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The Project System: A New Form of State Governance

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As the incremental component of the new dual track system, the project system aims to use special transfer payments from state finances and other strategies to break the shackles of the existing bureaucratic order, as represented by the work unit system. This approach seeks to curb the polarization arising from marketization and increase investment in people's livelihood and public services. The new project-centered system of governance has encouraged the formation of hierarchical central-local governance mechanisms, leading to a number of unforeseen outcomes for grassroots society. Collective debt at the grassroots level, departmental interests and the systemic risk brought about by the project system will have important implications for the sustainable development of society.

Keywords: the project system, new dual track system, project economy, project power, project chain

The project phenomenon has been a distinctive feature of China's social governance mechanisms over the past decade. Without resource allocation in form of transfer payments, national-level finance could never have stimulated economic growth through large-scale investment, nor could public services have attracted effective investment and achieved comprehensive coverage; and without their energetic pursuit of projects, local governments would have been unable to acquire special funds to cover their fiscal shortfalls and run public

affairs. Even enterprises that live by market operation and market competition boost their returns by applying to different levels of government for earmarked funds for special projects. This is even truer for cultural activities such as publishing, teaching and scientific research, which would virtually come to a standstill without government project funding. Therefore, “the project system” refers not just to the process of project operation or regulations for project management, but to a governance model integrating relationships among all levels of government from central to local and among various areas of society. Thus the project system is not just a system, but also a system-activating mechanism, as well as a mode of thinking that determines the strategy and tactics by which the state, social organizations and even individuals construct their decisions and actions.

I. The Structural Conditions behind the Formation of the Project System

What we call “project” is a concept with a broad meaning. It refers to a task-centered mode of mobilization or organization, a temporary rather than permanent social system constituted by teams within or across organizations to accomplish particular tasks (or services) under time and resource constraints.¹ From the organizational perspective, project organization differs from routine organization. It is short-term, not belonging to any hierarchy or *situs*, but rather temporarily breaking away from the conventional organizational structure; it breaks away from both vertical departmental hierarchies (*tiaotiao*) and horizontal regional arrangements (*kuaikuai*) by recombining different elements of these types of organization.

But the meaning of the word “project” in the project system discussed in this paper is slightly different. As She Xiaoye *et al.* have pointed out, the “project” in “project system” refers to a situation in which, under conditions of tax-sharing and increased centralization of revenue, the allocation of funds operates extra-institutionally. That is to say, the project system allows financial transfer payments to be flexibly managed outside the administrative hierarchy.² Zhou Feizhou has pointed out that after the introduction of tax-sharing reform, with the increase of the “two ratios” [the ratio of fiscal revenue to GDP, and the ratio of central government revenue to total revenue], a range of funding was allocated downwards by means of “special items” or “projects,” and this has increasingly become a major means of financial expenditure.³ Here “project” means “project system,” for project processes and linkages, including planning, application, assessment, distribution, modification, conversion, supervision, response, etc., go beyond the task-centered characteristics of a single project to become part of an institutional mechanism in the joint operation of state and society. That is why the above-mentioned researchers have raised the concept of “governing through projects”

1 See the US Project Management Institute, *A Guide to the Project Management Body of Knowledge*.

2 She Xiaoye and Chen Yingying, “The Mechanism and Governance Logic of the Hierarchical Operation of the Project System: A Sociological Case Study of Projects Going into the Village.”

3 Zhou Feizhou, “The Problems of Earmarked Funds: On ‘Governing the State through Projects.’”

or “project-centered governance.”

The way in which the project system, in the form of projects, took on a kind of governance logic with institutional characteristics necessarily has its institutional roots and historical moment. The dual track system of the 1980s, premised on maintaining the stocks of the existing system, used incremental growth to expand the space for the free flow of resources;⁴ the enterprise contracting reform set aside the problem of right of possession and legitimated independent enterprise operation; and the financial contracting reform gave local governments room to share power, serving as a catalyst for local market opening. However, the inherent structural contradiction of the dual track system was apparent. There was a fuzzy middle ground between the two tracks of stocks and increments, resulting in rampant rent-seeking activities, and local governments threw themselves into setting up enterprises to expand the scale of local investment, thus causing both an overheated economy and serious local protectionism.⁵

To solve the structural contradictions caused by fiscal decentralization, in 1994 the central government implemented tax and fiscal system reform. The tax-sharing system changed the previous financial contract system under which the central and provincial governments had haggled over the division of tax revenue every year, while the new tax distribution plan helped standardize fiscal relations between the center and local governments.⁶ As a result, there was a rapid increase in the central government’s ability to collect tax, to counterbalance the power of local governments and to regulate the macro-economy by fiscal measures, and to “extract” and “allocate” funds. As a whole, its ability to implement its vision of overall governance also greatly increased.⁷ Generally speaking, it is the following structural elements that have made the project system into an institutional mechanism with governance significance and a pivotal role in linking and integrating various socio-economic factors.

