State Strategies Under Global Rules: Chinese Industrial Policy in the WTO Era

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State Strategies under Global Rules: Chinese Industrial Policy in the WTO Era

A dissertation presented

by

Yeling Tan

to

The Department of Public Policy

in partial fulfillment of the requirements
for the degree of
Doctor of Philosophy
in the subject of
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State Strategies under Global Rules:
Chinese Industrial Policy in the WTO Era

Abstract

This dissertation examines the strategies that various actors within the Chinese state adopted in response to World Trade Organization (WTO) rules demanding far-reaching modifications to China’s domestic policies and institutions. While several scholars have noted the unevenness of reforms resulting from WTO entry, I ask: why did more liberalizing reforms take place in some parts of the state and not others. I provide a framework explaining why policy responses to the WTO were neither top-down nor monolithic, despite single-party rule. To understand this divergence, I identify three competing philosophies of economic governance from which such responses are drawn: market-replacing (directive strategies), market-shaping (developmental strategies) and market-enhancing (regulatory strategies). I demonstrate that policy divergence originates from a combination of international and domestic forces, which emphasize the likelihood of sanction for deviating from WTO norms and the prospects for bureaucratic advancement for diverse actors within the Chinese state. Across administrative levels, I show that while WTO rules provoked a regulatory response from the central state, the same rules inspired economic strategies based on directive and developmental measures at the subnational level. I further show that within the central state, WTO rules altered the balance of power between dif-
ferent economic agencies, increasing the leverage of agencies advocating regulatory strategies while provoking quite a different response from developmental agencies. The ability of these agencies to advance their preferred policies is further mediated by the ability of the party leadership to punish the central bureaucracy. Finally, I address how WTO entry has intensified the conflict between central and subnational states over the governance of key industries. While WTO entry has heightened the central state’s determination to build globally-competitive national champions, paradoxically, it has also enhanced the ability of subnational states bypass the center, by increasing their direct access to global markets and foreign capital. In sum, this study offers a new explanation for why WTO rules, usually thought to constrain member states or credibly commit them to international norms, in fact provoked divergent responses within the state, in ways neither expected nor desired by the architects of those rules.
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<tr>
<td>AIIB</td>
<td>Asian Infrastructure Investment Bank</td>
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<td>CCP</td>
<td>Chinese Communist Party</td>
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<td>CIQ</td>
<td>China Exit Inspection and Quarantine</td>
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<td>CNCA</td>
<td>Certification and Accreditation Administration</td>
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<td>DSM</td>
<td>Dispute Settlement Mechanism</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<tr>
<td>MEP</td>
<td>Ministry of Environmental Protection</td>
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<td>MIIT</td>
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<td>MOFCOM</td>
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<td>MOFTEC</td>
<td>Ministry of Foreign Trade and Economic Cooperation</td>
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<td>OBOR</td>
<td>One Belt, One Road</td>
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<td>PBSC</td>
<td>Politburo Standing Committee</td>
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<td>PPSC</td>
<td>Provincial Party Standing Committee</td>
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<td>RCEP</td>
<td>Regional Comprehensive Economic Partnership</td>
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<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
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<td>SASAC</td>
<td>State Assets Supervision and Administration Commission</td>
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<td>SAQSIQ</td>
<td>State Administration of Quality, Supervision, Inspection and Quarantine</td>
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<td>SAQTS</td>
<td>State Administration of Quality and Technical Supervision</td>
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<td>SCM</td>
<td>Subsidies and Countervailing Measures</td>
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<td>SDPC</td>
<td>State Development and Planning Commission</td>
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<td>SEC</td>
<td>State Economic Commission</td>
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<td>SERC</td>
<td>State Economic Restructuring Commission</td>
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<td>SETC</td>
<td>State Economic and Trade Commission</td>
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<td>SEZ</td>
<td>Special Economic Zone</td>
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<td>SOE</td>
<td>State-Owned Enterprise</td>
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<td>SPC</td>
<td>State Planning Commission</td>
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<td>SPS</td>
<td>Sanitary and PhytoSanitary Measures</td>
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<td>TPP</td>
<td>Trans-Pacific Partnership</td>
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<td>Transition Review Mechanism</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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1  WTO Rules and Implications for Economic Governance in China

