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*"In a party-state capitalist system, the state's prioritization of political goals drastically limits the scope for making compromises with private capital."*

# Party-State Capitalism in China


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The structure of China's economy has taken center stage as mounting global tensions and anxieties have accompanied the country's increasingly global economic footprint. Along with the conservative turn under Xi Jinping's leadership, China's economic model has evolved to solidify a much stronger role for the state.

For decades, China has been cast as exemplifying "state capitalism," a broad concept meant to explain mixed economies in which the state retains a dominant role amidst the presence of markets and private firms. State capitalist systems are found in a variety of regime types, ranging from authoritarian countries like China and Russia to democratic states such as Norway, Brazil, and India. These systems typically feature state ownership and other tools of government intervention that aim to achieve economic development goals, especially growth and competitiveness in globalized sectors.

Recent changes in China's model, however, make it less comparable to state capitalist systems because the tools of state intervention and its underlying logic are different. Ruled by a Chinese Communist Party (CCP) that is celebrating its centennial this year, contemporary China is better understood as a sui generis form of political economy in which the party-state's political survival trumps developmental goals. This mode of what we call "party-state capitalism" has profound consequences for China's domestic politics and relations with other governments.


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## THE ROAD FROM 'MARKET SOCIALISM'

China's post-Mao economic reform process has always been multifaceted, nonlinear, and contested. It has not followed a singular established blueprint.

From the 1970s through the early 1990s, the CCP worked in fits and starts to layer market activity on top of a planned economy. Agricultural reforms set up markets for goods that farmers produced over and above required quotas. Private enterprises were informally encouraged, even as state-owned enterprises (SOEs) remained dominant and the state continued to control key economic inputs, especially land and capital. Special economic zones first demonstrated the viability and promise of foreign investment and export-driven growth before all Chinese cities were linked to the global economy.

It was only in the late 1990s that the CCP began to significantly privatize and downsize the state-owned sector. By the mid-2000s, China's state capitalism was primarily about managing the remaining large SOEs to contribute to economic growth, create wealth for the party-state, and look out for its economic and strategic interests at home and internationally. This circumscribed role for the state left ample space for private businesses to grow, a phenomenon captured in the common Chinese phrase, "The private advances, the state retreats."

As institutional and evolutionary approaches to political economy have established, even apparently stable systems are pressured to adapt to changing conditions or face the prospect of extinction. In developed democracies, postwar capitalism adopted the Keynesian principles of "embedded liberalism," by which states were open to global trade and competition, while providing social welfare and other benefits to protect citizens




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from the vicissitudes of global markets. But as fiscal crises associated with the rise of the welfare state emerged, this model was displaced during the 1980s by neoliberal reforms whereby many developed democracies abandoned or eroded protective interventions in order to more fully embrace laissez-faire market forces.

Likewise, in East Asia, rapid industrialization in the authoritarian postwar developmental states of Taiwan and South Korea generated structural changes in government–business and state–labor relations that supported their respective transitions to democracy. The Asian financial crisis of the late 1990s also led these governments' leaders to question the sustainability of state-led industrialization.

By the late 2000s, China similarly faced a critical juncture in its reform process, out of which party-state capitalism emerged. The global financial crisis of 2008–9 amplified already widespread concerns in China about the country's economic dependence on exports. Beijing responded to the crisis with a massive credit-driven economic stimulus, much of which went into infrastructure and land development. Within a few years, rising local government and corporate debt raised fears of oversupply in these sectors.

These economic trends, combined with growing social instability and widespread corruption, called for policy responses. Intellectuals associated with the "New Left" sought correctives to what they perceived as the more pernicious effects of markets and private ownership, especially inequality and bourgeois decadence.

Such views on the need to undo the harms of capitalism underlay the "Chongqing Model" of local Party Secretary Bo Xilai. Bo, widely seen as a rival to Xi Jinping before the end of the Hu Jintao administration, attracted national popularity and international attention for a suite of policies he carried out in the southwestern provincial municipality of Chongqing. He sought to use his leadership of this sprawling megalopolis to introduce a new development model. As some of its architects wrote in their 2010 book *The Chongqing Model*, it would "fuse capitalism and socialism" to "control the selfish desires and impulses" associated with Deng Xiaoping's reform strategy of "market socialism with Chinese characteristics."