(1) First, in terms of fiscal relations, the tax distribution system only set up bottom-up methods of extracting fiscal revenue, such as the proportional allocation of central-local shared taxes and the separation of institutions collecting central taxes from those collecting local taxes. However, the establishment of the project system requires top-down fiscal redistribution to ensure that the central government can make transfer payments to local governments through standard channels. The system of departmental budgets and centralized treasury payments adopted in the 1999 budget reform strengthened both the spending powers of national-level finance (the treasury) and the vertical financial control of specialist and administrative departments, thus guaranteeing the two basic conditions for assigning projects: authority and professionalism.⁸

4 Sun Liping, “‘Free Flowing Resources’ and ‘Space for Free Flow.’”

5 Qu Jingdong, Zhou Feizhou and Ying Xing, “From Macro-management to Micro-management: Reflections on China’s Thirty Years of Reform from the Sociological Perspective.”

6 Zhou Feizhou, “The Decade of Tax-sharing Reform: Institutions and Consequences.”

7 Chen Shuo, “Tax-sharing Reform, Local Fiscal Autonomy and Public Goods Provision.”

8 Ma Jun, *Reform of China’s Public Budget*.

(2) Another important condition for the existence of the project system is that project finance must act as a strong incentive for local governments or grassroots society. Under the financial contracting system, local governments could get most of their revenue by expanding the scale of their investment and setting up enterprises. Since the tax-sharing reform, they have had to pass on the value-added tax to the central government, and this has become a heavy burden. Therefore, they have had to find new ways to keep their revenue up. The introduction of the Land Administration Law in 1998 provided a legal basis for making rural land into urban construction land. Local governments' new focus is therefore on obtaining a land dividend from land management and building operations taxes. In the course of urbanization, local governments often try to increase their non-budgetary revenue by packaging various projects in comprehensive urban planning to add value to land development. As a result, the "project economy" is becoming an incentive mechanism for mobilizing local governments.

(3) The emergence of the project system was also an objective requirement of the development of China's market economy. In terms of its economic growth model, China's market economy has always been driven by investment, consumption and exports. But as the economy developed, structural problems appeared, such as insufficient domestic demand, shrinking foreign trade and unbalanced distribution. In a situation of weak demand from both domestic consumption and exports, the only way to expand aggregate demand was through "expansionary macroeconomic policies," including four trillion yuan of investment and ten trillion yuan of loans.⁹ The only way the central government could inject such large-scale investment into the market was through projects. Compared with consumption and exports, national-level investment requires greater standardization and professionalism to break down and distribute resources in different social and economic fields. The allocation of investment requires both the existing authority of the administrative hierarchy and the special channel of the project system.

(4) The project system came into being not only because of the structural pressure of economic growth, but also because of the need for the government to provide public goods and services. The 1990s tax-sharing system's "extraction" of local government revenue transferred many of the grassroots fiscal burdens to farmers. Coupled with the intensifying of conflicts between labor and capital under capital conditions, this has led to numerous social confrontations and conflicts. In these circumstances, the central government must act effectively to "give back" to grassroots society the revenue that has been extracted; only in this way can it moderate and balance the social divisions brought about by development. In the three main categories of central government transfer payments to local government, the proportion of special transfer payments has increased, while the share of regular tax revenue returned to local government has declined from 79.6 percent in 1994 to 36.1 percent. The

9 Zhang Jianjing and Si Fangwu, "Wu Jinglian: Expansion of Rent-seeking Activities Has Reached the Extreme Level and a Top Level Design Is Needed for China's Reform," retrieved on Dec. 1, 2011 from <http://finance.ifeng.com/opinion/zjgc/20111201/5179916.shtml>.

special transfer payments, plus the “extra-corporeal circulation” of special funds allotted by various departments of the central government to their subordinate units, most which are in the nature of public service projects, constitute the fundamental financial resources for the operation of the project system.¹⁰

(5) Fundamentally, the existence of the project system is inseparable from the mode of thinking centering on performance legitimacy. Yang Hongxing and Zhao Dingxin have argued that the strongest pressure constraining government behavior comes from performance legitimacy rather than other forms of consciousness and ideas.¹¹ The development model of the last thirty years has made all levels of society in China fully aware that if the current system were to revert to the previous state-controlled administrative hierarchy and mandatory planning, the Chinese economy would have no performance or profit to speak of; but if the market system is allowed to run riot and the government fails to ensure adequate social security and public services, the exploitation of labor by capital will intensify. To address these institutional issues, the rule of law, normalization, adoption of technology, standardization, etc., have become central topics in oversight and administration-building since 2004. People in all walks of life, from the grassroots to government officials, believe that as long as administrative officials’ terms of office are fixed, their responsibilities are clear, and they are properly supervised and subject to strict accountability, and as long as administrative agencies are well-designed, abide by the regulations and have a clear division of labor, public services will become more effective and social construction will be launched on a fair and equitable path. This idea of technocratic governance places much emphasis on rational management by objectives and process control. It happens that the project system is precisely in line with the spirit of such institutions.

In short, the development of the project system is the product of given historical and social conditions as well as the dominant structural base provided by the existing national system. Equally important is the fact that only when the whole society embraces the belief that performance legitimacy has to be guaranteed by technological rationality will the idea of governance through projects gain a psychological basis and be implemented in every social and economic sphere.