1.1 Xi Jinping: Globalization’s Savior?

The mood was somber as the global elite gathered in Davos, Switzerland in January, 2017 for the annual World Economic Forum. Business and government leaders tried to anticipate the consequences of Donald Trump’s election as President of the United States and the United Kingdom’s decision to leave the European Union (“Brexit”) some five months earlier. Trump’s withdrawal from the US-led mega-regional Trans-Pacific Partnership (TPP) trade agreement and announcement of an “America First” trade policy, accompanied by the rise of nationalist anti-immigration far-Right parties in Europe and growing anti-trade sentiments on the Left led by figures such as Bernie Sanders and Jeremy Corbyn, cast a dark shadow over the future of the global economic order. Amidst this uncertainty, Chinese President Xi Jinping emerged as an unlikely champion of globalization. His speech to the Davos audience on January 17th was widely lauded as a much-needed affirmation of the benefits of free trade and the dangers of protectionism. He warned that “(t)he problems troubling the world are not caused by globalization” and that “no one will emerge as a winner from a trade war” (Xi[2017]). Headlines from Western media painted Xi as globalization’s savior [Fidler et al. 2017] [Anderlini et al. 2017] [Goodman 2017].
However, a closer reading of Xi’s speech reveals greater uncertainty over the exact type of globalization that the Chinese leader envisioned. Except for a single mention of increased voting rights for China in the International Monetary Fund (IMF), the speech was bereft of other mentions of multilateral institutions. Instead, Xi called broadly for “win-win” cooperation and a “win-win” opening-up strategy without elaborating on the meaning of his phrases. Such ambiguity was not new. While China had been gradually shifting away from its stance of maintaining a low profile\(^1\) to adopt a more assertive foreign policy position, the signals sent by the Chinese so far had been deliberately and consistently opaque.

In a speech in Moscow in 2013, Xi called for the international community to “build a new type of international relations with win-win cooperation at the core” (Ministry of Foreign Affairs of the People’s Republic of China 2013). At an address in Seattle to the National Committee on US-China Relations in 2015, he reiterated that “China is ready to work with other countries to build a new type of international relations with win-win cooperation at its core” (Xi 2015). The following year, in a speech commemorating the 95th anniversary of the founding of the Chinese Communist Party (CCP), Xi said that “the CCP and the people of China are fully confident that they can provide a China solution for humanity’s search for better social institutions” (italics added) (Xinhua News 2016).\(^2\)

All of Xi’s speeches – in Davos, Moscow, Seattle and Beijing – signal a more assertive, outward-looking China on the global stage. However, the meaning of the Chinese leader’s words remain undefined and there has been no further articulation of the substance of either a “new type of international relations” or the “China solution”.

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\(^1\) Commonly encapsulated in Deng Xiaoping’s phrase *taoguang yanghui* (韬光养晦), loosely translated as meaning to “hide one’s capacity and to bide one’s time”.

\(^2\) In Chinese the phrase read: “中国共产党人和中国人民完全有信心为人类对更好社会制度的探索提供中国方案”
At a time when China’s outbound foreign investment has been surging, alongside China’s creation of new institutions such as the Asian Infrastructure Investment Bank (AIIB) and the “One Belt, One Road” initiative for expanding overseas infrastructure and investment projects, scrutiny over China’s intent and concern for what has come to be called “Chinese state capitalism” has steadily expanded (Naughton and Tsai 2015). The lack of detail in the pronouncements of China’s leaders such as Xi leaves the outside world to speculate about the implications of a more assertive China for the global economic order.

Barack Obama, in attempting to gather domestic support for the TPP, had warned that the “TPP allows America – and not countries like China – to write the rules of the road in the 21st century” (Office of the Press Secretary of the White House 2016). While Trump’s election, fueled in part by widespread fears in the US over the economic effects of agreements like the TPP, has led to the collapse of the trade initiative, the question remains: If China could write the rules of the global economic order, what principles of governance would it abide by? Would it seek to strengthen and deepen the existing rules of the post-war Bretton Woods institutions founded on liberal market economy principles, or to revise the system to promote some Chinese style of “state capitalism”?

In order to understand what types of economic rules a more activist China might write on the global stage, we need to understand its past liberalization efforts and earlier trajectories of reform. To this end, this dissertation focuses on the critical event of China’s entry into the World Trade Organization (WTO) in December 2001. This development was a significant milestone in China’s opening-up and reform process, and was hailed as a major step forward for China’s integration into the international rules-based system. In 2000, China’s share of world exports stood at 3.9%, less than that of Japan (7.5%) and Germany (8.6%) (Blancher and Rumbaugh 2004).
Yet, its trading partners saw that China would come to be a systemically important player in the global economy. Economically, the sheer size of China’s market and its exporting capabilities meant that its prospective membership to the WTO invited unprecedented scrutiny and commercial demands from the international economic community (Kahn 2000; Clinton 1999; Wu 2016). Politically, major global powers saw WTO membership as a means to integrate China into the rules of the post-war international order. Indeed, it was in recognition of this opportunity that US trade negotiators sought to put together a set of terms for China’s accession to the WTO that would be comprehensive and tightly binding (Interview with Jeff Bader, April 15, 2016). As a result, China’s WTO entry involved substantial tariff reductions accompanied by unusually strong commitments to alter domestic policies relating to the rule of law, trading and distribution rights, government-enterprise relations, and regulatory transparency (World Trade Organization 2001; Lawrence et al. 2006; Zeng and Liang 2013; Qin 2003). It was widely expected that by joining the WTO, China would come to “play by the rules” of the global order and emerge as a constructive member of the international community.

