Did Policy Experimentation in China Always Seek Efficiency? A case study of Wenzhou financial reform in 2012

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Policy experimentation has been widely considered a ‘magic bullet’ of policy improvement and key to economic prosperity in China. This article, however, argues that policy experimentation in China does not always seek policy efficiency. Rather, it can be manipulated as a political symbol without actually affecting practices. By taking a case study on Wenzhou’s financial reform, this article illustrates that local policy experimentation can serve as a mechanism for the central government to legitimately delay reform practices—in the case of Wenzhou’s financial reform in 2012, out of a desire to maintain socio-economic stability during the power succession at the 18th Party Congress. In this reform, socio-economic stability was deemed more important than developing a sustainable and effective long-term policy. This article provides a new perspective on understanding policy experimentation in China by proposing the idea of ‘symbolic reforms’.

Introduction

Thirty years of spectacular economic growth in China suggests that the Chinese Communist Party (CCP) somehow got its market reforms right. China’s economic prosperity has prompted a plethora of political science and economics literature linking the policy experimentation with the economic miracle.¹ The existing studies

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consider policy experimentation as a ‘magic bullet’ of policy improvement and key to economic prosperity in China. Though the link seems natural, the existing studies have underemphasized political dynamics of policy experimentation in China, which this article will highlight.

This article argues that policy experimentations in China do not always seek effectiveness and efficiency; nudging policy experiments can allow the government to fake activity regarding problems which can no longer simply be ignored. Policy experiments may thus serve only to pay lip service to other parties involved without really tackling the core problems or launching meaningful reforms.

This article proposes the idea of ‘symbolic reform’ to explain why reforms can be manipulated as a political symbol to maintain the status quo. By taking a case study of Wenzhou’s financial reform, this article illustrates that local policy experimentation can serve as a mechanism for the central government legitimately to delay reform practices—in this case, out of the desire to maintain socio-economic stability during the power succession at the 18th Party Congress.

In Wenzhou’s reform, socio-economic stability was deemed more important than developing a sustainable and effective long-term policy. This stability-oriented reform succeeded in solving the debt crisis and restoring market confidence in the short term. Although it might be argued that maintaining stability was an improvement on the rather chaotic environment that preceded it, this reform did not tackle the core structural problems or significantly increase the efficiency of the financial system as both the local and central government promised.

The Wenzhou case was chosen because it has been a pioneer of local policy experimentation in China for decades, to the extent that it has been referred to as having developed a specific ‘Wenzhou model’. Financial reform has long been far behind other market reforms in China and Wenzhou has a long history of being a pilot area in which to practice financial reforms. The financial reform of 2012 in Wenzhou represents a typical case of policy experimentation, but it is also unique because this reform is closely related to Wenzhou’s debt crisis in 2012 that clashed with the once-in-a-decade leadership transition. It thus provides a great opportunity to examine how the central state balances its understanding that fundamental financial reform is necessary to promote long-term economic stability on the one hand, with the need to guarantee short-term socio-political stability on the other.

Notably, the purpose of this article is not to dispute the relationship between policy experimentation and China’s economic growth, but to explore its impact on regime survival that has been underemphasized by the existing literature. This article provides a new perspective on understanding policy experimentation in China.


3. For example, in 1987, Wenzhou first launched a floating interest reform. In 2002, Wenzhou was set as a comprehensive financial reform pilot area.
Policy experimentation in China

Institutions of the communist states, as proved by their history, have been widely regarded as extremely inflexible and rigid. China, however, seems to be an exception. Market reforms launched by the CCP leadership have fostered remarkable economic growth over the past three decades. The regime has showed great adaptability in overcoming the complex challenges of large-scale economic transformation while avoiding systematic breakdown. China’s economic prosperity and the poor practices of many developing countries on ‘Washington Consensus’ style reforms present constant challenges to the marketization-cum-privatization paradigm. How to explain the success of Chinese economy and market reforms?

Many link it to the decentralized experimentation of policymaking in China, which has been considered key to encouraging policy innovation and economic growth in China. For example, Heilmann argues that the core of China’s adaptability is ‘the unusual combination of extensive policy experimentation with long-term policy prioritization’. This experimentation ‘minimized the risks and the cost to central policymakers by placing the burden on local governments and providing welcome scapegoats in cases of failure’. Wang Shaoguang argues that there are learning modes to explore suitable welfare systems for China. The resilience of the Chinese system lies in its ‘deep-seated one-size-does-not-fit-all pragmatism’ and the adaptability of decision makers is key to the ‘China model’. In this sense, policy experimentation is at the core of China’s developmental experience.