The Chongqing Model promoted state-owned firms as capital investors in private enterprises, massive infrastructure construction, social policies such as subsidized housing, and accelerated urban citizenship and public benefits for rural migrants working in cities. Bo also drew on Maoist-style political mobilization through anticorruption drives and campaigns to "sing red songs" that invoked revolutionary and Maoist nostalgia. But Bo's political star fell in a spectacular scandal: his wife was accused of plotting the murder of a British businessman, a story revealed when Bo's own police chief and anticorruption czar fled to the US consulate in a neighboring province to seek protection.

While Bo's answer to the problems of market socialism was an emboldened state, prominent economic reformers, especially Wang Yang, the party secretary of southeastern Guangdong province, offered the competing case that greater liberalization and a diminished role for the state would better address economic distortions and social problems. When Xi assumed the mantle of the fifth-generation leader of the People's Republic of China, it seemed plausible that he might introduce bolder market reforms to break through bureaucratic and business interests vested in preserving a system of partial reforms. A prominent 2013 party document promised a new round of economic liberalization; although it emphasized that the public sector would remain important, markets for the first time were slated to have a "decisive" role.

*The party-state's political survival trumps developmental goals.*

Yet the changes heralded by this document did not occur. Under Xi's rule, the CCP has instead extended its authority and reach—organizationally, financially, and politically—into China's domestic and foreign economic relations. Although prior developmental goals remain intact, they have been overshadowed by initiatives that place politics in command with the objective of mitigating perceived risks to the party's political survival.

## RISK MANAGEMENT

Xi's initiatives have used state power to discipline private capital. He first targeted a problem widely recognized under the Hu administration: crony links between businesses and officials that have eroded the party's legitimacy and internal discipline. Similarly, the excessive debt burdens that emerged in the 2000s in both local governments

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and corporations were identified by the Xi administration as "grey rhino risks," or obvious problems that are ignored until they move quickly and cause dramatic destruction.

These risks erupted into a financial crisis in 2015. The crisis was blamed on malfeasance and collusion between market participants and regulators. In the same period, capital flight threatened the value of the currency, the renminbi (RMB). With access to domestic credit, large conglomerates embarked on global shopping sprees, snapping up real estate and other prestige assets in developed markets.

Xi and his team subsequently restricted outward investment in sectors like hospitality, sports, and entertainment; detained or arrested executives of large firms; and even restructured or nationalized some of the country's largest conglomerates, such as Anbang Insurance and HNA Group. Firms, including those with origins in the Chinese state, were no longer trusted to behave in ways that would advance the national interest.

The leadership also became fixated on acquiring the resources China would need to protect its economic security. In 2014, Edward Snowden's revelations that the US National Security Agency had infiltrated Huawei's servers to learn about the telecommunications company prompted widespread concern in China about dependence on foreign technology for its critical industries. If China was to advance beyond the status of a middle-income country and reach the top rank in global technological competitiveness, the leadership reasoned, it would need domestic know-how and innovation in frontier industries such as artificial intelligence, semiconductors, nanotechnology, and robotics.

These became the target industries for Made in China 2025, a massive industrial policy introduced in 2015. By 2021, it would channel more than 10 trillion RMB into domestic firms at the forefront of these sectors. To grow and prosper in areas vital to national security, Beijing had decided that China could no longer rely on global supply chains and interdependence with the world.

It is important to emphasize that, while the emboldened role for the state in China's economy and society seems to signal its strength, the underlying logic is one of threat and risk management. Xi took power aiming to address the threat of corruption, but he has encountered only increasingly diverse sources of perceived risk to the regime since 2013. Examples include trade and technology conflicts with the United States and others, the politicization of China's global Belt and Road infrastructure projects, and protests in Hong Kong. Party-state capitalism reflects the regime's strength as well as its fears, both of which in turn have been politically consequential for domestic state–business relations and for realizing China's ambitions in the world.

If state capitalism and "market socialism with Chinese characteristics" were characterized by familiar conceptual dyads—state versus capital, public versus private—party-state capitalism displays a novel blending of state power and firm organization, funding, and activities, a mixture that renders such dyads increasingly irrelevant. Three features of contemporary Chinese political economy in particular illustrate the political logic, as opposed to a more straightforward developmental logic associated with economic dirigisme, of China's new model: further encroachment by the party-state on the economy; blurring of state and private sectors; and demands for political fealty from firms.

## ENCROACHING INFLUENCE

In party-state capitalism, the tools for managing China's economy entail not only state ownership and market interventions, but increasing party-state institutional encroachment in other realms of economic activity. These new means of control empower new agents and prioritize discipline and monitoring by party-state actors.

One example is an emboldened role for the party in corporate governance. A basic indicator of the party-state's institutional expansion is the resurgence of party cells—units responsible to the party, and composed of party members—inside enterprises, including private businesses and even foreign firms. The presence of party cells in private and other "nonstate" organizations in itself is not new, but under Xi, emboldening party control and party building in firms became a key priority.