1.2 Research Questions

This dissertation examines the political and policy repercussions of China’s entry into the WTO. The size of China’s economy and its role as “factory of the world” means that it is a systemically important player on the world stage. Changes in its domestic economy have repercussions for the rest of the world, and the stability and functioning of the global economy depends in part on the degree to which China abides by the existing rules of international institutions. Whether China will behave

\[3\text{China became the world’s largest trading nation in 2013 (Monaghan 2014).}\]
as a revisionist or status quo power depends on the degree to which the US and other major economic powers were able to bind China to the international community through its membership in the WTO.

Moreover, the unusually stringent terms of China’s WTO accession represents an early example of the “deeper integration” agenda commonly found in today’s trade agreements, which have come to contain ever-more intrusive commitments aimed at altering domestic institutions. As trade rules increasingly focus on domestic regulations, debate has risen over whether or not the rules of the WTO unnecessarily restrict the policy space of developing countries (see Section 1.4.1). Given global scrutiny and concern over China’s domestic trade and industrial practices, China’s WTO entry represents an important case of the extent to which external trade rules can change domestic state behavior. In addition, a growing diversity of nation-states are now participating in such deep-integration agreements, as evidenced by the inclusion of Vietnam and Brunei in the TPP. As such, questions about when authoritarian states such as China adopt one set of responses rather than others to global economic rules, and why they do so, hold both theoretical and practical significance.

Around the time of China’s accession, conventional wisdom held that WTO membership would result in broad-based liberalization and a weakening of the state-owned sector within China (Rosen 1999). Expectations were that as the rule of law and market competition expanded, government intervention would be circumscribed and China’s economy would come to operate on rules shared by major market economies (Chow 2003, The Economist 2001a). China would go from “shallow integration” to “deep integration” (Fewsmith 2000), and some even speculated that the economic liberalization would strengthen the rule of law, enlarge the middle class and provide an enabling force for political change (Eckholm 1999).

However, the degree to which these expectations would be fulfilled was far from
certain. WTO rules reflect a set of norms influenced by orthodox market liberalism, while China’s economic governance is marked by measures that are opaque and heterodox when judged by liberal market standards, and driven by a single party that continues to own major segments of the economy. Although China’s top leaders sought to use WTO membership to credibly commit to domestic liberalization (Fewsmith 2001; Pearson 2001), the depth and breadth of these commitments might generate resistance from parts of a bureaucracy that did not want its discretion circumscribed by external rules.

To date, there are several puzzling aspects to the institutional and policy changes that have taken place in China post-WTO entry that have yet to be explained. Given the demands that China’s Accession Protocol placed on how the state should govern the economy, what explains variation in policy responses to WTO entry within the vast Chinese state? I approach this puzzle by breaking it down into three inter-related questions: Why did some parts of the state and not others adopt liberalizing responses to WTO entry? Why, in the years following WTO entry, did concerns over Chinese ‘state capitalism’ start to rise? And finally, given divergent responses to WTO entry by different state actors, why is the central state able to execute stronger ‘national champion’ policies in the some industries and not others?

In the next section, I summarize the features of WTO rules that have implications for how the state conducts its economic governance, while Section 1.4 examines theoretical gaps in the existing literature in international political economy and the political economy of China. The chapter ends with an overview of the argument in brief and the organization of the dissertation.
1.3 WTO and New Global Rules for Trade

The rules governing trade liberalization have steadily extended beyond mere tariff reduction to involve ever-more detailed explications about how to govern the economy, leading to substantial requirements for behind-the-border adjustments in national institutions. The growing legalization of international rules means that these requirements have also become increasingly enforceable (Keohane et al. 2000). One such critical development in the international order was the establishment of the WTO to replace the General Agreement on Tariffs and Trade (GATT) in 1995 (Hoekman 1995).

When it was established in 1947, the GATT was primarily focused on facilitating the reciprocal reduction of border barriers – tariffs and quotas – amongst its members. The process of negotiating trade concessions was loosely grounded in the principles of Most Favored Nation (MFN)\(^4\) reciprocity and flexibilities (special and differential treatment) for developing countries. As the tariffs imposed by major economic nations were substantially lowered through multiple rounds of GATT negotiations, attention turned over time to non-tariff barriers as potential ways to reduce trade frictions, starting with the Tokyo Round in 1979 (Barton 2006, p.45).

