Will China's Brand of Stakeholder Capitalism Sustain Development in the Next 20 Years?

Ronald W. Anderson

Since 1978, China has developed strongly using a particular form of capitalism that has relied on close relations between private enterprise and the state, and the continuing presence of state-owned enterprises, both centrally and at local levels. This model has been criticised as being responsible for the rapid rise of debt since 2010, and more recently for the slowdown of growth. I assess the challenges to China's stated growth ambitions, emphasising the demographic factors that vary across regions. Using examples at the regional and local levels, I illustrate the workings of this system and highlight the challenges for adapting it to support China's growth ambitions for the coming decades. The conclusion is that China's public-sector development can no longer be financed principally through land sales, and Chinese savers will need to shift away from real estate and redirect their investments toward equities and other capital-market vehicles.

Journal of Economic Literature (JEL) codes: G3, H2, K4, P2

Keywords: state capitalism, debt overhang, infrastructure, local public finance, enterprise reform

1. Introduction

In this paper I consider a large question: is China's brand of capitalism capable of meeting the challenges of China's development strategy over the coming 10 to 20 years. Since 1978, China has developed strongly using a particular form of capitalism that relies on close relations between enterprises and the state. The enormous

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growth of private enterprises accounts for much of the growth of Chinese GDP and real incomes. However, the state continues to assert its leadership role in guiding the growth process as evidenced by its continued use of 5-year plans to set quantitative targets for GDP growth and its reliance on state-owned enterprises to guide investment toward priority sectors.

The result of these policies has been sustained growth of production and incomes. Between 1977 and 2006 the average annual real growth rate was 9.8 per cent (based on the World Bank's measure of GDP expressed in constant 2015 USD), a result that is widely recognised to be an unprecedentedly strong growth record over three decades. However, with the onset of the financial crisis starting in 2007, China was confronted with a series of challenges to its continued growth. Following the 2007–2008 bank failures in the US and Europe, China responded with a massive fiscal stimulus that resulted in considerable domestic investment that supported China's continuing growth and mitigated the effects of the crisis world-wide. Subsequently, China has been confronted with continuing challenges in meeting its growth targets, which currently have been set at approximately 5 per cent for 2025. Issues that have preoccupied analysts are (1) the enormous growth since 2010 of debt issued by the non-financial enterprise sector[1], (2) the fact that authorities have adopted a series of policies that rely more on channelling investments through state-owned enterprises, which serves as a drag on innovation and technical progress[2], and (3) the fact that the hand of the state remains visible across a wide range of private firms both big and small[3]. In my own analyses of China's deleveraging policy, I argue that much of the debt growth can be traced to

[1] The risks posed by the very rapid growth of debt after 2010 were signalled by the *OECD* (*2013*) and the *IMF* (*2016*). Analyses by Chinese scholars traced the origins of this debt growth to the policy of fiscal stimulus the Chinese authorities adopted in 2008 to counteract the effects of the global financial crisis (*Bai et al. 2016*) and also to the emergence of Chinese shadow banking (*Chen et al. 2020*). Chinese authorities responded to these developments with a variety of measures starting in 2014, aimed at containing the growth of debt (*Wong 2018*). For an overview of how the structure of the credit bond markets has evolved since 2009, see *Chen and Anderson* (*2024*).

[2] Official discussions of China's economic development have consistently maintained that China is constructing socialism with Chinese characteristics. Even after the first wave of reforms of the state sector, which saw the number of industrial state-owned enterprises (SOE) drop from 127,600 in 1996 to 61,300 in 1999 (*Lardy 2014*), central authorities reaffirmed their commitment to state ownership and the 5-year plans that set investment priorities. However, analysts have had a hard time establishing an evidence-based case that would justify this. *Zhu* (*2012*) surveys contributions in growth accounting literature to assess the factors contributing to China's high growth rates. He finds that between 1978 and 1998, productivity growth was much higher in the non-state sector than in the state sector. Subsequently, following the reforms put in place in the late 1990s, there was a significant increase in state-sector productivity. However, by far the largest contributor to growth was labour mobility – specifically, the movement of a large part of the labour force out of the agriculture sector (and to a lesser extent the state sector) into the non-state sector engaged in non-agriculture activities, where the *level* of productivity was much higher than in the state sector. Also see *Lardy* (*2019*) and *Ljungqvist et al.* (*2015*).

[3] It should be noted that many analyses implicitly assume that the *purpose* of Chinese firms, both private and state-owned, is to maximise investor returns. They do not take seriously the idea that the interests of a broader group of stakeholders may also be served. Nor do they consider that some firms may actually be pursuing some form of public good provision or may be engaged in mitigating some public bad. In contrast, Dani Rodrik has argued that much of China's success in rapid growth and poverty reduction is attributable to being able to balance public and private interests. See *Rodrik* (*2020*).

financing infrastructure investments that carry public benefits as part of China's urbanisation strategy (*Anderson and Lu 2018, Anderson 2020*). I further show that, at the time the policy was announced, investors viewed the debt of both private firms and state-owned enterprises as carrying implicit state guarantees. Subsequently, between 2016 and 2018, it became increasingly clear that guarantees would be restricted to heritage infrastructure issues of state-owned entities, and this was reflected in the pricing of debt (see *Anderson 2020*).

To assess these challenges and the steps that authorities have taken to sustain high growth going forward, it is important to recall that the principle of decentralisation and self-reliance is deeply embedded in the Chinese system. It has given rise to a model of mixed public-private provision that exists with local variations throughout China. Regional authorities in China are responsible not only for organising public goods in the region, but also for finding the resources to support them. This principle was embedded in the Chinese system early in the market reform era, notably in the first experiments with Special Economic Zones (SEZ) in 1979–1980. In negotiating the creation of the Shenzhen SEZ, party leader Deng Xiaoping stated to Guangdong provincial leaders that "the party centre has no money. So, we will give you a policy that allows you to charge ahead and cut through your own difficult road." (*Vogel 2011*: p. 398). This gave the Guangdong authorities the freedom both to seek funding from overseas Chinese for new investments in the SEZ, and to sponsor enterprises that provide public services needed to support the incoming investments as well as support the growing population.