II. The Growth of the Project System and New Dual Track System

The institutional changes of the past 30 years show that, in theory and practice, the essential connotations of reform have been premised on keeping the existing institutional stock while nurturing and developing incremental accumulation outside the system to form structural drivers of change that will trigger a stress response in the original system, thus realizing the gradual transformation of the social structure. In other words, the reforms controlled excessive

10 Zhou Feizhou, “The Problems of Earmarked Funds: On ‘Governing the State through Projects.’”

11 Yang Hongxing and Zhao Dingxin, “Performance Legitimacy and China’s Economic Development.”

incremental expansion by protecting existing stocks, thus avoiding the systemic risk entailed in deviating from the logic of path dependence. At the same time, the effect of the evolution of the existing stock was achieved by gradual incremental expansion in which the stock component changed in an orderly fashion, avoiding the social unrest that might have attended sudden structural change. Essentially, the reform followed a kind of “dual track” logic.

The reforms of the 1980s took the work unit system and the overall system on which it was based as the stock component to maintain the stability of the overall structure; at the same time, they used incremental mechanisms such as the “household contract,” the “financial contract” and other systems to divide the overall system in an appropriate manner in order to expand the movement of free resources. As a result, the institutional bottlenecks and normative effects of the work unit system were relaxed.¹² This dualist institutional spirit not only fundamentally changed the relations between the central and local governments, using the financial model of soft budgetary constraints to give local governments room for spontaneous decentralization in line with the logic of increments, but also allowed some enterprises to abandon the planning system and interpret management power as incremental legitimacy, thus laying down the intellectual foundations of the later market economy system. The establishment of the market system in the 1990s gave the market the status of a formal system, greatly reducing the work unit’s sphere of influence and functional capacity in economic activities.

However, although the market economic system has clarified economic relations such as property rights, labor and capital, etc. in institutional terms and has promoted the rapid growth of the national economy, it has also brought about many social problems.¹³ To address the structural contradictions resulting from comprehensive marketization, new reform approaches were needed to form a new dual track system. The tax-sharing system provided a financial basis for this approach, while the project system established a new incremental logic. The latter treats both the work unit and the market as existing stock. It contains a clear realization that although the work unit system could maintain the stability of the structure, it could not provide development performance. Conversely, the market system could raise efficiency, but could not maintain inclusive social growth. The project system, deliberately assuming the role of the incremental component of the new dual track system, uses fiscal transfer payments to project basic public services in as many areas of society as possible, highlighting the government’s legitimate function of maintaining equity by strengthening the state’s redistribution system.

From the point of view of government finances, the allocation and management of project funds stress the following key points in relation to structural mechanisms: first, both

12 Zhang Jun, *Dual-track Economics: Chinese Economic Reform (1978-1992)*.

13 With the advent of the 1990s, China’s Gini coefficient increased rapidly, reaching 0.46 as opposed to 0.16 before reform and opening up (see Zhao Renwei and Keith B. Griffin, eds., *A Study of Chinese Residents’ Income Distribution*).

allocation and management emphasize control by central government departments to avoid the possibility of arbitrary implementation of projects due to local decentralization; second, they emphasize the specialized nature of the projects to guarantee that earmarked funds are spent as intended and specific personnel have specific responsibilities; third, they emphasize standardized technical procedures to ensure the project's performance legitimacy through rational goal-oriented management and process control; and fourth, they emphasize that earmarked funds must be used in a way that serves the overall interests of economic growth and public services. All these elements are essential for implementing the idea of state governance.

It is noteworthy that the implementation of the project system has actually produced results that are the opposite of its basic goal of balanced regional development and expanded public services. Following an analysis of 2006-2010 data on local financial behavior, Zhang Jing pointed out that the project system had not only failed to weaken the segmented system of local finances, but had, on the contrary, accelerated the establishment of "economic relations" between higher and lower levels of government based on the pursuit of funds through such measures as transfer payments, project support, evaluation and incentives.¹⁴ She Xiaoye has also pointed out that projects have become dynamic cells that catalyze economic development. Local governments use the construction of project hubs and "project heights" to consolidate various special funds, then enter the market and undertake borrowing and lending operations as direct investors and operating units.

The original purpose of the project system was, first, to use professional departmental systems to break through the institutional constraints of the work unit system and implement the state's governance vision of maintaining economic growth and improving the people's livelihood; and second, to reduce barriers between different departments and lessen the economic fragmentation resulting from fiscal decentralization. But the project system actually operates by linking up with and fitting into the bureaucracy of the original work unit system. When the project system attempted, through its "new vertical linkages," to prevent the expansion of the "old horizontal ties," the result was not only that "new horizontal ties" formed within the departmental system itself, but even the "old horizontal ties" quickly found new ways of cultivating their own territory. In the course of "pulling up" and "sending down" funds, local governments convert and transform earmarked funds, making it hard to implement projects in accordance with the desired objectives. Furthermore, they take advantage of the system and use sleight of hand to unite in one body the roles of investor, owner, consignor and manager, so that the original design of the project is seriously compromised and public services and utilities cannot be guaranteed. More often than not, the relevant departments' possession of non-substitutable resources, information and powers means that in the course of project implementation they gradually become independent kingdoms as far as projects are concerned.