The creation of the WTO in 1995 through the Marrakesh Agreement substantially altered the scope and legal basis of multilateral trade liberalization, with implications for altering politics within the state, or the interests of various actors within the state, in the following dimensions:

\(^4\)The principle ensures that a concession that one WTO member grants to another trading partner should also be offered to all of its other trading partners.
1. Demands on Domestic Policy

The formation of the WTO brought together a number of agreements, including the GATT, the General Agreement on Trade in Services (GATS), and the agreements on Sanitary and Phytosanitary Measures (SPS), Subsidies and Countervailing Measures (SCM), Trade-Related Investment Measures (TRIMS), Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Technical Barriers to Trade (TBT). Together, these agreements moved the responsibilities of membership far beyond that of lowering border barriers. The SPS, TRIPS and TBT agreements all deal with production processes that previously would have been under the purview of domestic agencies, from regulating health standards to setting guidelines for what counts as a counterfeit or unlicensed product. In particular, the TRIPS agreement “signaled a new era for the regime”, given the substantial legal institutional requirements for effectively regulating and adjudicating intellectual property rights protection (Barton 2006, p.47, 139, 142).

The SCM agreement sets out guidelines for categories of subsidies that are either prohibited (e.g. export subsidies) or actionable (e.g. specific production subsidies), while TRIMS prohibits the use of measures such as local content requirements. GATS further introduces requirements for the state to disclose certain information regarding the provision of services, and for the establishment of judicial bodies to deal with administrative disputes (Barton 2006, p.129).

In short, WTO rules govern not just tariff levels, but also how domestic economic policies and regulations should be conducted, and provide an enforcement

\footnote{A set of flexibilities and exceptions are granted to members with developing country status in the organization. Under the Generalized System of Preferences (GSP), developed countries can offer concessions such as zero or very low tariffs to imports from developing countries. Developing countries are also given longer implementation periods for acceding to various agreements, as well as assistance to strengthen their capacity to engage in WTO-related work.}
mechanism via the Dispute Settlement Mechanism. As the scope of trade rules has expanded, so has the number of interest groups who now have a stake in the trading system, such as environmental, health and consumer protection groups, just to name a few. However, given the breadth of domestic policies that WTO rules now have jurisdiction over, it is arguably the state – and the multitude of actors and interests contained within it – that is most affected by these new trade rules. These rules impose not just potential restrictions on what may not be done, but also actively generate a set of demands for the establishment of regulatory and legal institutions grounded in liberal market economy norms, from health and safety standards to dispute settlement procedures, requiring states to undergo a “fundamental and intrusive restructuring” of domestic institutions (Goldstein 2012). Such restructuring is an inherently political process, with the potential for altering the balance of power across different agencies within the state.

2. Demands on International Representation and Adjudication

The WTO also generates demands on nation-states to participate in international economic diplomacy, both in negotiating new rounds of talks and in managing trade disputes. Certain sections of the state’s governing apparatus will have to take up the responsibility of international representation and to account for domestic actions to a broader international community of nation-states. The WTO’s main enforcement mechanism (and one of its strongest institutional elements) is its Dispute Settlement Mechanism, which allows member states to bring complaints about the actions of other members before a panel at the WTO. Member states can also appeal panel decisions via the Appellate Body. If a member state is found to be in violation of WTO rules, it can either comply,
or if not, be subject to retaliation by the complaining member through a sus-
pension of concessions adding up to the amount of monetary damage deemed to
have been inflicted. Dispute settlement cases generate requirements for informa-
tion gathering and the production of evidence to defend one’s case. Moreover,
the responsibility falls on certain agencies within the state to represent and ac-
count for the domestic policies accused of being in violation of WTO rules. In
the event that a nation-state loses a case, the pressure to comply with panel
rulings can potentially alter the relative influence of different state agencies that
might be competing over control of economic policies.

3. Demands on Information Disclosure and Monitoring

Compared to the GATT, the WTO provides substantially more information
and surveillance about any given member state’s trade and economic policies,
and also demands a high level of information provision from each member, in
the following ways (Hoekman and Mavroidis 2000, p.71):

- Information collection and surveillance. The WTO provides comprehensive
trade-related data on all member states, from tariff and non-tariff barriers,
to regular comprehensive trade policy reviews of country practices. As the
scope of the WTO has come to include a growing number of ‘behind-the-
border’ domestic policies, so has the surveillance and scrutiny over these
policies (previously deemed to be the sole prerogative of sovereign states)
come under the mandate of the WTO.

- Notification and disclosure. The WTO imposes over 200 notification re-
quirements on member states, and requires all members to make public
their trade laws and regulations as well as general laws and administrative
rules.
• Dispute settlement (see above). In the event of a case brought before the
dispute settlement body, each side is obliged to present its own evidence
to support their argument. Information on a WTO member’s trade and
domestic policy tools has therefore come to carry high economic benefits,
as such data can be used as evidence in arguing (and potentially winning
or losing) one’s case.

• Availability. All of this information (collected by WTO staff and provided
by member states) is in turn made publicly available on the WTO website,
which can then be used and disseminated by the media and other non-state
actors.

This information environment imposes requirements on nation-states that are
terribly different from GATT practices in the 1940s, which allowed all corre-
spendences between trade delegates to be privileged and confidential, and to
stay confidential in perpetuity if a delegate did not formally rescind the confi-
dentiality request within three years ([Goldstein and Martin 2000]). The process
of acceding to the WTO’s rules and practices on information disclosure hence
has the potential of altering not just lines of information flow or information
asymmetry within the state, but also the information environment between state
and non-state actors. Such changes are arguably more intrusive and demanding
for authoritarian states used to operating in opacity.