Others, on the contrary, argue that decentralized experimentation is not the primary cause of the economic miracle and reform success in China; rather, they consider local policy experimentation as a product driven by political factions. It is argued that the central leaders tend to broaden their bases of political support by proving the effectiveness of their preferred policies in local states. Cai and Treisman argue that the pro-reform factions, Deng Xiaoping and his allies in particular, frequently used effective local experiments as opportunities to promote their supporters and replace anti-reform or conservative officials. For example, Deng Xiaoping replaced the conservative local leaders of Fujian with more enthusiastic reform supporters because of the slow reform progress of the Xiamen Special Economic Zones in the late 1980s.

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11. Cai and Treisman, ‘Did government decentralization cause China’s economic miracle?’.
Above all, both views suggest that local policy experimentations in China are launched to explore more efficient policies, either in order to promote economic growth or as part of political struggles. As this article will demonstrate, policy experimentations in China are not always seeking a better policy.

There are many kinds of policy experimentation in China and the case study of this article emphasizes those launched by the central government and practiced in local regions. In this kind of policy experimentation, the central state would usually launch reform programs first. The local states then voluntarily practice those experimental programs with some of the successful local experiences later adjusted into national policy and rolled out countrywide. During the process of experimentation, the central state usually expresses support for certain local initiatives or programs, but keeps some distance from local pilots. This distance encourages the self-innovation of local governments with less intervention from the top. It also washes the central government’s hands entirely of responsibility for potential reform failure. The power structure of the regime reduces the costs and risks of the central state. If there is any popular protest caused by reforms, local governments might be blamed for ‘mismanagement’ or ‘misleading’, and the central government will play a moral role of savior. The central government thus retains a favorable position in that it can contain and quell local protests without affecting its own appearance of legitimacy.

This model of policy experimentation in China has successfully transformed a great number of local projects into national policies. The agricultural reform, for example, started the entire reform process in 1978 and later emerged as a national policy after experimentation in different provinces. The acceptance of private ownership as a legitimate form in China in the 1980s also followed successful local experimentation in Wenzhou where the case study of this article is based. Policy experimentation is the process of turning local input into national policy and Chinese style local–central interaction. Many noted the local–central interaction as the Chinese style of federalism. Some argue that it is a model of decentralization.

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Others argue that neither of the above terms can grasp the essence of China’s local–central interaction. Heilmann defined it as ‘experimentation under hierarchy’ because there are no vertical checks and balances in China’s authoritarian system and the central government has the unchallengeable authority.  

**Theoretical explanation**

*Symbolic reform*

To date, there is no in-depth analysis of symbols on the experiences of policy experimentation in China, although political symbols of reform have been extensively studied in the area of public administration. Symbols are defined here as a set of positive normative concepts, which might be embedded into plans to construct positive reform languages. Going one step further, this article proposes the idea of ‘symbolic reforms’ (象征性改革). Symbolic reform refers to those reforms which merely comprise political symbols without corresponding substantive changes. There are many popular sayings expressing similar meanings, such as ‘a change in form but not in content’ (换汤不换药), ‘an old wine in a new bottle’ and ‘loud thunder without rain’ (雷声大，雨点小), among others. When the political actors are either incapable of or unwilling to launch meaningful reforms but they still make significant reform promises to address pressure for reforms, those reforms are likely to be symbolic. The case of Wenzhou financial reform demonstrates that policy efficiency is not always the primary goal of policy experimentation; rather, it can be used as a symbol of changes that ironically act to maintain the status quo instead.

Political symbols of reform are particularly important in China where political marketing is a strength of the CCP. Chinese leaders are keen to portray themselves as being more positive and forward looking than their predecessors so as to win popular support, despite the fact that they do not necessarily need popular votes. For example, when President Hu Jintao and Premier Wen Jiabao took power, the Chinese government used official propaganda in many ways to portray the new leadership as reformists. In the first few years, it was widely called the ‘new politics of Hu and Wen’ (胡温新政). However, Hu’s leadership has achieved very little progress in political system reforms in the past decade and his era is considered by many as a ‘lost decade’. A similar strategy was subsequently applied to promote the reform credentials of the new leadership of Xi Jinping and Li Keqiang. After the 18th Party Congress, official propaganda invested in building an image that suggested that the

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new leadership was determined to combat corruption and promote reforms. Xi Jinping’s visit to Guangdong Province has been deliberately publicized in the style of Deng Xiaoping’s South Visit which launched a new era of reform in China. To what extent this image reflects the reality still needs further observation and will take some years to become clear.22

Political symbols have been used not only in political system reforms but also in Chinese administrative reforms. The importation of the Super-Department Reform is a fitting example. The Chinese government launched a superficial Super-Department Reform to serve domestic purposes by symbolically learning from the West.23 Some argue that the Chinese government has been manipulating the Super-Department model as a symbol of Western reform ideas with weak implementation.24

Manipulating broad symbols of reform policies by political actors can produce several benefits.25 First, in the short term, symbolic reforms tend to be less costly when facing a complicated problem with ambiguous solutions. Second, political leadership can gain legitimacy by using reform symbols. Third, the symbols given in talks and plans can have the same effect as practice or reality in shaping people’s reform perceptions, at least at first.