The new dual track system embodied in the project system shows a dialectical logic that

14 Zhang Jing, "Government Finance and the Public Interests."

is worth noting. First of all, this logic constitutes a process that leads from the system (the work unit system) to the market, and thence back to the system (the project system). The pre-tax-sharing dual track system achieved its governance effect by moving from centralization of the overall system to local decentralization by using extra-institutional market increments to change existing institutional stocks, whereas the post-tax-sharing project system controls the over-expansion of the market by expanding project-type increments within the system. In short, the old dual track system was founded on finding increments outside the administrative system, whereas the new dual track system creates increments within the administrative system. This analysis makes very clear the relationship between the project system and the work unit system (the hierarchical system). The question is, can the effective operation of the project system become a force that still controls the original system at the same time as it controls the market? Or can it only control the market by joining forces with the original system? Can the project system effectively get rid of the dilemma of centralization and decentralization and establish a balance between them? Or will it eventually fall into institutional centralization once again?

III. Hierarchical Governance under the Project System

She Xiaoye has pointed out that from the point of view of project process, the mechanism whereby central departments seemingly control all aspects of distribution and management on the basis of their professional functions has in fact resulted in “a governance hierarchy”; that is, the three steps of “issuing contracts,” “packaging” and “contracting” correspond respectively to the project activities of central departments, local governments and villages or enterprises (or other grassroots social organizations).¹⁵

In this three-level governance structure, the central departments have complete power over the allocation and management of special funding. Although the operation of the project system seems to bypass the conventional hierarchy because of its clearer targets, stricter supervision and more standardized management, features which allow the center’s financial powers to be disaggregated into a variety of more professional and technocratic governing processes, in fact the capacity for tasks to be devolved to lower-level departments during the planning and implementing process has been reduced, with the departments at the top of the vertical chain of command acquiring greater centralized power. In addition, since almost all projects fall outside the routine administrative responsibilities of the bureaucracy, being targeted on a specific item, the standardization of the project system simply implies the strengthening of the regulatory standards of the project itself, a development that can weaken routine bureaucratic standards. The term “one project, one policy” refers to the privileged policy position of the project itself. In addition, although the “Project Guidelines” issued by

15 She Xiaoye and Chen Yingying, “The Mechanism and Governance Logic of the Hierarchical Operation of the Project System: A Sociological Case Study of Projects Going into the Village.”

the establishing departments set out strict rational rules for project objectives, establishment conditions, application procedures, allocation of funds, implementation guidelines, review and audit measures, etc., the fact that they are mandatory in nature mean that they tend to become a replica of departmental ideas and expert opinion, disregarding realities on the ground. Moreover, since the allocation of projects uses the application model, including in some cases competitive tendering, the “Project Guidelines” can easily become the standards for competition. Competition among local governments for projects becomes more and more like a “tournament.”¹⁶

However, under this new authority of the project, local governments demonstrate considerable enthusiasm. They’re perpetually “thinking of projects” and “hankering for projects,” and even try to mobilize people with slogans like “making the greatest efforts you will get a big project and there will be big development; making less efforts you will get a small project and there will be small development; and making no efforts you will get no project at all and there will be no development.” Here we have to ask: what do projects or the project system really mean to local government? The answer is, firstly, project funds are better than nothing as they represent resources transferred to the lower levels; secondly, local governments or departments often intentionally overstate project budgets in order to retain more of the surplus funds, or alternatively, because the central government has looser specifications for project budgets, local government may initially understate the budget to get through the approval process and then, once approval has been granted, apply for supplementary funds on the grounds that the project cannot be completed, and so on. And higher authorities tend to agree to supplementary appropriations to avoid the waste that would be incurred if the project was abandoned halfway.

A more severe deficiency in project system design is the fact that projects always strictly adhere to the principle of “one project, one policy” and “special project, special funds,” so that each individual project has its own implementation objectives and process management. But all local affairs involve synthesis. A task seen as specific by higher authorities is actually just one part, an inseparable part, of the overall work in the eyes of local government. The construction of a central village, for example, may be closely related to infrastructure construction, and may be inseparable from planning for returning housing land to agricultural use, as well as garbage collection, sewage treatment and other issues. To the higher authorities, each of these public goods needs independent project support, but to local governments, what is needed is to break the boundaries between different projects to achieve overall coordination and planning. An unforeseen effect of these different approaches is that local governments, in line with the principle of maximizing returns to the projects, prefer to plan separate applications for each of these items to get as much as possible out of such opportunities, instead of integrating all similar tasks and applying for a comprehensive package that will cover all the issues. As a result, we see the phenomena of “large projects linked to small ones” and “one project

16 See Zhou Feizhou, “The Tournament System.”

begetting many others.” Local governments do their best to think up project items; the more items, the more project space and the more project money.

The appearance of phenomena like fraud, duplication and “nesting” in the project system points to gaps and flaws in its design. One-line project management and the higher level departments’ bureaucratic view of “individual supervision for an individual project” determine that it is difficult to effectively control other related projects linked to the individual project. However, local governments have their own reasons for operating projects this way. Project packages represent a correction of the vertical contract-issuing model of project management. The project process is not just an input process, but more one of embedment. On the basis of the objective requirements of local public construction and social governance, local governments hope for more flexible space for operation. So they integrate, coordinate or package multiple projects into a comprehensive plan, aiming to make effective use of special funds to realize their own governance intentions.