Finally, while the GATT regime allowed members flexibilities and differential

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6Some work has been done on how the WTO’s information requirements might alter domestic
interest group politics (e.g. [Goldstein and Martin 2000]; [Hoekman and Mavroidis 2000]). Other
literature has examined the effects of information provision on the functioning of the global trading
system [Hoekman and Mavroidis 2000]; [Collins-Williams and Wolfe 2010]; [Ghosh 2010], and the
domestic determinants of compliance with international rules [Rosendorff and Milner 2001]; [Dai
2005].
treatment in the application of rules, the WTO requires new members to accede to all existing rules in a “single undertaking”. This was a particularly onerous task for China, as it represented a process of change that was much at odds with the incremental and heterodox nature of reform that had marked its previous three decades of growth (see Chapter Two).

In addition to these demands, Article XII of the WTO Agreement states that a newly acceding member is to join the WTO “on terms to be agreed between it and the WTO”, effectively giving current members the power to impose on new members obligations and commitments that go beyond existing WTO rules (Qin 2003). In the pre-accession stage, the acceding nation has a weak bargaining position vis-à-vis existing members, allowing the latter to negotiate accession terms far stricter than those imposed on the existing members themselves. This can potentially raise the amount of domestic adjustment that the acceding nation-state has to implement as a price for accession, as Chapter Two will discuss.

The final Protocol of Accession for China’s entry into the WTO included detailed and wide-ranging requirements over and above those imposed on existing WTO members, designed to commit China to a sweeping set of changes in its domestic economic governance. Given these substantive and intrusive external demands imposed by the WTO accession protocol, how should we go about understanding the politics behind why different parts of the Chinese state responded differently to the demands of WTO entry? The next section discusses gaps in the literature on the relationship between international rules and domestic policy, as well as the neglect of the international environment in research on the political economy of China, before turning to present this dissertation’s main argument.
1.4 Gaps in the Literature

1.4.1 Clarifying the Relationship between International Rules and Domestic Policy

The growing demands that international trade rules place on the state to alter and transform its domestic functions means that much more focus needs to be given to questions of how the state itself, or actors within the state, respond to WTO entry. Yet this topic has been relatively neglected, with the main outcomes of interest in literature on international trade institutions focused on topics such as institution formation (Rosendorff and Milner 2001; Davis 2004; Kucik and Reinhardt 2008), dispute settlement (Johns and Pelc 2014; Chaudoin 2014), the economic benefits of membership (Allee and Scalera 2012; Goldstein et al. 2007) and the politics of accession (Pelc 2011; Davis and Wilf 2011). Relatively less work examines how the greater intrusiveness of international rules might alter domestic economic policymaking (Gourevitch 1978; Ruggie 1982; Goldstein and Martin 2000).

Indeed, the changing content of international economic rules is often an omitted variable in the international political economy literature, which has been focused instead on “open economy politics” (Oatley 2011). Given this focus on open economy dynamics rather than the rules of liberalization, literature on the political economy of trade has tended to be framed in binary terms, with a focus on protection as the main alternative to liberalization, and demands for protection premised on economic interest groups organized along class lines or sectoral cross-class coalitions (Rogowski 1987a; Frieden 1991; Hiscox 2001; Scheve and Slaughter 2001).

In order to shift our analytical focus to how the changing content of trade rules affects domestic policy, we need to move beyond the treatment of the state as merely
a supplier of protectionism responding to the demands of economic interest groups (Grossman and Helpman 1994; Gawande et al. 2009). However, the study of the effects of international rules on state behavior has been focused on the largely binary outcomes of compliance versus non-compliance. Mechanisms thought to influence the probability of compliance include audience costs and sinking costs (Fearon 1997), reputation costs (Simmons 2000; Kono 2007; Simmons and Danner 2010), delegation in the case of monetary policy (Bernhard et al. 2002), as well as domestic politics channels such as information, uncertainty and signaling (Dai 2005; Goldstein and Martin 2000; Davis 2012).

In the literature specific to the WTO, research has gone beyond the compliance question but nonetheless focuses on a ‘yes or no’ debate about whether the more binding rules of the WTO (compared to the GATT) have constrained the policy space of developing countries. Those arguing for the WTO’s constraining effects point to how its rules restrict the use of policies that economically successful countries have long relied on for growth (Chang 2002; Wade 2003; Dicaprio and Gallagher 2006; Rodrik 2011). Scholars opposing this view argue that WTO restrictions still leave plenty of alternative measures – such as trade preferences, phase-in periods for certain commitments and safeguards – for developing countries to achieve their goals. Moreover, they argue, a wide range of domestic policy domains, such as R&D and non-specific subsidies and foreign investment remain relatively untouched by WTO rules (Amsden and Hikino 2000; Weiss 2005; Shadlen 2005).