At the 19th Party Congress in 2017, Xi declared that the CCP "exercises overall leadership over all areas in every part of the country." Since then, both Chinese and international media have noted signs of the enhanced vigor and influence of party organizations in private firms and joint ventures. The CCP itself reported that 1.88 million nonstate firms had established party cells by the end of 2017, accounting for over 73 percent of all such firms.

As the party heightens propaganda calling for party branch construction within private domestic firms, many business owners have expressed

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anxiety about the potential for state intervention in the management of their affairs. In addition to the party-state's own organization, key municipalities have assigned officials to new oversight offices within firms—including some of the biggest private companies, such as e-commerce giant Alibaba and automaker Geely. These officials report directly to the government.

Another expression of expanded party-state influence in the Chinese economy is "financialization," meaning the control of firms through financial instruments such as equity stakes. Party-state encroachment entails the expansion of state capital well beyond firms that are majority-owned by the state. Since Xi assumed power in 2012, the CCP has encouraged the establishment of "state-owned capital investment companies" that invest in nonstate firms with growth potential in strategic sectors. Investments generally involve state shareholding firms acquiring small (typically less than 3 percent) minority stakes in nonstate firms through purchases on equity markets.

This practice ramped up during the stock market crisis of the summer of 2015, when sell-offs suddenly erased the gains of the prior year on the Shanghai and Shenzhen exchanges. As part of a menu of bailout actions, the China Securities Regulatory Commission arranged for a "national team" of state shareholding funds to purchase over 1.3 trillion RMB in stocks on both exchanges between June and September, eventually holding half the shares of all listed firms. This broad financial intervention was not about allocating capital in pursuit of growth, but rather about risk management and maintaining stability.

*Xi's initiatives have used state power to discipline private capital.*

Expansion of state shareholding has not only been adopted in emergencies. Starting in 2013, the CCP began exploring the idea of creating "special management shares" for the state in media and technology companies—firms with strategic and political importance. Official documents indicate that special management shares are a class of equity shares with special governance power or greater voting rights than ordinary shares. The first purchase under this scheme occurred in 2016, when the official CCP newspaper *People's Daily* acquired 1 percent of a Beijing-based Internet company and installed a "special director" on the board who possesses veto power over content. The titans of China's digital economy—Baidu, Alibaba, and Tencent—have reportedly been pushed to grant the government 1-percent special management shares.

Another manifestation of the party-state's economic activism is evolution in the scope of industrial policy. The Made in China 2025 strategic plan was launched to encourage indigenous innovation, technological self-reliance, and industrial upgrading. The broad contours of the initiative resonate with more traditional "state capitalism," but its implementation, more than previous industrial policies, involves private firms as both targets of investment and managers of state capital. This blurring of state and private sector in China's efforts to advance its technological prowess has been met with alarm around the globe.

## PRIVATE FIRMS, PUBLIC INTERESTS

China's private sector has been a major source of the country's economic "miracle," outpacing the contributions of the state-owned sector by most measures. A common description of the private sector's economic value is "60/70/80/90," meaning that private firms contribute 60 percent of China's gross domestic product and generate 70 percent of innovation, 80 percent of urban employment, and 90 percent of new employment. Meanwhile, SOEs continue to accrue losses and suffer declines in productivity. To some degree, these problems are endemic to the sectors in which state enterprises have been concentrated historically—strategic and declining industries—but that explanation is secondary to inefficiencies and misallocation of capital by state financial institutions.

Despite the importance of the private sector to China's economy, the common connotation of the term "private"—relatively hived off from the state—is belied by features of the new model. It entails intensifying blending of not just ownership, but also function and interests, in a manner that upends the familiar public/private binary and illustrates the distinctive political logic of party-state capitalism.

Private firms have become key actors in support of the state's domestic security objectives. The digital revolution has diversified China's security industry, as seen in the party-state's growing reliance on technology-intensive surveillance tools and big data to monitor and discipline the large population. Private firms dominate the supply of

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hardware, technology, and information infrastructure that comprises the expansive surveillance apparatus. China's largest video surveillance manufacturers, Hikvision and Dahua, were founded by private entrepreneurs. The relationship between these companies and the party-state is reminiscent of the US military-industrial complex—except in China's case, the products are geared toward maintaining domestic rather than national security.