Subsequently this same principle has been deployed in rolling out economic reforms throughout China. This delegation between central and local powers in all spheres is described by *Xu* (*2011*) as a "regionally decentralised authoritarian" system. While Beijing has very strong powers to intervene in local implementation of policies, if it so chooses, in practice there are limits to its capacity to do so. This creates scope for local variations in the application of policies. In the area of industrial policy, this means that for activities where there are potentially big economies of scale, large firms (either state-owned or private) will be monitored, and possibly, regulated by organs of central government. For economic activities with a regional impact, comparable responsibilities will be assumed at the level of the province or large municipality. Similarly, county-level officials will bear some responsibility for the contributions to economic health and living conditions at the local level. This has led to close relations between public authorities and private business at every level of the Chinese system.

In my view, perhaps one of the most important characteristics that distinguishes China from other countries is the routine delegation of authority to the regional or local level, which in turn is counter-balanced by the centre's ability to give very clear guidance when it deems it necessary. One could argue that the centre exercising authority has become more frequent in the last ten years, and therefore it is more accurate to describe China's system as "state capitalism" rather than "stakeholder capitalism", as I have described it here. To get to the bottom of that debate would require a deeper discussion of comparative economic systems that is beyond the scope of this paper.[4]

While much power devolves to the regions in this system, the centre has still consistently taken responsibility for maintaining China's commitment to balanced growth, where benefits of development are widely distributed. In recent years this is reflected in the Party's commitment to "high quality growth", meaning growth that is sustainable economically, but also environmentally and socially. While central authorities can intervene actively through a variety of administrative means, one important tool, arguably the most potent, in affecting China's long-term development is the national system of residency registration. This is the so-called "hukou system", which indirectly shapes demographic trends throughout the entire country. Under this system, an individual is registered as a resident of a specific locality (either rural or urban), in most cases determined by the residency of the person's mother. In this way, it links the person's access to public services, such as education, healthcare and social benefits, to their place of registered residence. This system was introduced in the 1950s to control internal migration and allocate resources efficiently.

The effect of this system became visible in the years following the opening-up, starting in 1979–1980 as new Special Economic Zones began to take-off. The motivation of the first SEZs was to stimulate foreign investment and increase international trade, which would give rise to a process of export-led growth. This naturally created employment opportunities in coastal areas, which in turn attracted labour supply from rural areas and internal regions. However, the hukou system posed a significant obstacle that tended to restrain the flow of labour to regions with high demand. In the first instance, these contradictions of policy were resolved pragmatically. As word of opportunities in distant places reached the interior, workers set off for the coastal areas where they were housed in informal arrangements, and later in dormitories, as provided by employers or operated as new, private businesses. The new workers were not residents of the locality of the SEZ enterprise, and often their spouses, children and other family members

[4] Some useful contributions to the comparison of China's growth experience and economic structure can be found in other issues of this Review. See, in particular, *Csanádi* (*2017*), *Rippel* (*2017*), *Balogh* (*2017*) and *Komlóssy and Vargáné Körmendi* (*2019*).

remained in their place of legal residence where they had access to public services. Workers would return home at holidays carrying their savings and accessing any needed healthcare as best as they could.

Over time, the poor living conditions of newly arrived workers as well as the associated stress on their families became apparent, and authorities began to take steps to regularise the residential status and improve the provision of public goods in fast-growing regions. Again, the outcomes depended heavily on local initiatives and there was much regional variation. But overall, rapid economic growth has been shaped by demographic patterns in China, which in turn have themselves been shaped by the dramatic changes in the Chinese economy.

In *Section 2* I use Chinese demographic data at the provincial level to illustrate this interaction of demographic factors and economic development. And this, in turn, suggests how these factors will interact in the coming years based on some of the slow-moving characters of China's demographic profile. Then in *Section 3,* I use city-level data in one province, Guangdong, to discuss how demographic forces combined with local authorities' obligations for public good provision have interacted to produce some of the factors currently weighing on China's economic growth. This will suggest areas where central authorities might find ways to help local authorities avoid such problems going forward.

2. Regional demographic factors in China

I have already identified China's "hukou" residential registration system as one policy tool of the central authorities that has been important in shaping China's development path. A second important factor was China's "one-child" policy, which was introduced in 1980 and remained in place until it was relaxed in steps starting in 2014.[5] Otherwise, the main features of its development had things in common with many other countries: a country where initially most of the population is rural and is engaged in agricultural production with low levels of mechanisation and productivity. Development involves a flow of labour to urban areas to work in the manufacturing economy based on capital investments that promise high returns because of the availability of relatively cheap labour[6].