This focus in the literature on binary outcomes – of protection versus liberalization, compliance versus non-compliance, and constraint versus non-constraint – obscures the fuller range of potential outcomes that might result from entry into an international organization. What remains missing is an explanation of how evolving trade rules affect the “great variety of instruments and adaptation strategies” that
state actors can choose from to respond to integration (Clift and Woll 2012). Hence, much more focus should be placed on examining the mechanisms through which global trade rules might substantively alter domestic economic strategies, rather than simply constrain (or not), policies for economic development.

Such a re-framing is useful because there is often a range of options available to states in choosing how to respond to an external rule, with each option containing substantively distinct measures and political implications. Yet we know little about why a state might adopt one response over another. In addition, WTO rules have the potential to threaten the influence and autonomy of some bureaucratic agencies by reducing their discretion over how to govern specific aspects of the economy, from standards-setting to the provision of subsidies. At the same time, other actors might potentially see opportunities for expanding their influence with WTO entry, considering the degree to which WTO rules increase the demand for a technocracy well-versed in international trade law. In other words, external rules may substantively alter politics within the state, affecting the interests of specific actors differentially. We might therefore observe more than a single response to an event such as WTO entry. Given these cleavages and the direct stake that state actors now hold in ‘deep integration’-style trade agreements, how can we conceptualize the range of potential responses that these actors can adopt to WTO entry?

This study aims to provide a framework for understanding the different strategies that the myriad actors within the Chinese state can adopt in reaction to international trading rules, and why one type of response is chosen over another. In so doing, I show that the strategic interaction between state actors and external rules cannot be neatly categorized in terms of compliance or constraints, and offer instead an explanation for why states can respond to global economic rules with a set of multifaceted strategies.
1.4.2 Bringing Global Rules into the Political Economy of China

China’s accession to the WTO in 2001 provoked an early set of studies predicting the effects of WTO entry on the Chinese political economy. While Yang (2002) examined the ability of the Chinese state to fulfill its WTO commitments, Fewsmith (2001) discussed the potential impact of trade liberalization in worsening unemployment in specific sectors and exacerbating regional income inequalities. Yet others, such as DeWoskin (2001), Harwit (2001) and Hsueh (2011) analyzed the impact of trade liberalization on industries such as telecommunications, textiles and automobiles. Another set of literature investigates China’s behavior within the WTO itself, centered around the question of whether China has become a status-quo player on the international stage (Mercurio and Tyagi 2012; Gao 2011; Kennedy and Cheng 2012; Li 2012; Shaffer and Gao 2017).

However, in the decade and a half since China joined the WTO, there has been little assessment of how the WTO has affected domestic institutions, and whether events have matched the predictions made. While some studies have noted the establishment of new legal and regulatory institutions, the liberalization of large portions of the economy and a significant reduction in the number of SOEs in the post-WTO era (Yang 2004; Pearson 2004; Qin 2007), other studies have highlighted the “rise of industrial policy” particularly in strategic ‘national pillar’ sectors (Heilmann et al. 2013), and a new state ‘activism’ (Naughton 2007b; 2011). These contradictory findings are driven partly by the fact that many studies have focused on different partial – rather than holistic – responses to China’s WTO membership. And while some scholars have noted a heterogeneity in WTO-related reforms (Mertha and Zeng 2005), we still lack a framework for understanding why there is variation in responses to WTO
entry within different parts of the Chinese state.

Indeed despite the vast scope of literature on the political economy of China’s development, the international environment has tended to be a neglected variable in most of these studies (exceptions include Moore [2002]; Steinfeld [2012]; Hsueh [2011]). For the most part, the international economy is loosely acknowledged as a “passive” background variable by reference to a general opening of economic borders. This omission is an increasingly serious one, as China’s membership in various international institutions expands, and as the scope of these institutions gradually reaches behind the border to directly impact China’s domestic governance structure. The challenge that this dissertation takes up, then, is to connect the politics of globalization to the domestic politics of economic governance in China.

This subnational diversity further points to the need for a theory of change that allows for diverse modes of economic governance to co-exist in a heterogeneous fashion, rather than one that converges towards a single path or set of equilibria.

1.5 Organization of the Dissertation, and the Argument in Brief

Chapter Two provides an overview of the evolution of Chinese reform and industrial policies since 1978, highlighting the main debates that have occurred over the direction and goal of reform and underscoring why the incremental and uneven process of change has generated divergent approaches to governing the economy. The chapter then turns to the politics of China’s accession to the WTO, explaining why this event was an important ‘external shock’ to the Chinese bureaucracy.