However, the attractiveness of the projects to local governments goes far beyond the meaning of the projects themselves. One of the “tricks” is the regulations covering “matching funds”: central government projects usually require local governments to provide a certain amount of matching funds; local financial or planning departments have to give assurances of matching funds when applying for a project; and local funds also need to be invested in the project’s start-up phase. The effect of “matching funds” is reflected not just as an “inducement” by higher level governments;¹⁷ for local governments, the project system’s requirement for matching funds provides an opportunity to make use of a national-level project’s name and content legitimacy to restore and strengthen their own ability to mobilize financial resources. In the tailwind of the projects, local governments do their utmost to instruct their subordinate bureaucracies to raise funds in whatever way lies to hand: they set targets for the amount of money to be raised, or use “rent-setting and rent-seeking” to get money in, and even go to the most basic grassroots organizations to raise funds through private lending. Furthermore, local governments often turn the projects into “investments” to lure different types of capital into investing in the project. Of course, project mobilization shares the features of political mobilization, with a dedicated “project office” set up by local government in the shortest possible time with the aim of breaking down the local bureaucratic system and using the policy guidance of the project to start a “project campaign” that will make a splash.

In fact, a project campaign is never limited to the range delineated by the project, but rather catalyzes the overall socio-economic operation of the region. As mentioned above, the introduction of the tax-sharing system established a new pattern of central-local relations,

17 Zhou Xueguang points out that for each project, the higher level departments provide only a small proportion of the funds, with a view to stimulating the lower levels of government to raise funds to cover the funding gap and complete the project. The projects are like bait to lure local governments and mobilize their initiative to draw their attention to public investment and services. This is very much a kind of “fishing.” See Zhou Xueguang, “Inverted Soft Budget Constraints: Extra-budgetary Resource-seeking in Local Governments.”

turning local governments' development strategy from enterprise operation to land management, from mobilization of industrial capital to mobilization of financial capital, and from industrialization to urbanization. At the initial stage, land development was closely associated with the market. Construction projects, such as development zones, industrial parks, customs bonded zones, etc. all embodied local governments' philosophy of attracting investment, while the urbanization process basically expanded from urban or industrial centers to surrounding regions. However, in subsequent years, due to the decrease in the demographic dividend owing to shortages of surplus rural labor and the decline in the supply of land from the urban periphery, economic growth became increasingly dependent on policy-type capital investment. The land management focus of local governments has shifted from urban to rural areas and their ability to raise land finance has increased rapidly, with more substantial loans raised through financial guarantees, mortgages on land, etc. Land prices are raised by raising the added value of the land, and large-scale urban construction increases revenue from the construction business tax. In this way the operational trinity of land-finance-revenue comes into being.

In land management, land acquisition and development have to be extended to rural areas to solve the problem of insufficient stock of urban construction land. Several key links need to be dealt with by measures such as increasing the stock of housing land by constructing central villages or speeding up the urbanization process which makes the rural population into urban residents; increasing arable land by reclaiming housing land or mountainous uncultivated land for agricultural purposes and consolidating plots of land, then transforming the increments of arable land into stocks of residential land; and turning fragmented and scattered housing sites into larger holdings for urban construction through land swaps or deals. The purpose of these measures is to expand the urban area and increase the supply of land for urban construction in order to increase the added value of the land. However, all these measures need a solid rationale, and in particular they need a legal basis in policy. Implementing national-level and departmental projects provides precisely this legitimacy. For instance, village planning and construction projects in which farmers become apartment-dwellers can expand the stock of residential land; projects reclaiming housing sites for agricultural use can replace remote or scattered housing sites with cultivated land near urban areas; projects for reclaiming land for agriculture and for developing hills or slopes can exchange the newly reclaimed land for housing land; and projects for rural infrastructure can provide conditions allowing for the targeted transformation of the exchanged land into urban construction land. And so on. By using land as a medium, local governments not only get favorable conditions for indirectly turning public projects into business projects, but also save a lot of the social costs of land acquisition and management by invoking the legitimacy of the projects. Therefore, the attractiveness of projects to local governments lies not only in the funds attached to them, but also in their role as a kind of catalyst.

The land development and management undertaken by local governments in the course of urban construction likewise relies on support from projects. One of the most important ways of raising the added value of land is to call the land to be developed by the most impressive

name possible, to increase its future revenue expectations. For example, a fine piece of urban planning will effectively combine construction for public purposes and business construction, because any comprehensive development plan will inevitably include the construction of public facilities such as transportation, power and water supply, health care, culture and education, and also business centers, commercial residential buildings, service industries, etc. Out of these, construction of public facilities can usually get support from special project funds, while business construction can attract a range of business networks and financial capital from a great many sources. It can be said that the more comprehensive, ambitious and creative an urban plan is, the more spheres of public and business activity it will involve, the greater its potential for capturing projects, and, naturally, the greater its attraction for capital; projects and the market are mutually complementary and enjoy a win-win cooperation. In addition, local governments always calculate the benefits they get from the project on the basis of their overall calculations. This is because compared to the huge returns they get from urban development and operation, the “matching funds” put in at the initial stage are infinitesimal. For example, the true reason so many cities are enthusiastically launching subway construction projects is the massive potential returns from rising land and housing prices over wide areas along the subway lines, returns that exceed project spending.