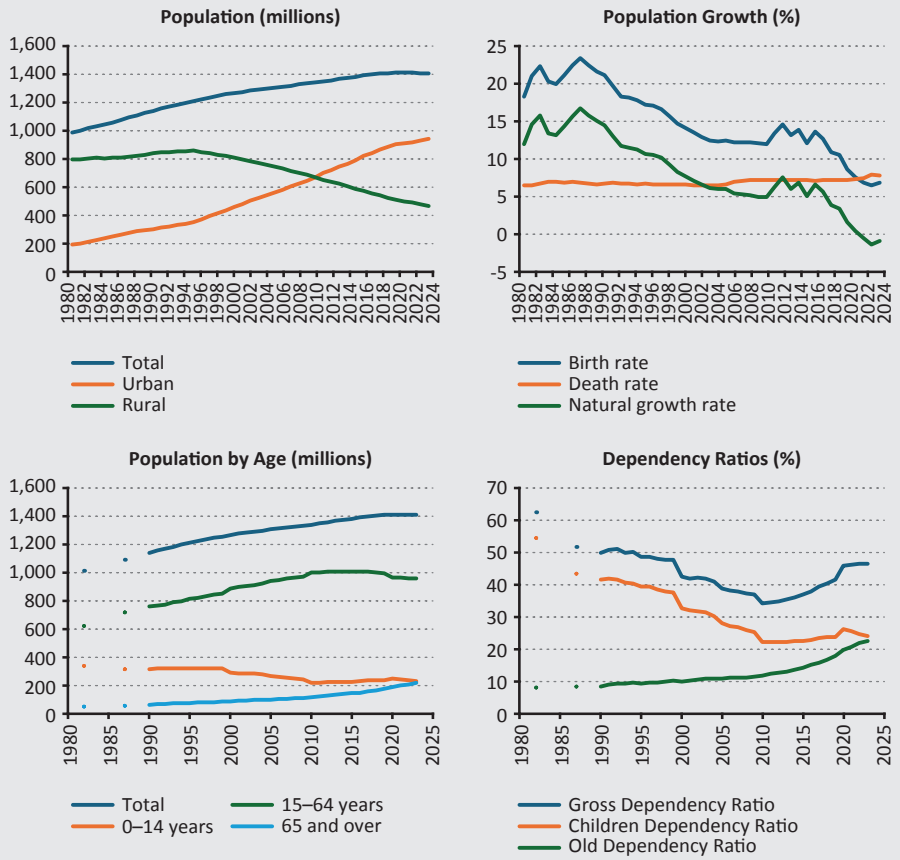
[5] Another dimension of the demographic forces at work in China is the overall aging of the population and its implications for savings, growth and the real rate of interest. These issues are discussed in *Pradhan and Goodhart* (*2024*). See also *Goodhart and Pradhan* (*2020*).
[6] See the classic growth theory set out in *Lewis* (*1954*). See also *Hirschman* (*1958*), *Lin and Shen* (2018) and *Wan and Zhang* (*2017*).

Figure 1 presents the evolution of Chinese demographics at the country level since 1980, based on statistics collected by the National Bureau of Statistics of China. The top left panel presents the population of China overall and broken down into rural and urban localities. In 1980 there was a total population of about 1 billion people, of whom 80 per cent were rural and 20 per cent were urban. Subsequently, the urban population grew strongly, as people were attracted by employment opportunities offered by new manufacturing companies opening in urban centres or in nearby rural localities that were transformed through urbanisation. The rural population continued to rise slowly into the 1990s, but then began to fall rapidly through a combination of low birth rates and emigration to urban areas. By 2010, half of China's population was rural and half was urban. At the end of 2024, the breakdown by residence was 67 per cent urban versus 33 per cent rural.

These broad patterns depict a rural exodus process that is the major feature of China's development in the last four decades, and is still ongoing. Labour was attracted by growth. This involved taking land out of rural areas that formerly had operated collectively in agricultural production, before selling off land rights for use in manufacturing and distribution in the first instance and then later for residential development and public services.

The increased need for public goods for newly arrived urban workers raised the question of how to pay for this social provision. Here, it was realised early on that the growth and prosperity of the newly urbanised areas would potentially lead to enormous imbalances if the tax rights in the new urban areas fell mainly to local authorities. In the face of this, the central authorities imposed a fiscal reform in 1994 that had local tax proceeds accrue to the central budget before being redirected by central authorities to regions all over China in line with priorities set out in the 5-year plans. Furthermore, regional authorities were constrained in their ability to borrow against the prospect of future revenues by prohibiting them from issuing local municipal bonds. However, the local authorities did retain the ability to use proceeds from land sales, and over time land sales became the single biggest asset in the balance sheets of regional governments (see *Anderson and Lu 2018*). The practice of land sales and distributing proceeds varies across regions, but in many cases, locally sponsored state-owned enterprises received proceeds from land sales as part of their capital base. Ultimately, these local SOEs were able to issue their own debt securities. Indeed, local SOEs' bond issues grew enormously as part of the fiscal stimulus launched in 2009, and account for much of the growth of non-financial debt through 2014 (see *Anderson 2020; Anderson and Lu 2018*).

Figure 1
National Level Demographics in China



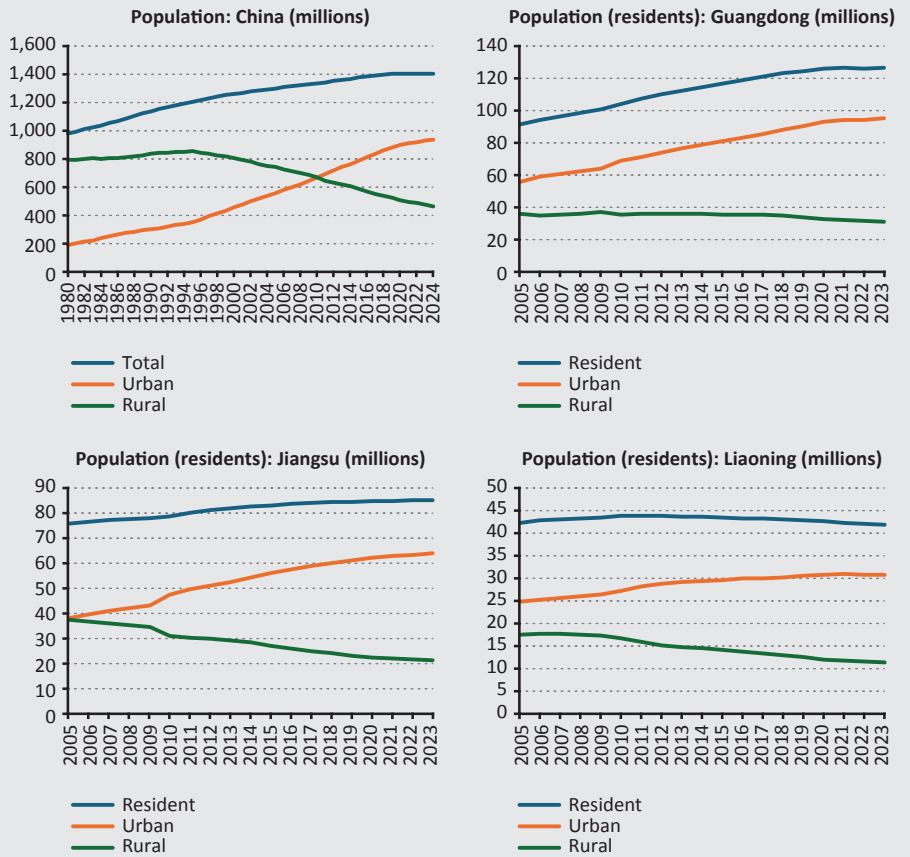
Sources: National Bureau of Statistics of China (https://www.stats.gov.cn/english/Statisticaldata/yearbook/)