Chapter Three starts by framing the ways in which different state actors can respond to WTO rules in terms of three competing state strategies: market-replacing (directive), market-shaping (developmental), and market-enhancing (regulatory). In considering which of the three state strategies will dominate in response to WTO entry, I draw attention to two sets of actors within the Party-state who have a stake in the consequences of China’s accession to the WTO. The first is actors across different administrative levels, i.e. the central and subnational states within China’s vast bureaucracy. The second group of actors comprises the political leadership of the CCP and the major economic and regulatory agencies within the central state. I then propose a theory for why international rules provoked a divergent rather than monolithic response from the Chinese state, highlighting the ways in which the varying likelihood of sanction from deviating from WTO rules and the prospects for bureaucratic
advancement combine to drive each set of actors to adopt different responses.

I show that the ways in which external trade rules would alter state behavior is mediated by the varying likelihood within the state of bearing the burden of potential WTO sanction, which generates scope for different state actors to adopt divergent responses to the WTO based on their own political calculus. This varying likelihood of sanction is driven in part by China’s internally fragmented governance structure that generates overlapping and conflicting accountability relationships across different actors within the state [Lieberthal and Oksenberg 1988]. Moreover, the diversity of socio-economic conditions across subnational regions drives a wedge between central and subnational priorities (Zheng 2010; Huang 1996; Chung 2001), while imperfect monitoring by the central state allows subnational actions to deviate substantially from central policies. As a result, state actors at lower levels of administration face a lower likelihood of WTO sanction, particularly relative to the central state.

At the national level, I distinguish between the party leadership and its central bureaucracy to examine why responses to the WTO varied within the central state. I propose that the ability of the party leadership to discipline the central state bureaucracy is also variable, changing depending on the degree to which leadership ties are embedded within the bureaucracy. This party-state relationship is consequential because the ability of the party leadership to discipline the state affects whether responses to WTO entry are driven by the party leadership or the central state – and while the party leadership in general was supportive of regulatory reforms, the central state was split between agencies supporting regulatory and developmental strategies.

WTO entry further affects the interests of state actors differentially, and therefore we need to consider the ways in which these international rules enhance or undermine a state actor’s prospects for bureaucratic advancement, defined broadly as the attainment of greater rank or influence within the state. I propose that WTO en-
try can affect prospects of bureaucratic advancement through two potential channels: New economic conditions introduced by liberalization affect the determinants of bureaucratic performance, while new trade rules alter the scope for different actors to enhance their bureaucratic influence.

Bureaucratic performance is important to state actors due to the intense competition within the bureaucracy for promotion up hierarchical ranks. As such, Chinese state actors, when responding to WTO entry, will be concerned with how the new economic resources available from trade liberalization (foreign capital and export markets) combine with new economic threats (import competition and unemployment) to affect their performance in terms of generating growth – the main criterion used to assess performance. Bureaucratic influence, on the other hand, is primarily important to actors in the central bureaucracy who are competing with each other for influence over the economic agenda. With WTO entry, some central state actors find that the new rules directly undermine their influence over economic policy, while others see new opportunities to deploy WTO rules as leverage to advance their bureaucratic position.

*Explaining Variation in Strategic Responses*

Chapters Four through Six show how the likelihood of sanction and prospects for bureaucratic advancement combine to affect the divergent choice of strategic responses by state actors (a) across administrative levels; (b) within the central state; and (c) across different industries.

Chapter Four explains variation in the responses of central, provincial and local states to WTO rules. It shows that counter to conventional expectations, WTO entry did not result in a uniform trajectory of liberalization in China. Rather, different state actors diverged in their responses to the common shock of WTO accession. I show that a state’s response to WTO rules is driven by its likelihood of sanction by WTO
rules and how trade liberalization affects its bureaucratic advancement depending on the diversity of the industrial base within its jurisdiction. Greater likelihood of sanction provokes a more regulatory response, while greater industry diversity, by reducing the impact of import competition, leads to developmental responses being privileged over directive ones.

Chapter Five examines why WTO entry has led counter-intuitively to a strengthening of the central state and an enhanced dualism and activism in central state institutions. I show that when the Party leadership is able to discipline the central state, it is able to deploy the state effectively as its agent to adopt regulatory responses to WTO entry. When Party cannot effectively discipline the state, on the other hand, the central state is able to drive strategic responses to the WTO. Which strategies are chosen by which actors within the central state in turn depends on how different agencies were able to use WTO rules as leverage to advance their policy influence. In the years immediately after WTO entry, pro-reform agencies were able to deploy WTO rules as leverage, thereby adopting regulatory responses in order to enhance their bureaucratic position. As WTO leverage weakened with time, however, the ‘losing’ coalition of developmental agencies were able to organize to enact more developmental policies, leading to the emergence of institutional dualism.

Chapter Six further explores the conflictual dynamics between central and subnational states by examining why the central government’s ‘national champions’ policy was more successful in some industries than others. While WTO entry has heightened the central state’s emphasis on building globally competitive national champions, the inability of the central state to discipline subnational actors allows the latter to adopt divergent strategies. At the same time, WTO entry has altered the incentives shaping the bureaucratic advancement of subnational states by providing direct access to external resources in the form of export markets and foreign direct investment (FDI).
show that the central state’s national champions policy suffers from more divergence in industries where subnational firms are more exposed to export markets and FDI. I also provide evidence showing that centrally-driven industrial policies are not necessarily welfare-enhancing, as industries with stronger national champions tend to be less productive.