Relatedly, a more recent addition to China's monitoring regime is its emerging "social credit system." Initiated in 2014, the system seeks to create a synthetic assessment of "creditworthiness" and "trustworthiness" for individuals and businesses by aggregating digital data on their past and present social and economic activities. The "trustworthiness" metric goes beyond traditional financial indicators of credit history, extending to normatively "sociable" or "unsociable" behaviors such as donating blood, jaywalking, spending time playing video games, and "spreading rumors" on social media. Those with higher social credit scores enjoy discounts on purchases, priority admissions to schools, and lower interest rates on loans. Whether the scores are used for commercial purposes or more Orwellian scenarios, the initiative relies on the capabilities and cooperation of private firms.

The relationship between private technology companies and different branches of the party-state is multifaceted—at times competitive, and yet unfailingly mutually dependent. The recent drama involving China's most famous entrepreneur, Alibaba founder Jack Ma, and his Ant Financial is a case in point. Ant is the parent company of Alipay, whose electronic payment system and Sesame Credit claim more than one billion users. For years, Ant's product development seemed to move faster than regulators, yet frequently with state support. In 2015 the People's Bank of China selected eight private technology companies, including Ant, to pilot consumer credit scoring. Three years later, however, the central bank tried to curtail Alibaba and Tencent's independent social credit programs due to concerns about their potential to market risky financial products.

In the fall of 2020, Ant was set to sell shares in the largest initial public offering (IPO) in history, but regulators abruptly suspended the IPO, and Ma disappeared from the public eye for several months. Weeks before the suspension, Ma had given a critical speech at a high-profile event, exhorting China's regulators to tolerate more financial risk if they wanted to see growth and innovation. Although much has been made of the speech, the state's alarm about Ant was about more than Ma's outspokenness: documents filed for the IPO revealed the systemic importance of this nonstate firm. Ant was fined $2.78 billion in April 2021 and forced to undergo a systematic restructuring of its business, with investigations still pending.

## DEMANDING POLITICAL FEALTY

A third aspect of party-state capitalism in contemporary China is the expectation of adherence to party-defined political correctness, not just by domestic economic actors, but also by foreign corporations that do business in China and in territories over which it claims sovereign authority. Some firms have been proactive in demonstrating political compliance by establishing party cells in their China offices. Recently, however, a growing number of major foreign brands and organizations have been pressured to express contrition for various political faux pas, primarily relating to how Hong Kong, Taiwan, and Tibet are portrayed in their advertisements, websites, or social media communications.

Businesses with significant stakes in the China market have changed their discourse and behavior, whether due to direct pressure or self-censorship. When the general manager of the Houston Rockets, a US National Basketball Association (NBA) team, tweeted support for Hong Kong protesters in 2019, the league was heavily criticized by state-owned China Central TV. The network suspended its NBA broadcasts and stated, "[W]e think any remarks that challenge national sovereignty and social stability are outside the category of freedom of speech." One of the league's top American players, LeBron James, concurred that NBA personnel should be wary of political commentary because of the repercussions for the league and players.

When protests erupted in Hong Kong against a proposed bill on extradition to China in 2019, Cathay Pacific Airlines suspended staff who participated in the demonstrations or expressed support for them on social media. Next came the resignation of the airline's chief executive.

When China introduced a National Security Law for Hong Kong in 2020, nearly all of the territory's tycoons and international business leaders signed a statement organized by the CCP's United Front Work Department in support of the law,

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before its text was even released. News outlets refusing to retract their choice of words or coverage of sensitive topics (such as the *New York Times*, the *Wall Street Journal*, and the *Washington Post*) have seen their reporters expelled from China on short notice.

Domestic business elites also have increasingly found themselves in the crosshairs of the CCP's efforts to silence dissent and maintain stability. If Ant Financial ran afoul of the state's regulatory apparatus, others have been dealt with by the state's repressive apparatus. Tycoons who spent decades cultivating ties with political elites, even managing their money, and building empires based on privileged access, have been detained for years without formal charges. Others who have spoken out against Xi or the CCP have been formally charged. After criticizing Xi's handling of COVID-19, property tycoon Ren Zhiqiang is now serving an 18-year prison sentence for corruption.

While the CCP has never been tolerant of criticism from business actors, domestic and foreign firms had typically been partners of the regime as it focused on economic growth. But in a party-state capitalist system, the state's prioritization of political goals drastically limits the scope for making compromises with private capital.

*New imperatives of political stability and risk management govern the state's approach.*

## CONSTRAINTS AND BACKLASH

The manifestations of China's newly emboldened model suggest considerable power on the part of the party-state. Indeed, most accounts of China's political economy, including this one, emphasize attempts to preserve control over economic actors. Yet it is important to recognize how the state is constrained in executing its strategic intentions, including by the negative effects of party-state capitalism itself.

