reformer and a victim of local governments that distort policy implementation. Nor do I suggest that state–business relations in China are simple, with local governments holding absolute power over private firms, making the latter mere victims of politics. Instead, the actors in this book – the central government and the Party-state's command center, local governments, private firms, and SOEs – are all strategic and sophisticated players with multiple goals. Each pair of these political relations is shaped by all actors involved.

To start with the first political relationship: that between local governments and China's national government, the Party center. Does the highest level of the CCP know what is unfolding on the ground? Are they aware of, for example, wasteful visibility projects? I asked every local official this question, and all of them were certain that yes, the national

15 "Laji fenlei, women weishenme juede nan?" *CCTV News*, 2017-06-18, http://m.news.cctv.com/2017/06/18/ARTIcY689r5oyIl3PycobKGR170618.shtml.

16 "Wo guo 8 chengshi shidian laji fenlei 14 nian shouxiao shenwei," *People's Daily*, 2014-06-14, http://politics.people.com.cn/n/2014/0611/c1001-25132656.html.

government eventually knows exactly what is going on. But why, then, is the central government always a step behind the gaming behavior of local officials and unwilling or unable to punish these actions later? One major challenge for the national government is the ineffective institutional arrangements for monitoring government officials. On a day-to-day basis, the Chinese national government monitors low-level officials by having the mid-level officials supervise their subordinates and report on misbehavior. For example, provincial leaders are supposed to supervise and monitor city leaders, and national leaders are supposed to supervise and monitor provincial leaders.

This arrangement is reasonable considering that in an authoritarian country lower-level officials are accountable to higher-level officials. But this is where the monitoring system loses power. Because officials always report one level up, having irresponsible subordinates means the superior officials did not do a good job managing their cadres. Therefore, superiors have little incentive to report lower-level officials' misbehavior. Instead, they might even have incentives to cover for the misbehavior of their subordinates so they do not get punished by their own superiors. Moreover, officials that rise in such a system would worry that if they started to report on their subordinates, they would be setting a precedent for others to report on their own misbehavior. As a result, few in the system have an incentive to proactively monitor and report misbehavior, essentially encouraging lower-level officials to game the system and distort policies to serve their own interests.

The central government understands this political logic. After all, the Party-state designed the system. So the system is complemented with two more strategies to keep local officials in check. One approach involves the national government directly assuming the monitoring role, often through central inspection teams (*xunshi zu*). This method is widely used on issues from corruption to various policy distortions, but it has two limits. First, it is highly constrained by fiscal and human resources. It is simply impossible for the central government to identify and curb all the problems in China's gargantuan governmental structure. Second, widespread nepotism and corruption practices reduce the effectiveness of this system. As described in Chapter 7, even when a central environmental inspection team is scheduled to make unannounced visits to cities, local governments could always learn about the inspection team's schedule through their connections. As a result, local officials can resort to ad-hoc measures to pass inspections rather than investing in long-term changes that this monitoring mechanism is intended to foster.

A second strategy employed by the central government is to establish a bottom-up feedback system whereby citizens can report instances of misbehavior by local governments. The most well-known examples include the Administrative Litigation Law, which allows citizens to sue the local government, and the petitioning system of the letters and visits offices (*xinfang*). These systems seem to be more effective at gathering information than deterring misbehavior by government officials (Thireau and Hua 2003; O'Brien and Li 2004; Heurlin 2016; Dimitrov 2023). Moreover, they could even encourage misbehavior from local governments, as they now have precise information on opposition and can use coercion against petitioners and plaintiffs, as well as bribery of relevant central agencies to have cases against them dismissed (Li, Liu, and O'Brien 2012). Occasionally, the central government also sets up online complaint forums for a very limited range of issues, mostly environmental concerns. For example, a "water watch" website was established in 2016 for citizens to register complaints about pollution of natural water bodies. However, worrying that citizens could organize online around a single issue, the central government rarely launches online complaint forums, and their effects remain unclear. In 2018, the national government initiated research into the possibility of implementing a "life responsibility system," wherein local officials could be held accountable for environmental degradation that occurred during their tenure in previous jurisdictions. But with so many officials holding the same position in the same locality over a relatively short period, it is unclear how the national government can determine which official should be responsible for specific aspects of a long-term issue such as environmental degradation.

These extra strategies by the central government, therefore, still fall short in deterring misbehavior by local government officials because the central government cannot actually have true bottom-up accountability systems that empower citizens too much. These systems, if designed to fully tie the hands of local government officials, would be dangerously close to resembling a democratic institution in which the public can hold the government accountable. Therefore, the central government, or the Party center, seems to have deliberately chosen not to fully deter misbehavior by local officials. The central government is therefore not merely a victim of local officials in policy distortion; rather, it has significantly contributed to these distortions by permitting them to occur in exchange for regime stability.

The other political relationship this book describes is the one between local governments and firms. It is true that private firms generally lag behind SOEs both in terms of budget constraints and political capital, as described in Chapters 2 and 3. But to think of private firms in China as solely "victims" of the government would overlook the broader picture of state–business relations in China. While this book demonstrates how political services impose higher costs for private firms than for SOEs, it should not be lost on readers that private firms actively seek opportunities to establish good relationships with the state. Additionally, they may manipulate the state when they have an information advantage.