Political actors might choose to label their reform in certain positive ways in order to attract broader public support.26 To embed a set of positive normative concepts into a reform plan as reform symbols is a clear way to construct positive reform languages. To a certain extent, reform symbols can substitute for actual practices.27 In the case of Wenzhou, the central state designed an ambitious financial reform plan to express its determination to implement a complete and deep reform. As I will explain later, it successfully helped to gain market confidence and maintain socio-economic stability without doing a great deal. In this way, a financial reform idea has substituted the actual practices in solving debt crisis.

Theoretical framework

The following section reviews theoretical explanations to introduce a context for the case study. The gap between reform ideas and implementation is widely observed as a ‘loose coupling’.28 It is usually associated with politics in liberal democracies but

22. However, in his interview with Duowei news, Deng Yuwen, who is the deputy editor of the Central Party School’s Study Times journal and an influential commentary writer, argues that the content of Xi Jinping’s ‘Chinese Dream’ is old but the bottle is new, thus it is ‘an old wine in a new bottle’. Please see http://china.dwnews.com/news/2013-06-28/59248571.html (accessed 14 July 2013).
24. Ibid.
can also be applied to the authoritarian regimes. Indeed, it is one of the major governance problems shared by both the US and China.\footnote{Yongfei Zhao and B. Guy Peters, ‘The state of the state: comparing governance in China and the United States’, \textit{Public Administration Review} 69, (2009), pp. S122–S128.} Pressure from the environment is one of the most important factors leading to this ‘loose coupling’, which ‘defines how much leeway political leaders have in making choices about reforms’.\footnote{Tom Christensen and Per Laegreid, \textit{Transcending New Public Management} (Aldershot: Ashgate Publishing Ltd, 2007).} For example, reforms might be initiated or heavily influenced by pressure from the environment, such as an economic crisis, in order to maintain the legitimacy of leadership and increase the efficiency of public sectors.

Elite reform activity is another important factor which can lead to this ‘loose coupling’ because reform credentials are closely linked with the legitimacy of leadership. When political actors are incapable of or unwilling to implement a real reform, political actors might cover it up by promoting ideas of reform to gain public support and ‘to have a broader political effect, hoping that people will care more about the promises of reform than about finding out what really happens to reform in practice’.\footnote{Christensen and Laegreid, ‘Administrative reform policy’; Tom Christensen and Per Laegreid, ‘Administrative reform policy: the challenges of turning symbols into practice’, in \textit{The Sixth National Public Management Research Conference}, School of Public and Environmental Affairs, Indiana University, Bloomington (2001).} In this situation, reform outcomes can be far from reform ideas.

An understanding that reform combines two central dimensions is used as the analytical framework in this case study. One dimension is the pressure from the environment: strong or weak environmental pressures for reforms (both domestic and international). The other is the reform activities of political actors: whether political leaders are capable of and active in promoting a systematic reform or are more concerned with simply establishing reform credentials when under pressure. Four possible combinations are listed in Table 1.

Model 1 indicates that the leadership might actively promote a systematic reform and effectively implement reform ideas. In this case, it is likely that a real reform will be launched. Model 2 suggests that the reform ideas are likely to be manipulated as hollow symbols to face external pressures for reforms. In this situation, a symbolic reform would be launched to maintain legitimacy and establish

<table>
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<tr>
<th>Model</th>
<th>Active reform activity: leaders who are capable of and active in initiating and promoting reforms</th>
<th>Low elite reform activity: leaders who simply intend to build reform credentials</th>
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<tr>
<td>Strong</td>
<td>Model 1</td>
<td>Model 2 (highly likely to be symbolic reforms)</td>
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<td>Elite pressure</td>
<td>Model 3</td>
<td>Model 4</td>
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\textbf{Notes:} a This table is developed from Lisheng Dong, Tom Christensen and Martin Painter, ‘A case study of China’s administrative reform: the importation of the super-department’, \textit{The American Review of Public Administration} 40(2), (2010), pp. 170–188.
the reform credentials of political leaders, rather than tackle the core problems or seek meaningful changes. Thus, the reform is likely to remain superficial ‘window-dressing’. In some cases, a political leader might be interested in implementing a complete reform but is unable to do so in the face of severe resistance from vested interests; nonetheless, the leader may still choose to make significant reform promises in response to reform pressure. It is also a kind of symbolic reform, which merely comprises reform promises as political symbols without corresponding substantive meaningful changes, and is applied to the low elite reform activity category of Model 2. Model 3 indicates that the reform elements will be selectively picked to fit in a local context setting. Model 4 suggests that no reform will be launched and the status quo will be maintained.