The slowing of population growth triggered by the one-child policy in 1980 became visible only with a long lag. This is seen in the top-right panel of *Figure 1,* which depicts the birth rate, death rate and natural growth rate of population annually. From 1980, China's natural birth rate hit its peak in 1987. It subsequently fell smoothly until 2011, by which time the 1985–1990 generation reached peak child-bearing age, increasing the birth rate somewhat for about 5 years. This nicely illustrates the long-term predictability of demographic forces. Another way to depict these factors is seen in the age composition of the population, which is shown in the bottom-left panel of *Figure 1*. This shows the steady rise of the population 65 and older, and the simultaneous slow decline of the population aged 0–14 years.

Overall, China's total population hit its maximum level in 2020, and it has been declining very gradually since. However, the composition of the population has changed dramatically since 1980. This is seen in the bottom-right segment of *Figure 1*, which reports the dependency ratio. The child dependency ratio is the ratio of the population aged 0–14 to the total population. Old-age dependency is the ratio of those 65 or older to the total. And the overall dependency rate is the 0–14s and 65s and older divided by the total population. China's overall dependency ratio has been rising sharply since 2010. Even more striking is the change in the composition of the dependency ratio. In the past, the child dependency ratio was much higher than the old-age dependency rate. The two rates are currently at the same level, and in the future the elderly ratio will become dominant. The implications for social service provision are palpable and dramatic. In the 1980s and 1990s the major need was for education and child-care. In the future, the needs for elderly care and medical care will dominate.

In light of China's characteristic delegation of responsibilities to regional and local authorities, it is clear that many of the consequences of the demographic forces we have described are felt most acutely at the local level. Furthermore, given the nature of China's export-led growth surge, a considerable variation of demographics across regions should be expected. To illustrate this, I compare the demographics of three provinces that were all strongly affected by the growth of manufacturing since 1980, but whose development paths differ in important ways. These are Guangdong, Jiangsu and Liaoning. Guangdong province, whose capital Guangzhou (Canton) is located in south China and includes the Pearl River Delta, has been a trading hub since the 19th century. Jiangsu province is in central-east China, with many important cities in the region of the lower Yangtze River. Its capital is Nanjing. Liaoning is in northeast China, with important transport links to Russia and Korea and port access to the East China Sea. Its capital is Shenyang.

Figure 2
Population trends

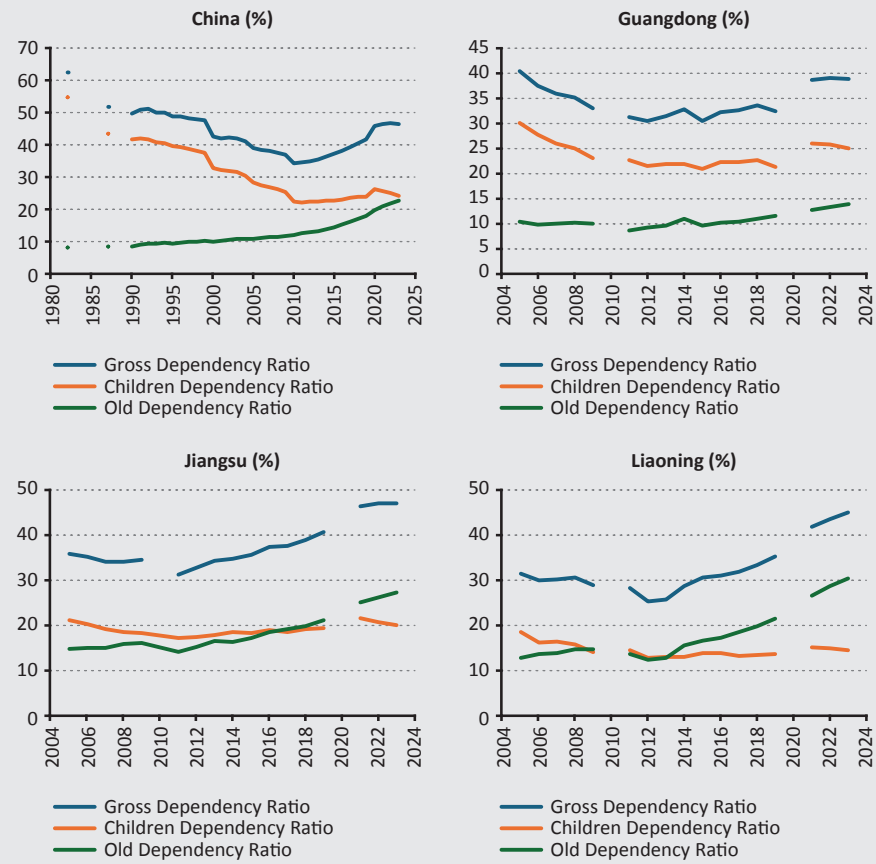


Source: National Bureau of Statistics of China (https://www.stats.gov.cn/english/Statisticaldata/yearbook/)