In both the urban bus and the solid waste sector, the two cases in this book, private firms do not refuse political services at first, but only when these services surpass their financial capacity. Some companies even enter these sectors intending to provide political services. In the bus sector, for example, I have encountered private bus firms in several cities that are operated by local mafia groups, which control underground casinos and brothels. By providing bus services and visibility projects in the bus sector, these mafia groups in return receive protection for their illegal businesses. As mentioned in Chapter 1, firms in authoritarian states understand the importance of good state–business relations, and within their budget limits, many firms would be happy to provide political services either as a form of reciprocity for favors from local officials or in anticipation of future benefits from the local government.

Furthermore, sometimes the interests of the state and business align in these political services. In the solid waste sector, for example, both the local government and waste incineration companies have an incentive to suppress societal protests against incineration plants, as described in Chapters 6 and 7. Therefore, political services in this sector – namely, societal control – essentially lead to state–business collusion. By becoming the local officials' allies and scapegoats against the public, firms, state-owned and private, receive government protection and tolerance of their cost-saving measures, some of which are illegal and result in excess pollution. Unlike in the urban bus sector, private firms in the solid waste sector do not oppose their political services nearly as much. They only gradually lose favor where public awareness and opposition to waste incineration increases, which prompts local governments to favor SOEs that can provide better political support for suppression.

It is also important to note that the politicization of business not only increases costs for business, but has also reinforced a business environment where success is often determined by a company's adeptness in political strategies. This is similar to a corrupt environment, where success is not necessarily determined by a company's capacity, efficiency, or know-how, but by a company's ability to pay bribes. In the solid waste treatment and wastewater treatment sectors, I have come across new companies established by a silk factory, a coal mine, and a fish hatchery. These companies lack experience in municipal sanitation sectors, but they all have experience in polluting the environment and colluding with local governments to manage public protests against their pollution. Their experience in societal control might have been valued by local governments, which were therefore willing to overlook their lack of experience in waste and wastewater treatment.

This creates two problems in these sectors. First, other firms in the same sector will have to compete in providing political services, which could reduce a firm's investments in the actual business they conduct and limit service quality. Secondly, firms that cannot compete in terms of political services also struggle to effectively form alliances to pressure the local government to cease politicizing business with those that can compete. As a result, once a sector is politicized, firms that cannot afford the costs of politicization exit the sector, leaving a sector dominated by the most competent in providing political services. Moreover, those that are competent in providing political services are less inclined to invest in genuine upgrades and are less concerned about maintaining quality, both because they are investing more in political services and because the state tolerates their lower quality more as a reward for their political services. This essentially manifests as a crowding-out effect of politicization, with politically adept firms thriving and conducting business according to political logic, often at the expense of business and sectoral development.

To sum up, both the relationships between China's central government and local governments, as well between the Chinese state and business, are dynamic. Politicizing business is a result of interaction between all levels of governments, as well as between the government and business.

THE INSTABILITY IN CHINA'S POLITICAL ECONOMY MODEL

Back to the beginning of this chapter and to end this book, a country's regime type is key to its development and sustainability. China has long been the poster child of the potential success of authoritarianism and the irrelevance of regime type in growth and development. By observing the country's past success in economic growth and its recent slowdown, it would be easy to come up with explanations such as that state capacity is more important than regime type in growth and development, and that if Xi Jinping had not risen to power, China would have continued its market reform instead of turning against its private and foreign investors. These explanations certainly have merit, as state capacity, without question, matters for growth and development. Xi Jinping, a more personalistic leader, is also not helping with growth or attracting investment. But the authoritarian foundations of the Chinese political economy model have always provided the sufficient and necessary conditions for reversing trends and preying on private capital, and the Party-state's fluctuating attitude toward entrepreneurs and investors has been evident since the beginning of China's economic reform, as described in Chapter 1.

These fluctuations and reversals of the state's attitude toward the private economy stems from an important but less discussed feature of China's political economy model: The Chinese state constrains capital beyond its legal and regulatory framework. In other words, even when entrepreneurs and investors operate within the legal and regulatory framework in China, they still do not have complete autonomy in their operations. The Chinese state reserves the rights to politicize firms when it deems it necessary, and this is deeply rooted in an authoritarian state's fear of a potential organized opposition with abundant resources.

By taking a deep dive into how state–business relations and sectoral development unfold on the ground, this book reveals that politicization of business is an integral part of China's political economy model, affecting different sectors at different times. Unless the Party-state ties its own hands and gives businesses more autonomy in their economic decisions, politicization will discount China's investment outlook. For the Party-state to refrain from politicizing firms, it must be confident that it has resolved the classic competence–loyalty trade-off and overcome the dictator's dilemma. This would require either regime change or an innovative institutional reform of authoritarianism, both of which are extremely difficult to accomplish. Therefore, the politicization of business is likely to continue as part of China's political economy model, creating instability in China's economy and uncertainty for investors.