The case of Wenzhou financial reform

After discussing the theory, let’s return to the case of Wenzhou. Chinese banks have privileged large and state enterprises in their lending decisions over small and medium-sized enterprises (SMEs) even during years of financial expansion. The SMEs are in an unfavorable position when it comes to gaining loans, which has led to the prosperity of the underground lending market (民间借贷). The debt crisis of Wenzhou and prosperity of the underground market are mainly caused by the high interest rate of private finance on the one hand and limited official investment channels to attract the private idle fund on the other hand. A meaningful solution should not lie in solving specific issues in Wenzhou, but rather in solving the structural problems in the financial system that force people into shadows. As we shall see, the central government seems not to be interested in reaching the core structural problems in the financial reform of Wenzhou.

Debt crisis in Wenzhou

Wenzhou has a leading developed private economy in China with abundant private funds and financial activities. It is one of the manufacturing powerhouses in China, producing and exporting products including lighters, clothes and shoes. Many successful, privately owned enterprises are based in Wenzhou. In recent years, many SMEs have reduced their investment in traditional business because of declining profits.32 Windfall profits, on the contrary, were made in the real estate market.33 Many local entrepreneurs, therefore, took their money out of the struggling industrial manufacturing sector and put it into the profitable real estate market. In 2011, the central government began to tighten monetary policy to curb soaring inflation, which made it even harder for SMEs to receive credit from banks. Many SMEs had to look for financing from the underground lending market. The interest rate of this underground market is much higher than the benchmark interest rate and it is usually organized for

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32. There were many reasons for this decline in profits, including: appreciation of RMB currency, economic recession in the US and Europe, and increasing labor costs in China.
33. Interest rates on deposits are so low that simply depositing money in the banks is not an attractive option; therefore, many choose to invest in the housing market.
short-term borrowing. Figure 1 shows Wenzhou’s interest rates in the private lending market. While the benchmark interest rate hovered between 5% and 7%, the interest rate in the private lending market reached over 20% in 2011. It also indicates that the interest rate of the private lending market has been dramatically growing since July 2010. Within half a year, this rate doubled, reaching a peak in 2011.

The high return of the private lending market attracted a great amount of private capital from various individuals and organizations, including officials and formal guarantee companies (Figure 3). Figure 2 shows the scale of the private lending market in Wenzhou. It indicates that the underground market has been growing at a very rapid rate since 2003. In 2011, when the debt crisis occurred, the scale of private lending in Wenzhou reached 125 billion yuan. According to the report by the Wenzhou Branch of the People’s Bank of China, over 50% of SMEs were borrowing through personal channels and 89% of family individuals and 57.67% of

Figure 1. Interest rates of the private lending market (%) in Wenzhou from 2003 to 2011. Source: Chunxi Zhou and Lu Jiang, Research Institute of Sinolink Securities, 应重视基本面恶化带来的第二波冲击—中小企业与民间借贷专题 [We Should Pay Attention to a Second Wave of Impact Made by the Deteriorating Fundamentals—Topics of Small and Medium Enterprises and Private Lending] (Research Institute of Sinolink Securities, 2011).

34. According to the author’s interview with underground market insiders (March 2012), the monthly interest rate is usually set at between one cent (一分) and three cents (三分), or sometimes even ten cents (一角). A one cent interest rate means the interest is one cent per yuan every month. This high interest rate is partly a result of the massive financing demand of SMEs combined with the limited supply of China’s banks.


36. This is also a result of the low interest rate of banks in China.

enterprises in Wenzhou participated in private lending in 2011. In addition, at that time, over 37% of those private funds were speculative investments (Figure 4).

As the underground market is not recognized by the government, the operating mechanism of this market mainly depends on social credits and a mutual guarantee mode is adopted to strengthen this credit. The guarantors are responsible for lending practices, thus taking the risk of any lending loss if the lenders cannot repay in time. In order to access more finance, many SMEs in Wenzhou adopted a mutual guarantee, which tied up the risks. If they were unable to repay the loans on time, some SMEs

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38. Interview with underground market insider, March 2012.
39. It means that many SMEs would guarantee one another as a group. If any of these SMEs is unable to repay a debt, the entire group is responsible for compensating for the loss.
chose to borrow more from the underground market to pay off the interest and the interest rate on this was higher than on previous loans: a vicious circle. In fact, the profit from real estate was largely affected by government control policies and it was impossible to sustain such high returns. After the financial chains eventually broke, some of the local entrepreneurs fled and a few even committed suicide, leaving substantial debt behind in Wenzhou. While the situation was more severe in Wenzhou than in other parts of China, this ‘local’ crisis nevertheless had repercussions beyond the immediate environment and various reports expressed serious concern about the potential impact of the collapse of the Wenzhou private lending scheme on the Chinese economy as a whole.40