Figure 2 reports the total, urban and rural populations based on official residency (hukou) each year in each of these provinces between 2005 and 2023. For comparison, I include resident population statistics for China as a whole. We see there have been significant differences in demographic experiences across the three selected provinces. Between 2005 and 2023 overall, China's population grew by 8 per cent, Guangdong's grew by 38 per cent, Jiangsu's by 12.4 per cent, while Liaoning lost 1 per cent of its total population. Guangdong's large increase in population was driven by significant growth in the urban population, whereas its rural population declined by 13 per cent, which is well below the 38 per cent shrinkage of the rural population for China as a whole. The implication is that most

of the newcomers[7] to urban Guangdong came from other provinces. In contrast, since 1990 the overall population has grown moderately in Jiangsu (12 per cent) and not at all in Liaoning. However, there has been rapid growth in the urban population (67 per cent in Jiangsu and 24 per cent in Liaoning), while at the same time a huge rural exodus (–43 per cent in Jiangsu and –33 per cent in Liaoning). This suggests that the authorities in these two regions were faced with the task of reorienting public good provision away from rural areas towards newly developed urban areas.

Figure 3
Dependency rates



Sources: National Bureau of Statistics of China (https://www.stats.gov.cn/english/Statisticaldata/yearbook/)

[7] new registered residents

These regional differences can be seen from a different perspective by looking at dependency rates in these regions. This is depicted in *Figure 3* using data obtained from surveys of registered residents available in the selected provinces since 2005. In Guangdong province, the overall dependency rate declined during the period of its rapid growth from 2005 to 2015. Most of the dependency rate over the reporting period was concentrated in youth dependency, implying a need for schooling and other services to prepare the young for entering the workforce. By contrast, the overall dependency ratios have risen sharply in Jiangsu and Liaoning, driven by old-age dependency rising sharply to 24 per cent in Jiangsu and 31 per cent in Liaoning by 2023. The implication is that the authorities in those two regions have been faced with a need for increased public provision in urban health care, a major change from what was needed in the past.

3. Examples of Development Strategies at the Local Level

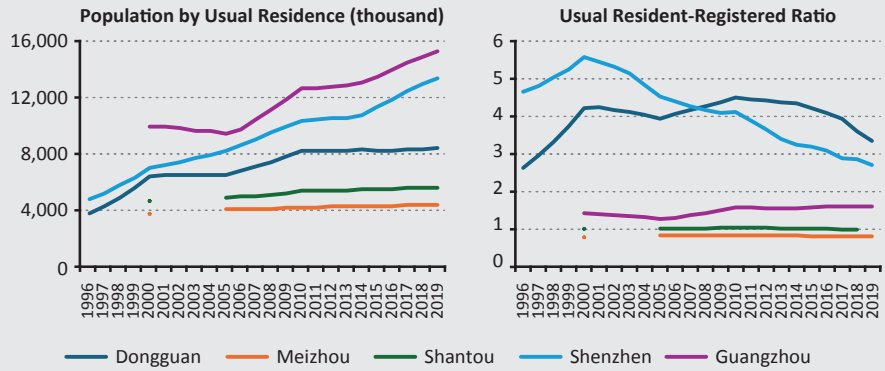
I have emphasised that both delegating public good provision and finding the means to finance it have led to a variety of solutions at the local level in China. To illustrate this more clearly in this section, I will focus on examples taken from five localities in Guangdong Province, a part of China I have visited often over the last 30 years, including extended visits in the last 8 years. These include Guangzhou, the long-standing provincial capital, and Shenzhen, the immediate neighbour of Hong Kong and the initial SEZ as described above. I include two other areas designated as SEZs at about the same time as Shenzhen. These are Dongguan, a large district adjacent to both Shenzhen and Guangzhou, and Shantou, a coastal port about 400 km east of Guangzhou. Finally, I include Meizhou, a historic city and district in the steep hills inland from Shantou. It was one of the homelands of the Hakka Diaspora found worldwide.

Figure 4 presents information about the evolution of the population in these five localities in a way that gives some insight into Chinese urbanisation patterns in the market reform era. The left panel of *Figure 4* reports the total number of people "usually resident" in each city. This includes both residents, people with hukou in that locality, and other people who have hukou elsewhere but are working and usually residing in the locality. The right-hand panel of *Figure 4* reports the ratio of the number of persons "usually resident" (with and without hukou there) to the number of registered residents in the locale.

If you recall, under China's household registration system, upon birth a child is registered in the locale where his or her parents are registered residents. Normally, this was meant to compel them to live and work in that locality in order to have public benefits such as school and medical care. However, after 1980, as certain locales began to prosper, many people left the rural areas to seek job opportunities

in cities. Once in a job they would find housing under informal arrangements or in dormitories provided by their workplace. While this practice was tolerated, the workers did not have the same rights as registered residents. As the numbers of such 'temporary' workers grew in some areas, local authorities began collecting statistics on the numbers of people normally residing in the locality.