Principally, China's era of dramatic growth was characterized by a rough alignment of interests among the state, local officials, and firms in pursuit of economic growth—and, frequently, personal prosperity. The high-growth era was also characterized by engagement with global markets, many of which were eager to see nonstate firms succeed in China. Now, however, given China's growing global economic footprint and emphasis on regime security, party-state capitalism may threaten this alignment of interests, producing conflict between firms and the state. And it has already provoked suspicion and backlash from foreign governments that view the fusion of state and private interests in China as a threat to their own national security.

Domestically, several trends point to increased anxiety among business actors whose space for autonomy has narrowed under party-state capitalism. Waves of asset expatriation and political crackdowns have generated instability in China's external accounts and uncertainty for business elites. Meanwhile, Chinese firms have marched abroad as party-state capitalism has taken shape. Although Beijing has encouraged this "going out," it is finding that internationalization presents an exit option for business actors as much as it offers a strategic opportunity for China. The CCP is now sending anticorruption investigators abroad and developing new means to align firms' global behavior with its own strategic interests.

The party-state's intolerance of instability, particularly in the financial sector, creates its own challenges. The expectation that the state will intervene to avoid instability may generate a sort of moral hazard, whereby firm managers, confident they will be bailed out of any trouble, divert and misallocate resources at society's expense. Such a dynamic is unfolding in several arenas.

China Minsheng Investment Group, a private financial firm established by the state to be "China's Morgan Stanley" and provide financing for firms in frontier sectors, fell into state receivership within just a few years, after self-dealing and poor decisions left it saddled with hundreds of billions of RMB in debt. Even in advanced technology sectors like semiconductors, local governments all over China have competed to nurture local firms only to find much of their effort wasted by fraud and malfeasance. Ultimately, if the state offers itself as a solution to economic instability, lack of discipline among market players may end up costing the state a great deal.

The international backlash against China's new model, especially from countries belonging to the Organization for Economic Cooperation and Development (OECD), has been dramatic. Blurred lines between state and nonstate firms have been used to justify sweeping new exclusions of Chinese investment, and even recommendations for economic "decoupling" from Chinese suppliers. In just the past few years, China has gone from

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being a major tech investor in OECD countries to finding itself institutionally excluded. Major "national champion" firms such as Huawei and ZTE have been banned from building telecommunications networks in the West due to fears that networks built by these firms could be vulnerable to Chinese government intervention.

The backlash against Chinese capital—whether state, private, or hybridized—has mixed implications. On the one hand, anti-Chinese sentiment and protectionism could incentivize Chinese businesses across ownership categories to pursue nationalist goals. On the other hand, the impulse toward continued capital accumulation among all economic actors, regardless of ownership type, has already created centrifugal forces that are not readily reversed.

## PARTY-STATE SOLUTION?

Over the course of most of the post-Mao era, market forces were invited to solve economic problems generated by the state's historic dominance in various areas. By contrast, over the past decade or so, the party-state has increasingly imposed itself as a solution to the problems generated by markets. Party-state capitalism places the party's leadership and political needs at the center of the organization of the economy. In addition to the deployment of state and market forces to pursue development and global competitiveness, new imperatives of political stability and risk management govern the state's approach. From the CCP's perspective, economic challenges to the regime abound domestically and abroad, and it is the prerogative of the CCP to address them however it sees fit.

The idea of an unrestrained state able to fend off threats is a central theme in the work of Carl Schmitt, the twentieth-century German political theorist and Nazi, whose work has become popular in China over the past fifteen years. Although party-state capitalism in China cannot be easily understood in terms of other state capitalisms practiced in the contemporary global political economy, there is a shadow of a historical analogue in the rise of fascism in interwar Europe. Fascism, identified by many mid-century social theorists as "state capitalism," was promoted as providing a political solution to the problems of market capitalism by fusing the interests of state and society. As the political scientist Sheri Berman observed, fascist regimes in both Italy and Germany during that era proclaimed that they would allow and even protect private property, but in each country the state put its own interests above any other social or economic interest.

With a similar logic, the CCP has shown its imperatives of domestic and national security to be the most fundamental force driving the emergence of party-state capitalism. This phenomenon is neither an opportunistic power grab nor the realization of a long-held plan, but rather the intentional adoption of a new model to present the party-state itself as the solution to China's domestic and international challenges. Whether it succeeds, fails, or muddles through, the CCP's new approach has already reshaped both China and global capitalism. ■

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