After the mass media exposed the flights and suicides of SME owners, the lenders requested that SMEs pay back their borrowings. The underground lending market shrunk rapidly, which led to an ever greater number of SMEs collapsing. A chain reaction in Wenzhou’s economy and waves of collapsed SMEs seriously challenged the local socio-economic stability. In late September 2011, the news reached a climax when the SinceTech chairman was reported to have escaped to the US, leaving a debt of over two billion RMB.41

Response of the government

Soon after the debt crisis, on 3 October 2011, Premier Wen Jiabao visited Wenzhou with many top finance officials, including Financial Minister Xie Xuren, the Governor of the Central Bank Zhou Xiaochuan and the CBRC Chairman Liu Mingkang. They visited the industry bases and met with many SMEs during their visit to Zhejiang. Wen emphasized that ‘local government should properly handle the

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40. Research Institute of Sinolink Securities, 应重视基本面恶化带来的第二波冲击 [We Should Pay Attention to a Second Wave of Impact Made by the Deteriorating Fundamentals].
recent risky events, protect people’s legal rights, and strengthen market confidence'.

On 28 March 2012, the State Council approved ‘The Overall Program of Wenzhou Financial Comprehensive Reform Pilot Area in Zhejiang Province’. It pointed out that ‘the broken funding chain and the fleeing of local entrepreneurs in Wenzhou affected economic and social stability’ and clarified 12 central tasks of Wenzhou financial reform. Through the ambitious and complete financial reform plan, the central state signaled to the market that it was determined to solve the debt crisis and funding problems of SMEs. Wenzhou again became a pilot zone for far-reaching financial reforms.

The debt crisis was gradually solved after the announcement by the State Council. It is notable that the reform announced by the State Council was a vague plan and the specific implementation measures were left to the Wenzhou government to organize. Interestingly, those specific rules were postponed several times after the immediate debt crisis was solved. In July 2012, the Wenzhou Financial Office claimed that the specific rules would be announced on 28 August 2012; however, the Office failed to announce them. Relevant conferences of Wenzhou financial reform were held on 29 September 2012, just half a year after the announcement of the State Council, which seemed to be a good time to release the specific rules. Wenzhou Financial Office Director, Zhang Zhengyu, explained that specific rules would be released in the press conference on 29 September 2012, but this conference was later cancelled. According to a source at Securities Times, it was cancelled because there had been no substantive progress achieved by this reform in the government’s opinion. Not surprisingly, the repeated delays of specific rules have made many who had high expectations of this reform feel disappointed.

The leadership transition in late 2012 (i.e. the 18th Party Congress) and the need for stability are among the reasons why the reform rules were postponed. According to a research report by Essence Securities, a major reason which led to the slow progress of the Wenzhou financial reform is that the key target of the local government was to maintain stability. Therefore, they emphasized the risk control. This report expected that progress would be faster after the 18th Party Congress. On 23 November 2012, a week after the leadership transition at the 18th Party Congress, the Wenzhou government finally released the specific rules. As we shall see, those rules left many insiders disappointed again.

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43. Executive meeting of the State Council of China, on 28 March 2012.
45. Ibid.
46. Ibid.
47. Ibid.
49. Ibid.
Theoretical framework and the Wenzhou financial reform

After introducing the debt crisis and the government response in Wenzhou, let's use the aforementioned theoretical framework to analyze the Wenzhou financial reform.

External pressures

The immediacy of the Wenzhou debt crisis generated strong pressures from the CCP and social forces. First and foremost, the primary pressure came from the CCP leaders, which was extremely high as it was relevant to the survival of the regime. The crisis of Wenzhou has caused economic difficulties in China’s leading local economy. If it could not be contained immediately, it might have become a national crisis. Economic success is widely considered as a principal (if not sole) pillar of political legitimacy in China, and Chinese intellectuals are seriously concerned about the negative impacts of bad economic performance on regime legitimacy. In this sense, the Wenzhou debt crisis did pose a serious challenge to the legitimacy of the entire regime, and was not just a local problem in Wenzhou itself.

In addition to economic problems, this crisis also undermined social stability—Wenzhou fell into panic immediately after the media exposure about the flight or suicide of local entrepreneurs. To maintain a stable social order is highly valued by Chinese leaders. According to Deng Xiaoping, ‘in China, the overriding need is for stability. Without a stable environment, we can accomplish nothing and may even lose what we have gained’. In Jiang Zemin’s speech at the 15th Party Congress, Jiang clearly elaborated that ‘without stability, nothing can be achieved’. Hu Jintao also warned that ‘we should always keep in mind that there is nothing we can achieve without social stability; we should properly handle the relationship among reform, development and stability, and maintain the overall social stability’.