Figure 4
Population characteristics



Sources: CEIC (https://www.ceicdata.com/en)

Thus, in 1996 for example, Shenzhen had a population of 4.8 million based on usual residence. At the same time, it had a usual resident/registered resident ratio of 4.67, implying a registered resident population of 1.03 million. This reflected the enormous influx of newcomers to Shenzhen in the first 16 years of its development as a SEZ. Subsequently, Shenzhen's usual resident population grew strongly so that by 2019 it had a population of more than 13 million. Between 1996 and 2000, the usual/registered ratio rose steadily, reflecting a continuing predominance of new workers engaged on a temporary basis. Subsequently, the usual/registered ratio fell steadily and stood at less than 3 in 2019. This tells us that many of the recent arrivals in Shenzhen have been drawn based on employment that qualified people for registered residence status, and allowed them to have their families settle in Shenzhen as well. These dry numbers suggest something about the stunningly fast transformation of Shenzhen from being an underdeveloped rural community to a boom-town living off light manufacturing, and then later emerging as a world-class tech centre.

Figure 4 shows that Dongguan, Shenzhen's neighbour to the north and also an SEZ, experienced an even sharper increase in population between 1996 and 2000, dominated by an influx of temporary workers. Between 2000 and 2005 the usually resident population remained stable. This period saw the closure of many factories that had lost a competitive advantage to other areas of China or other countries. The population has subsequently grown slowly in a process of industrial renewal with a changing mix of products, but it is still dominated by workers with temporary status.

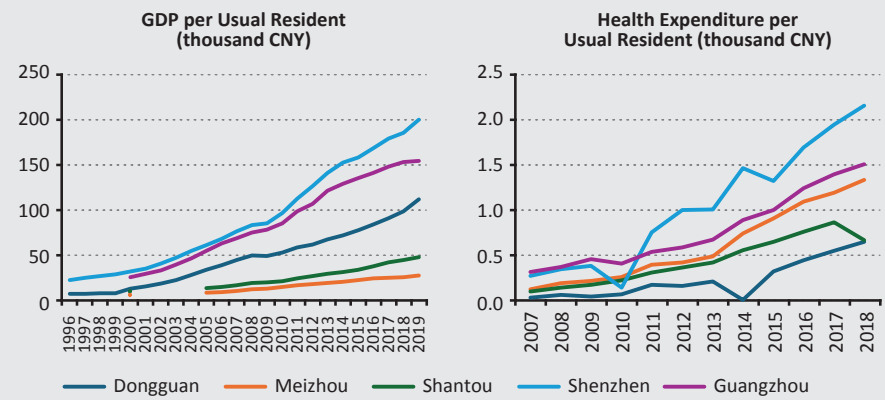
In Guangzhou, the resident population rose strongly from 9.9 million in 2000 to 15.3 million in 2019. Over the same period, the ratio of resident population to registered population rose modestly from 1.42 to 1.6. This reflects the fact that as the capital of the province it has been able to benefit from the rapid development of the surrounding region, including Dongguan and Shenzhen, but also Foshan, Zhuhai and other localities on the western side of the Pearl River Delta.

From *Figure 4* we also see that Shantou and Meizhou have not seen anything like the rapid population growth of Shenzhen, Dongguan or even Guangzhou. Shantou grew from a resident population of 5 million in 2005 to 5.7 million in 2019. Over the same period Meizhou went from 4.1 million to 4.8 million. During this time their ratios of usual residents to registered residents were static at around 1.0. This suggests a process of gradual evolution rather than radical change, even for Shantou, despite its 4 decades of experience as a SEZ.

These population growth patterns seem quite understandable if one considers how the localities are connected. Shenzhen and Dongguan have long had sea access to Hong Kong, Macao and other countries, and also to other areas throughout the Pearl River Delta. At the beginning of the market reform era there was already a railroad link between Guangzhou and Hong Kong (Kowloon) that had stops in Shenzhen and Dongguan. Thus, with the introduction of the SEZs there was already a skeletal transportation network and a great many possible and relatively cheap extensions of that network that could produce a wide variety of agglomeration economies. In contrast, Meizhou and Shantou were hampered by poor transport links either to the Pearl River Delta in the west or Xiamen and Zhejiang Province to the east. These transport links have improved only gradually. In 1996 there was no direct train from Guangzhou to Shantou. By 2008 a direct train service was in place with an overnight train ride taking 7 hours. The Shenzhen-Shantou high-speed rail link came in 2013 and has reduced travel time to about 2 hours. The Guangzhou-Shantou high-speed line is still under construction, and is scheduled for completion in late 2025. Once finished, it will reduce travel time to about 90 minutes.

Figure 5 gives some additional insight into social and economic development in these five cities. The left panel gives the GDP in the locality per usual resident of the locality. By this measure, the burgeoning prosperity of Shenzhen stands out. In 2000, twenty years after it took to its "own difficult road" as set out by Deng Xiaoping, it had more than equalled Guangzhou, long the most prosperous city in southern mainland China. By 2019 this gap had widened. GDP per usual resident was 200,400 CNY (29,000 USD) in Shenzhen versus 154,400 CNY (22,286 USD) in Guangzhou. The evolution of per capita GDP in Dongguan reveals the boom-bust-renewal pattern suggested by the population figures. In Meizhou and Shantou, this measure is consistent with the moderately increased prosperity in line with the scenario suggested by the slower growth of their resident populations.