But the problem is that the funds needed for the implementation of this comprehensive construction plan are often insufficient, even if one adds the project funds and financial resources that can be mobilized by local governments. Therefore, the foundation of local financing platforms is possession of the eligibility and capacity for large-scale borrowing. In this regard, the moderately loose monetary policy and active fiscal policy adopted by the central government in recent years to cope with the international financial crisis has provided them with very favorable conditions. Government credit is the main reason local governments have been able to obtain large loans with financial guarantees and mortgages on land, and all the project support provided by state funds has effectively raised these governments’ eligibility as a borrower. The result is that local government financial operations have gradually shifted from mobilizing “matching funds” for the project system into the establishment of local financing platforms. Local governments integrate land, equity, fees and bonds, among other sources, plus budgetary appropriations and subsidies, to establish economic entities with the status of an independent legal person which draw on different sources of funds to engage in comprehensive municipal and public projects.¹⁸

18 In the second briefing on the economic and financial situation held in April 2010, the then Chairman of the China Banking Regulatory Commission Liu Mingkang emphasized that by the end of 2009, the loan balance of the local government financing platform totalled 7.38 trillion yuan, an increase of 70.4% on a year-on-year basis, and accounted for 20.4% of the general loan balance. Total increased loans for the year amounted to 3.05 trillion yuan, accounting for 34.5% of all new loans. These figures are very close to the internationally recognized warning level of 60%. See “China’s Local Debt Soars from Four Trillion to Seven Trillion,” retrieved on February 6, 2010, from http://www.ibtimes.com.cn/articles/20100604/difangzhaiquan_1.htm.

It can be said that with the effective operational integration of land, finance and revenue, local governments have established a new framework of local governance. In this, the project system has played a very important role. It is precisely because local governments use national and departmental projects as pivots, intermediaries, platforms and commanding heights that they can elevate the policy status of their overall operations, their public services' grounds for legitimacy, and government credit for their financing activities, as well as ramping up their market appeal to all kinds of capital. All of this enables them to take the advantage and emerge the winner in this sort of gaming.

IV. An Unforeseen Consequence of the Project System: Social Disintegration and Reorganization at the Grassroots Level

The above analysis touches on two of the hierarchical governance links under the project system. But the impact and function of the project system on grassroots society involves the basic issues of the transformation and construction of grassroots society and the structure of endogenous sources of social stability and sustainable development. Here, we should on the one hand examine the choice mechanism in the process of bringing the project into grassroots society and the institutional channels by which it is implemented, and on the other the structural changes in collective assets brought about by the project and the ensuing evolution and restructuring of social relations in grassroots communities. Beside this, we should note that, because project input generally uses vertical institutional channels, it has strengthened the expenditure powers of the county level in particular, thus changing the responsibility structure and governance relations of primary level governments with regard to public affairs.

As a national governance system, the project system has twofold goals: first, to accomplish a specific project objective on the basis of task-centered principles; and second, for ideological reasons, to establish standards and offer models at the local level in order to implement the state's policy goals. Therefore, what kind of village is chosen for a project depends not only on whether the actual conditions of the village allow it to implement and run the project, but also on the extent to which the village can embody the symbolic significance of the policy implications in the project design, since the project is in the nature of a "pilot." What She Xiaoye means by the project policy of "grasping two ends" is that project designers always choose two "types of village": the "model village" and the "weak village" (or "village for remodeling").¹⁹ Villages representing the richer and the poorer type respectively are strongly dependent on projects. Project thinking always moves from point to area and to the combination of point and area. "Point" refers to providing a model and improving project

19 See cases cited by She Xiaoye *et al.*: To get project support, a village must first of all be selected as a "construction village." She Xiaoye and Chen Yingying, "The Mechanism and Governance Logic of the Hierarchical Operation of the Project System: A Sociological Case Study of Projects Going into the Village."

quality through the demonstration effect and spreading the news about project performance by highlighting individual cases, while “area” refers to the idea that a project should cover a certain area. Therefore, choosing a weak village as the project destination helps improve the relative performance of the project and also helps achieve the quantitative criteria of management by numbers.

But in terms of project goals, projects have as their original objective the achievement of a performance average and the promotion of overall improvement and balanced development in all parts of grassroots society as a whole. However, the performance average mentioned above is generally just the average of the two extremes, and is in fact is totally atypical; it does not conform to the concept of a “type” in the sense of equal social development. Even villages with better conditions, under the pressure of “making the loan produce returns as soon as possible,” often reallocate the funds, on the strength of the projects, to comprehensive public construction in the village by coordinating the allocation of different project funds. The regulations governing “matching funds” under the project system actually produce a logical paradox: grassroots society must transform a project’s publicly oriented objectives into profit-oriented ones to sustain the performance of its public commitments; but the public construction promoted by the project often turns out be a kind of “debt-based development.” How to maximize returns from the project funds and repay the debt as soon as possible thus ends up being the highest objective of primary governments.