While this emphasis on stability has been something of a constant in contemporary Chinese politics, it appears to have been an even greater and urgent consideration in


52. Also, during his talk with leading members of the CCP Central Committee on 24 December 1990, Deng again insisted that ‘I have said more than once that stability is of overriding importance and that we cannot abandon the people’s democratic dictatorship’ [我不止一次讲过，稳定压倒一切，人民民主专政不能丢]. See Xiaoping Deng, Selected Works of Deng Xiaoping Vol. 3 [邓小平文选第三卷] (Beijing: Foreign Languages Press, 1994), p. 365; English translation is cited from People’s Daily, available at: http://english.peopledaily.com.cn/dengxp/vol3/text/d1170.html (accessed 15 July 2013).


54. ‘我们要始终牢记没有稳定的社会局面，就什么事也干不成，妥善处理好改革和发展稳定的关系，保持社会大局的稳定.’ Hu Jintao, excerpt from a talk during Hu’s visit in Brunei, 21 April 2005.
2012 because of the once-in-a-decade leadership transition. Seven out of the nine most powerful leaders including President Hu Jintao and Premier Wen Jiabao were replaced in late 2012. For an authoritarian regime, successfully transferring the top power and preventing a split in the leadership during this process have always been extremely challenging. Around 68% of authoritarian leaders have been overthrown by ruling elites rather than by the masses. Power succession in China has always been a moment of crisis and great change, except for the two most recent transitions.

In 2012, the scandal of Bo Xilai, a member of the Politburo and a leading candidate to enter the Politburo Standing Committee, indicated an intense political struggle under the table. Bo was removed from his post as Chongqing Party Chief several months before the leadership transition because of a ‘disciplinary offence’, and his wife was charged with murder. As the power transition period has a high incidence of crisis and instability, the CCP was very sensitive to any potential risks and tried their best to maintain stability during this period in order to perform a smooth and orderly leadership transition. As such, the central leaders could not simply ignore the debt crisis and they immediately responded with a financial reform idea to establish their reform credentials and maintain their leadership legitimacy.

In addition to intra-party concerns, some pressure also came from domestic private enterprises, which are in an unfavorable funding position in trying to compete with state-owned enterprises in the current financial system. The debt crisis was also originally caused by those SMEs that could not gain sufficient loans from Chinese banks. Not surprisingly, the SMEs expected that the central government could reform the financial system in order to reduce their financing costs. However, as I will explain below, this reform neither reduced financing costs for SMEs nor improved the efficiency of the financial system as it promised. Although both the party leaders and social forces push for the financial reform, they expected a different outcome from the reform. In short, the SMEs attempted to gain greater economic benefits from the reform, whilst the central leaders considered it as a mean to restore socio-economic order.

**Elite reform activity**

As mentioned above, compared with the inefficiency of the current financial system, the leadership of Hu Jintao and Wen Jiabao seemed to be more concerned about the instability caused by the debt crisis at the sensitive period of leadership transition. They were either incapable or unwilling—perhaps most persuasively both of the above—to launch a complete reform to solve the structural problems of the financial system.
system in China. The primary reason is simple: a market-oriented financial reform might cause uncertainties and the CCP needed stability in 2012, as I mentioned earlier.

Moreover, it was perhaps an awkward time to start a tough reform. Such a complex reform needs sustainable support and commitment from the central government. Although we can expect the new leadership to adopt a path-dependent approach on major issues, whether they will show the same level of support for this financial reform is still questionable.

In addition, policy consistency might be affected by the leadership transition. For example, the new premier Li Keqiang has staked his financial reform plan on the ‘China (Shanghai) Pilot Free Trade Zone’ rather than the ‘Wenzhou Financial Comprehensive Reform Pilot Area’. Although the central government claimed that Wenzhou financial reform would be highly valued when it was launched, this reform did not receive corresponding support from the central government after the debt crisis was solved—indeed, the support of Li Keqiang’s State Council for pilots in Shenzhen and Shanghai seems to have been much stronger than that for Wenzhou, as I will explain later.

Above all, the above discussion suggests that Wenzhou financial reforms fit the categorization of Model 2 (strong external pressure with low reform activity) in the theoretical framework. It indicates that reform remains superficial without meaningful changes. This is evidenced by Wenzhou’s ambitious reform ideas in contrast with poor reform practices.