Figure 5
GDP and Health Expenditure per usual resident



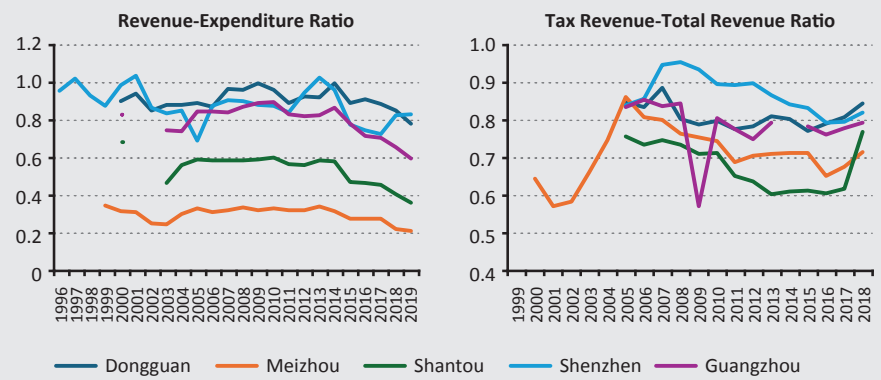
Source: CEIC (https://www.ceicdata.com/en)

The right-hand panel of *Figure 5* reports the total expenditure on health and family planning in public facilities in the locality per usual resident in the locality. We see that this measure of socio-economic development has tended to increase with rising GDP, but not in lockstep. It is particularly interesting that, by this measure of public health provision, Meizhou attains a status close to Guangzhou, the provincial capital that boasts a large number of excellent hospitals and specialised health facilities. By comparison Shantou, and particularly Dongguan, lag behind.

I think these patterns well reflect the consequences of China's system of regional self-reliance. Health authorities in a prefecture-level city in China fund expenditures through a combination of (a) contributions from the municipal budget or higher-level (provincial or national) budgets under specific programmes, (b) fees for services provided to patients paid by insurers (based on household registration, employment

or private insurance) plus patient co-payments, and (c) from sales of medicines and other health products in shops embedded in public facilities. Thus the relatively high level of health expenditures in Meizhou may be a consequence of high demand for health services by the local population reflecting demographic characteristics (e.g. a relatively older population) as well as income levels. However, it may also reflect the fact that Meizhou is the main city servicing a wider region that includes many isolated rural communities. It would be the nearest and most convenient place to seek medical assistance for any relatively complicated medical condition. Finally, since citizens are free to seek their medical assistance where they like, high demand may reflect a good reputation. Thus, there is an element of competition at work. Staff of a medical facility may seek excellence as a matter of pride. But they may also appreciate the financial benefits that a strong flow of co-payments brings. These same considerations suggest why, in *Figure 5*, Dongguan appears to lag behind the other cities in terms of local health expenditures. It may be that some its healthcare needs are best served in nearby Guangzhou or Shenzhen. Also, the many recent arrivals without household status in Dongguan may also find it preferable (due to cost, waiting time or familiarity) to seek health services when they return home to visit their families. For example, when a Meizhou native working in Dongguan worker falls ill, he may well return home for an operation where post-operative care is cheaper, and where he has family members for support.

Figure 6
Revenue-expenditure ratios



Sources: CEIC (https://www.ceicdata.com/en)

Figure 6 sheds light on the ways in which slow-growers like Meizhou, and to a lesser extent Shantou, stand apart from their fast-growing neighbours in the Pearl River Delta. The left panel reports the ratio of municipal public revenues to total municipal public expenditures. In 2019 this ratio stood at 0.2 in Meizhou and 0.37 in Shantou[8]. This compares to 0.83 in Shenzhen, 0.78 in Dongguan and 0.59 in Guangzhou. In the right-hand panel, we see that the ratios of tax revenues to total municipal revenues are similar in all 5 localities. Thus, there seems to be a general structural difference that results in a higher level of local public good provision in Meizhou and Shantou. One possible explanation is that some of these services are being funded either through commercial activities generating payments earned directly by the entity providing the service (fees for health, education, etc.) or from subsidiaries or other branches of the same entity providing the public service.

Unfortunately, it is not easy to use publicly reported data to understand which of any contributing factors account for the proportion of public services paid for off-budget. As discussed by *Wong* (*2018*), weaknesses in China's reporting systems result in inconsistencies across jurisdictions and over time. In particular, it is not clear that all the relevant entities are identified and are required to report using the appropriate accounting framework. This was recognised in the 2014 Budget Law that called for the introduction of a new government financial reporting system to collect comprehensive information on government revenues including extra-budgetary and earmarked levies, land sales, remittances from SOEs and receipts from various pensions and social insurance schemes (*Wong 2018*: pp. 276–277). However, progress on implementing this has been slow. In part, this reflects the difficulty of identifying the relevant reporting entity and in classifying them correctly as either a public service or a commercial entity. For example, a city may sponsor many SOEs organised as a large group with many subsidiaries, some of which providing public goods and others purely commercial. It may be that profits from commercial activities are used to fund some of the expenditures of the public service entities, but that these transfers are not included among the public revenues.

Proponents of enterprise reform in China have long embraced the principle that public and private provision should be unbundled by clearly identifying an enterprise as either a commercial or a public service. Furthermore, since about 2000, one of the objectives of enterprise reform has been to "securitise" SOEs with a commercial purpose by structuring them as either limited liability companies or joint stock companies. However, this agenda has never been pushed consistently across all regions. In a comparative study of enterprise reform, *Lu* (*2018*) reports that as of 2014 in Guangdong Province there was a relatively low level of securitisation

[8] The money needed could come from any of the sources indicated above in (a), (b) and (c). Note that this includes payments made by non-residents for health services they receive in the localities (Meizhou or Shantou).

among local SOEs: as of 2012, only 21 per cent of total local SOE assets were in listed firms, compared to the target of 60 per cent set in the 12th Five Year Plan. In her assessment, many SOEs in Guangdong were sprawling conglomerates without clear core competencies.

Some insight into this issue can be gained by using information available on SOEs issuing enterprise bonds listed on either the Shanghai or Shenzhen stock exchanges that were used to fund infrastructure projects. The Shantou Investment and Financing Group Company, an AA-rated local SOE, issued a 1.8 billion CNY enterprise bond in March 2014 to fund municipal construction projects in Shantou. As reported by Wind Financial Services[9], it describes itself as active in financing "investment industry, agriculture and traffic, municipal facilities, real estate industry, ... import and export, ..., implementing the Municipal party committee and the city's decision-making, land reserve development, ... engineering advisory service, flowers cultivation, plant cultivation, technology study, development and operation." This seems to align well with the characterisation of lacking a clear core competency. It is certainly consistent with the view that some public good provision in Shantou may be financed through internal resource flows within this broad publicly owned group.