The logic behind “matching funds” is that the introduction of a project requires matching funds, and matching funds depend on taking out a loan; the loan must be repaid by the returns on the investment, but getting returns on the investment depends on attracting investors and industrial operations... This shows that the introduction of a project involves not only investing special funds, but also managing investment. At the grassroots level, this naturally takes the form of debt-based local investment. It could be said that the problem of collective debt resulting from matching funds has become the biggest risk to grassroots society, hanging over it like a sword of Damocles. Compared with local government, grassroots society, especially the vast rural areas, lacks smooth legal channels for raising funds, making it more difficult to deal with the problem of debt.

In a paper devoted to collective debt,²⁰ Zhou Xueguang analyzes in detail the process of formation, expansion and handling of debt, clearly displaying the consequences of the way in which collective debt weakens collective governance. One case is that of a road network project: it was supposed to promote rural public transport, but due to funding shortfalls, the village had to raise the matching funds by every possible means, including credit, so that after the completion of the project, they had to use collective assets to pay off the debt. The villages that are keenest on projects end up not only running through collective assets accumulated over many years, but also burdening themselves with overwhelming debt, debt they can’t pay

20 Zhou Xueguang, “The Road to Collective Debt: Government Bureaucracies and Public Goods Provision in Rural China.”

off for many years.

This not only shows the damage done to the governance of public affairs at the grassroots level by the collective debt incurred as a result of projects. Still more important is the fact that whether it is a matter of taking out a loan or repaying it, this system has brought about a total change in the essential meaning of China's rural collective system. Social cohesion and security of livelihood in China's vast countryside rely on the collective ownership of land as well as the traditional resources of relatives and friends. However, in the structure of collective debt arising from projects, the identity of the creditors varies, and the relations between the village collective and the creditors are extremely complex. As shown in Zhou Xueguang's case studies, even where money is borrowed from friends and relatives, it is tricked out of them, and this in turn means that creditors ignore the logic of friendship when they seek repayment. To mortgage collective assets for a term of ten to twenty years to mortgage-holders outside the village actually equates to abandoning the collective's right of recourse to collective assets; and if they have to deal with the underground capital market and take out high interest loans, the entire collective faces a still more fearful financial risk, and may even find itself blackmailed and controlled by the underworld. The debt structure created by the project system means in reality that grassroots society ceases to regard collective ownership as the basis of its social integration; instead, collective ownership is gradually transformed into a complex network of debt. This not only damages the social contract among members of the collective, but also leaves the entire village adrift due to its loss of financial autonomy, a situation that will eventually result in hollowing-out.

The project system not only affects the project terminals of the related village community at the grassroots level; it also changes the structure of vertical governance at this level. This is because it severs the relationship of financial responsibility between the township government and the village, so that village public services in rural areas cannot be effectively guaranteed or coordinated. Zhou Feizhou shows in his analysis of a case study of compulsory education that because public funds are no longer coordinated by the two levels of county and township government but fall entirely under the county government, the township government has, in principle, no further responsibility for spending on compulsory education. In terms of institutional structure, this is in fact equivalent to completely removing the township level of administration. Before the system of "county authorities assuming the main responsibility" was implemented, shortfalls in educational funds were actually tackled by township finance. By "tackle" we mean either using off-budget revenue, such as fees, fund-raising, borrowing, etc., or "scraping together" emergency funds for immediate needs through the network of associates. However, once the country government took over, township governments were no longer responsible for expenditure on education due to the upward shift of fiscal responsibilities. As a result, the refurbishment and maintenance of school buildings in rural areas has become an enclave beyond the reach of public funds. And when upper levels of government deal with similar matters in accordance with the requirements of the project

system, this entails a high cost in terms of management and trust as well as highly complex administrative procedures.²¹

The project system, in conjunction with the upward shift of financial power, has led to a number of unforeseen outcomes: (1) because there is not a smooth flow of information between county governments and the villages under their jurisdiction, what is going on at the grassroots is not communicated to higher levels, so that trivial matters build up over the years and may ultimately result in major incidents with a huge impact. (2) The information asymmetry between higher and lower levels of government leads base-level units to maximize their budgetary expenditure with the idea of “making it without payment,” and county departments, in turn, carry out their government procurement according to uniform standards without paying attention to the specific realities at the grassroots, resulting in the waste of project funds. (3) The functional upward shift arising from the project system has ended up strengthening the bureaucratic character of county governments. Detailed and tedious project specifications require large numbers of specialized personnel, causing overstaffing, increased payroll costs and delayed responses. (4) The upward shift of power in the project system has strengthened the authority of county level administrative departments, increasing their opportunities for rent-setting and rent-seeking in the process of project planning and establishment.

Project thinking holds that the flexible, changeable and arbitrary behavior associated with grassroots governance can only be effectively restrained by the formal rationality of project design and by control of procedural techniques. It fails to realize that grassroots governance follows the logic of custom, relying on daily experience of governance to handle matters flexibly. The project system considers only the defects of “horizontal” governance at the township level and fails to see its functions of communication, coordination, control and oversight. In its efforts to eliminate the townships’ financial influence and do away with the evils of the administrative bureaucracy, it ends up simultaneously strengthening higher-level administrative authority. The absence of protection and mediation from an intermediate level leads to power imbalances, information asymmetry, misdirected projects and communication blockages. This not only leaves the conundrum of primary governance with no effective solution, but contributes to the build-up of social contradictions. The system leads to an upward shift of governance risks and administrative burdens, so that the whole system is overburdened.