Symbolic reform: ‘loud thunder without rain’

The reform ideas in Wenzhou were highly ambitious and positive, which led to another wave of news coverage after the debt crisis and raised high expectations in the market. However, its actual practices seemed to deviate from this goal. After the specific rules of reform were released by the Wenzhou government, many industry insiders felt very disappointed and used the words ‘loud thunder without rain’ (雷声大，雨点小) to describe this reform.58

For instance, the vice president of the SMEs Association and the president of Wenzhou SMEs Development Promotion Association, Zhou Dewen, argue that Wenzhou financial reform did not make any breakthrough and its rules were too vague.59 According to Zhou, the Wenzhou reforms lacked courage and the government restricted itself.60 The vice dean of the Shanghai Advanced Financial School at the Shanghai Jiaotong University, Zhu Ning, argues that the results of this reform are mixed. Whilst it has helped the economy to recover in Wenzhou, however, the extent to which the reform ideas have been implemented is a serious problem.61

59. Tong, ‘温州金改：细则不“细” 隔靴搔痒’ ['Wenzhou financial reform'].
60. Li, ‘温州金改细则难产民众参与热情大减’ ['Specific rules of Wenzhou financial reform have not been announced yet'].
61. Ibid.
Ye Tan, a prominent Chinese financial analyst, argues that Wenzhou’s financial reform only ‘changes a new dress without improving its body’ (改皮不改骨).\(^6^2\) Ma Guangtuan, a prominent Chinese economist, is more pessimistic. After several visits to Wenzhou and communication with local officials and institutions, Ma argues that the specific rules of Wenzhou financial reform ‘failed badly’ (很失败)\(^6^3\) and the reform ‘only exists in name’ (名存实亡).\(^6^4\) Why were those insiders and analysts so disappointed about this reform?

First of all, many parts of the content of the reform were not new. The second task of the reform program approved by the State Council, for example, is to ‘accelerate the development of new financial organizations: encourage and support private funds to participate in village banks, loan companies, and rural capital unions’.\(^6^5\) Indeed, the China Banking Regulatory Commission (CBRC) released similar policies for village banks as far back as 2006. Regarding small loan companies, ‘Suggestions to Adjust Access Policy of Banks and Financial Institutions in Rural Areas’ in 2006 and ‘Guidance of Small Loan Companies Pilots’ in 2008 announced by the CBRC also formed similar policies.

This task has not been well implemented either. According to Zhou Dewen, only two small loan companies were established in Wenzhou and none of the small loan companies changed into a bank for the villages and towns after the reform was announced.\(^6^6\) The financial reform of 2012 emphasizes the idea of accelerating the development of new financial organizations, but no specific measures (such as loosening conditions to establish small loan firms or simplified government approval procedures) were released to achieve this goal. According to Zhou, this is perhaps because the local government restricted itself and lacks courage.\(^6^7\)

The biggest breakthrough of this reform is perhaps the official recognition of private finance. This policy helps the government to monitor private finance; however, its real impact on the operating mechanism of private finance is very limited. This issue refers to a more important reason why the financial reform of 2012 is symbolic: it deliberately avoids touching upon the core issues. Under the control policies of the interest rate, the official interest rate in China does not respond to the market and thus it is not very attractive for private idle funds. In this situation, private idle funds will still be motivated to go to underground markets which offer high interest rates. This prediction has been confirmed by the latest data. Figure 5 shows the interest rate of private finance and banks from 2011 to 2012. It indicates that there is a wide gap between the interest rate of private lending and that of banks after the reform. A year after Wenzhou’s debt crisis, the interest rate of private finance per

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\(^6^2\) Ye, ‘叶檀：温州金改改皮不改骨’ ['Wenzhou financial reform changes the skin without improving the core parts'].
\(^6^5\) For the contents of the reform, please see http://politics.people.com.cn/GB/1024/17523916.html.
\(^6^6\) Li, ‘温州金融改革细则难产民众参与热情大减’ ['Specific rules of Wenzhou financial reform have not been announced yet'].
\(^6^7\) Ibid.
year was 21.78% in November 2012 and 21.54% in December 2012. These rates were almost 3.5 times more than the benchmark interest rate.

More importantly, the financial reform of 2012 avoided touching upon the most important issues: the marketization of the interest rates. Both the 12 tasks of financial reform announced by the State Council and the specific rules of the Wenzhou financial reform released by the Wenzhou government failed to mention this issue. As explained above, the high financing cost of SMEs was the primary cause of Wenzhou’s financial crisis. To solve this problem, the liberalization of interest rates is the key.

Over the past two decades, various scholars have frequently proposed reforming interest rates in China. Ten years ago, Wenzhou did explore interest rate marketization in the first round of financial reform. Some financial institutions were tentatively established and massive deposits were attracted by their higher interest rate. The pilot was eventually revoked under strong oppositions from other financial institutions. Wenzhou’s reform of 2012 is actually much more conservative than the one of 2002 regarding this issue.

Not surprisingly, symbolic reform can help to maintain the stability and legitimacy of leadership, but it cannot solve the real problems. The Wenzhou financial reform failed to alter substantially the funding difficulties of SMEs. As indicated in Figure 5, the financing cost for SMEs is still very high and the financial reform does not control the excessive interest rates of the private market. In September 2011, when the debt crisis began to appear, the private interest rate was 21%. This was even higher after

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**Figure 5.** Interest rate of private lending market in Wenzhou from 2006 to 2012 (%). *Source: The information before 2012 was provided by Zhou Chunxi (Zhejiang Gongshang University) and the data for 2012 were updated by the author from the private lending comprehensive interest rate index [民间借贷综合利率指数]."