The case of Shenzhen Metro Group (SZMG) gives a different impression. It is an AAA-rated local SOE that issued two enterprise bonds in 2013 and 2014 for a total of 8 billion CNY. It is described in Wind as a firm concentrated in "construction, operating, development and comprehensive utilisation of subway and light-rail traffic projects". Its core activities are described on its website (in Chinese and in English) as the construction and operation of Shenzhen's rail transit lines, which had a total length of 210 kilometres in 2016. However, in addition, it undertakes a variety of commercial activities that are treated as integral to the metro developments, including commercial and residential property development, advertising and station commerce. In fact, real estate development accounts for a large share of its profits, which in 2019 stood at 11.7 billion CNY as compared to revenues of 21 billion CNY from metro operations. Its owner, the Shenzhen Municipal Government, contributes capital mainly in the form of land use rights. Costs of development are funded by retained earnings and debt, which is reimbursed largely through proceeds from commercial and residential real estate.

However, SZMG is not just a big real estate developer. It also represents the interests of Shenzhen in transportation planning and coordination activities at the provincial and national level. It cites its active involvement in targeted social services, including the provision of free transit for elderly residents and the construction of 22,000 units of affordable housing. Finally, it states that "Shenzhen Metro Group Co., Ltd. emphatically advocates and creates the enterprise culture

[9] https://www.wind.com.cn/

with the core value of 'mutual undertaking of responsibilities, mutual creation of values, and mutual sharing of achievements'", dedicated to the creation of a learning-oriented enterprise with a spirit of strict discipline and humanistic management, a harmonious and balanced "iron sole". While this mission statement uses enthusiastic language that exceeds the current norm in the West, it is in fact reminiscent of the statements of purpose used by many of the prominent cooperative enterprises developed in Europe in the early 20th century, some of which are still deeply embedded in important sectors such as insurance and banking.

4. Conclusion

To close this exploration of the operations of Chinese-style stakeholder firms, I now return to the question presented at the outset, which I reformulate as follows: Do the struggles of local governments for resources drive reform of local SOEs? And, if so, how does this affect the provision of public versus private goods? There is some evidence that China's deleveraging policy since 2014 is indirectly placing pressures on local governments to reform their SOEs. As detailed in *Anderson* (*2020*), the main elements of this policy are (a) prohibiting local governments from making open-ended debt guarantees or from committing proceeds from future land sales for that purpose, (b) channelling general-purpose local government borrowing through municipal bond issues by provinces or provincial-level cities, and (c) channelling public funding for capital investment projects through partnership projects (PPP[10]), where a local SOE joins with an outside partner (a private company or another SOE) that contributes their management expertise in infrastructure plus financial capital for about 20 per cent of the project cost, with the remaining 80 per cent funded by debt, often from a domestic policy bank. Following the Directive of the State Council in 2014 setting out this programme, it became clear that the policy was being reinforced by the National Development and Reform Commission, which reduced the flow of new approvals for enterprise bond issuances that had formerly been a major funding channel for local governments' infrastructure projects. Furthermore, during 2016 and 2017, repeated statements from the Ministry of Finance and the State Council emphasised the limited scope of government guarantees. At the same time there were highly publicised cancellations of several major PPP projects plus associated disciplinary actions against local government personnel for violating PPP guidelines.

[10] public–private partnership

All of this has had the effect of reducing local governments' ability to move resources freely among government departments and their associated SOEs. City and county governments must make their cases to provinces to gain access to resources, and the provinces need to convince Beijing that their allocations are coherent and effective. During 2018 and 2019, it became clear that local governments were feeling the effects of this regime when some highly indebted municipalities encountered major difficulties in rolling over infrastructure debts that were falling due[11]. More recently, in the wake of the trade disputes with the US and the Covid-19 pandemic, the central authorities dialled back somewhat on the deleveraging campaign. For example, they have allowed "special-purpose" municipal bonds to be used to recapitalise local publicly owned commercial banks, and have abolished a rating metric of "local public finance quality", which penalised localities with a low proportion of total expenditures funded through local taxes. However, despite these stop-gap measures, the pressure is on local governments to confine their commercial ventures to those that contribute resources rather than drain them, and to channel these resources to public services that are needed by local people.

The challenges to China's development model have been focused on the real estate sector since 2020, and particularly since the high-profile defaults of *Evergrande* (*2021*) and *Country Garden* (*2023*)[12]. Through 2024 most of the significant defaults have been confined to private enterprises and have taken place in the offshore market, especially Hong Kong. Some pressures have come to bear on public-sector finance, as evidenced by delays in payments of some short-term commercial paper issued by so-called local government funding vehicles. Most recently, the central government authorities have taken steps to contain these pressures by making capital infusions into several of the largest state-owned commercial banks and by targeting a central fiscal deficit in 2025 of 4 per cent of GDP. In so doing, they have tacitly recognised that China's future public-sector development can no longer be financed principally through land sales, and that Chinese savers will need to shift away from real estate and redirect their investments toward equities and other capital-market vehicles.

[11] See e.g., *The Local Government Debt Crisis that Just Won't Go Away*. Caixin, 10 April 2019. https://www.caixinglobal.com/2019-04-10/in-depth-the-local-government-debt-crisis-that-just-wont-go-away-part-1-101402567.html

[12] See *China Default Review 2024: Through Before the Third Wave*. S&P Global Ratings, 23 April 2024. https://www.spglobal.com/_assets/documents/ratings/research/101596523.pdf

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