In research on the project system, we further found that project investment in grassroots society was not confined to a single specific project, but often involved a series of projects: problems left over or arising unexpectedly from a previous project need a further project to solve them; then, if the new project produces further problems, yet another project is needed to fix them, and so on. In other words, the governance logic that informs the project system, the logic of the single targeted project, turns out to endow the system with a marked

21 Zhou Feizhou, “The Problems of Earmarked Funds: On ‘Governing the State through Projects.’”

reproductive capacity; the results of a previous project are more often than not the cause of the next one, and the repeated cycle of cause and effect leads to an institutional inertia peculiar to the project system, producing a sustained cumulative effect. The original principle of the project system was “individual management for individual projects,” but due to the unforeseeable and uncontrollable outcomes of each individual project, follow-up projects are needed to fill the gaps and resolve the problems of their predecessors.

The risk in the project system is not the failure of one single project, but rather the possibility that in responding to specific local conditions and implementation effects, the unique inertia of the project system’s “management by objectives” often gives rise to a chain of successive project investments. This process of investment is also a process of constant change in the grassroots social structure. This is particularly true of the process of transforming a public project into a development one, where all the risks and pressures may well fall on the most basic social units.²²

V. Conclusions and Comments: The Project System and Systemic Risk

In recent years, the new dual track system embodied in the project system and its governance logic and institutional spirit have penetrated all aspects of China’s social and economic life. The idea that projects alone allow the acquisition of greater financial the effective development of public utilities, innovation in knowledge and technology and the full implementation of national policies has seemingly become a consensus shared by central and local government and even by grassroots society. However, every level of government imposes a multiplicity of intentions and objectives in the course of project implementation, complicating the overall project structure and operating mechanism and creating a governance process that mingles importing and embedding, regulation and flexibility, and disposition and response.

The central government and government departments have multiple aims in allocating projects: they want to improve the public services provided by all levels of government so as to improve people’s livelihood while maintaining stable and rapid economic growth through investment; they want to have a rational project-issuing process with a project design incorporating mandatory features, while determining the key points for transfer payments through local competition; they want to control local decentralization and protectionism by distributing and managing project funds, while strengthening local government’s capability to mobilize financial resources through rules on matching funds; they want to exercise project governance through objectives for individual projects, while synthesizing results at the macro-policy level; they want to earmark project funds according to task-centered principles, while

22 See cases cited by Xun Lili and Bao Zhiming, “Environmental Policies Based on Government Mobilization and Their Local Implementation: A Sociological Analysis of Ecological Migration at S Banner in Inner Mongolia.”

expanding ideological influence through the projects themselves; and they want to realize project aims through the vertical chain of command represented by functional departments, while trying to avoid the development that the concentration of power will make these departments into new horizontal structures, forming departmentally based monopolies.

Likewise, in the course of project investment, local governments and departments also incorporate in projects a variety of purposes of their own: they “package” projects from their own point of view and reallocate funds based on their actual circumstances, while fully meeting the formal requirements of the processes of project establishment and conclusion; they use the competitiveness of their projects to demonstrate their own performance, while turning them into conditions and policy tools that help them achieve economic growth targets; they take advantage of the loopholes in the system to transfer project funds to build their own financing platforms while strictly implementing project budget management according to project regulations; they are the main driving force in mobilizing local financial resources and throwing everything into “project campaigns,” while demonstrating their appreciation of policy by willingly accepting project mobilization; in the name of projects, they use market mechanisms to the full while employing project authority to strengthen their powers of administrative fiat; they use comprehensive city planning to expand their room for operation and development and implement the “project economy” strategy while achieving the projects’ public services objectives; they raise their credit rating by virtue of the projects while improving the government’s image through the project’s legitimacy in terms of public services; and they seek every opportunity to turn “vertical” resources into “horizontal” ones and grasp the opportunity presented by project investment to strengthen and upgrade their own industries, while strictly abiding by the authority of the “vertical” departments.

The project system has formed a kind of “project power” outside the original administrative system, and the combination of this power with the existing administrative system constitutes an even stronger form of state power. In the existing growth model, the financial centralization of project transfer payments is often closely tied up with the investment economy, and the two very easily form a dialectical relationship. Earmarked funds often produce meritorious performance in public services only when they change into local governments’ investment operations, while large-scale investments of a policy nature can only be made in local areas through the project system. Therefore, the project system is most likely to bring about the following results: the greater the incremental special funds and the government’s public investment, the greater local governments’ scope for investment operations and the greater the intensity of their credit-based financing. This will eventually form a financial capital chain pivoting on the project, drawing in even the lowest levels of society.

In addition, technocratic governance can often contribute to the monopolization of projects by departments. The more specialized the functions of the “vertical” departments and the more irreplaceable their project technologies and procedures, the greater their power to operate the projects on their own and the stronger their monopoly. Once such departments

fully grasp the monopoly power over projects, they gain greater weight in national policy-making and draw all areas of project operation into their own hands. Once governance by authority and technocratic governance joint hands effectively, the project system breeds every kind of “leviathan,” one that monopolizes technology, capital, information and even power, with significant implications for the future of the national economy and the people’s livelihood.

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