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the financial reform and reached 22.3% in September 2012, a year after the debt crisis. The latest rate of December 2012 provided by the Wenzhou government was 22.05%, which is higher than the average rate for 2011.

In addition, this reform also fails to improve the investment channels of private idle funds. Limited official investment channels led to the inefficient allocation of private idle funds and this is one of the major reasons why the underground market is so prosperous. Various Chinese scholars have proposed building a more diversified official investment channel for private idle funds. This reform promised to ‘build a diversified financial system and encourage development of private funds’, but it did not implement this goal. According to the report by the Economic Herald, various private idle funds in Wenzhou were excited by this financial reform; however, the Wenzhou government deliberately controlled the progress of the reform, which made the legal investment channel of the private fund still quite limited. This indicates that the government wanted to maintain socio-economic stability. In the words of the Wenzhou Finance Office, ‘stability’ is a guiding principle. The local officials are also wary of taking any risk. In the words of the Zhejiang Party Chief, Zhao Hongzhu, and the Wenzhou Financial Office Director, Zhang Zhengyu, ‘Wenzhou financial reform failure will not be tolerated’ (只许成功，不许失败).

The Chinese Academy of Social Science (CASS) provides a more comprehensive and authoritative evaluation of Wenzhou financial reform based on its scholars’ fieldwork in Wenzhou in August 2013. Although this report acknowledges the progress of the reform in three aspects—launching various measures to promote financing and investment of the SMES, establishing a financial safety net and efforts in building the insurance system—it points out seven major problems that still exist in Wenzhou’s financial market. It clearly points out that the reform ideas were not well-implemented. It also argues that the policy support and tax incentives are insufficient because the central government did not give sufficient to the pilots in Wenzhou compared with pilots in Shanghai and Shenzhen. According to the report, the crisis of the mutual guarantee mode is still ‘spreading’ (蔓延) in Wenzhou. A more straightforward expression is given by Zhang Ming—one of the CASS report’s two authors and a CASS research associate—‘the financial reform failed to solve big problems’ (金融改革没能解决大问题).

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71. Chao Shi, ‘温州金改受阻民间借贷仍限投资受限’ [‘Wenzhou’s financial reforms are not effective yet, investment channels of private funding are limited’], 经济导报 [Economic Herald], (2012).

72. Ibid.

73. Xiang Gao and Junhua Hu, ‘温州金改成长记：重点在制度创新’ [‘Development of Wenzhou financial reform: emphasis should be innovation of institutions’], 每日经济新闻 [National Business Daily], (2012).


Concluding remarks

As demonstrated by the case of Wenzhou, policy experimentation in China does not always seek policy efficiency that is at least implied in some of the literature. Reforms can be manipulated as political symbols to restore socio-economic orders by promoting the ideas of ‘change’ and to maintain the legitimacy of leadership by establishing their reform credentials.

To understand the extent to which policy experimentation in China is used as a hollow symbol, it is necessary to understand the interests of the central government. Although economic power has been highly decentralized in China, the central state still holds the unchallengeable power in this authoritarian system. It still dominates the power to set policy goals, choose local practices, define the ‘success’ of policy practices in local states, and decide whether local practices will be upgraded into a national policy. In this way, the central state can filter local practices in its own right, and there is little doubt that this filtering process will be affected by the interests of the central government. As illustrated in this article, a more efficient and effective policy does not always coincide with the interests of the central state. In the case of the Wenzhou financial reform, the priority of the central state is to maintain stability, which could be at the expense of policy improvement. Thus, Wenzhou financial reform is likely to go through a ‘tinker through’ process.

As Heilmann argued, the pattern of central–local interaction lies at the core of China’s policy experimentations.76 In this sense, it is important to understand how the interests of the central government affect the design of local experimentation. The central government has to step in every time local governments fail, but it might not always impose a meaningful solution or tackle the real problems. More importantly, the extent to which symbolic reforms represent the cases of Chinese reforms needs to be studied carefully given its implications for the development of China.

Nowadays, many China watchers tend to find explanations for adaptive governance from China’s political system. They consider this authoritarian system as ‘resilient’.77 It implies that China’s political system somehow helps to encourage reform and policy innovation. While there is much room for those arguments, we should not undermine the limits of the authoritarian system. In democratic countries, alternations of the government will not necessarily lead to the collapse of the political system. However, in China, the state, the political system and perhaps the economy are combined. The cost of a split leadership during the process of power succession will be paid for not only by the regime but also by the entire political system. At all times, the survival of the government is the first priority for the party-state; it might be at the expense of policy and reform merits.

76. Heilmann, ‘Policy experimentation in China’s economic rise’.