The concluding chapter discusses the various contributions of this study by highlighting the value of understanding why domestic politics in China produce varied responses to global economic rules. It emphasizes that even in a one-party regime, different parts of the vast party-state apparatus respond to international rules with their own political logic. Therefore while international agreements are increasingly designed to bind members to a set of common principles, the resulting responses may not necessarily lead to a convergence in state behavior. Next, the chapter discusses how the findings of this analysis expand our understanding of the channels through which global rules alter the politics of economic policymaking. I then examine the implications of this study for our understanding of institutional change in China and China’s engagement with global economic rules. Finally, I discuss how the book’s findings extend to other large decentralized states and single-party regimes.
2 China’s Reform Process and the WTO “Shock”

This chapter starts with an explanation of why the incremental and uneven process of economic reform in China has generated divergent approaches to governing the economy. It presents an overview of the evolution of Chinese reform policies since 1978, situating China’s efforts at setting out an industrial policy in the context of major debates within the government over the direction of reform, highlighting the heterogeneous and contested nature of the policy process. The second half of the chapter then turns to the politics of China’s WTO entry. It details the factors shaping the US’s demands for Chinese concessions and the domestic politics within the Chinese government over how high a price to pay for entry, explaining why this event was an important ‘external shock’ to the Chinese bureaucracy.

2.1 Chinese Industrial Policy and Reform in the Pre-WTO Era

In identifying distinct periods in the reform era, I rely on official documents and policies, as well as the writings of prominent Chinese economists such as Wu Jinglian, Qian Yingyi and Xue Muqiao. The different periods presented here broadly conform with those identified in Wu Jinglian’s September 2008 speech on “Thinking through
China’s Thirty-Year Economic Reform Process from an Institutional Perspective” (Wu 2008). In the discussion of each reform period, I focus on how China’s evolution away from the planned economy involved the introduction of new governance approaches that supplemented, but never fully replaced, pre-existing modes of policy-making. Indeed, China’s incremental process of liberalization has meant that each period of change has involved debate and contestation over the appropriate goals and instruments of reform. Therefore even on the eve of China’s entry into the WTO, there was no consensus within the party-state over how the state should govern the economy.

Pre-reform Era (1949 to 1977)

In the Maoist era, China operated according to a planned economy, with economic development skewed towards heavy industry and driven by military strategic considerations. In order to prepare against the threat of war with the Soviet Union, Mao built up a “third line” of defense in the interior of the country, which led a range of heavy industries to be scattered across China’s inland regions (Zhang 1997). The Great Leap Forward campaign (1958 to 1962) encouraged every locality to build up an independently complete industrial structure, leading to further decentralization and duplication of industry across the country (Zhang 1997). In terms of trade, the economy was highly insulated from the world economy. Trading rights were restricted to 12 specially designated state-owned trading enterprises, and the foreign exchange system was fixed and non-convertible (Naughton 2007a, p.380-381).

Start of the Reform Era (1978-1983)

When Deng Xiaoping came to power after Mao’s death, economic reform and restarting growth was seen as a critical priority in order to recover from the combined
damage of the Great Leap forward (1958 to 1962) and Cultural Revolution (1966 to 1976). However, the policy changes adopted did not follow any clear objective or strategy. Instead, Deng’s approach to reform was experimental and incremental, exploiting opportunities for change outside of rather than in the planned economy. While little reform occurred within the plan, the non-state sector expanded rapidly, driving much of China’s economic development in the late 1970s and early 1980s.

Deng Xiaoping and his leadership team tentatively experimented with trade liberalization by designating four cities as Special Economic Zones (SEZs): Shenzhen, Zhuhai and Shantou in Guangdong province and Xiamen in Fujian province. Within the SEZs, inputs used for the production of exports could be imported duty-free, and local arms of the state trading enterprises were also given more operating discretion to retain their foreign exchange earnings. “Dual track” pricing allowed for the retention of planned targets while prices above quotas were liberalized, introducing stronger market incentives into the production process.

These reforms, while serving to re-ignite economic growth, left the core of the planned economy largely in place, and in absolute terms the state sector actually grew

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1 This period is most representative of the famous phrase describing China’s reform process as one of “crossing the river by feeling for the stones” – often attributed to Deng but actually said by party elder Chen Yun.
in size during this period (Qian and Wu 2003). All of these experiments involved a
decentralization of policy authority from the center down to local and even household
levels, and in that sense the trajectory of reform was very much opposed to the
implementation of any industrial policy, insofar as that would have been synonymous
with the traditional planning approach to growth (Zhang 1997).

Alternative Models and Establishing a Socialist Commodity Economy (1984-
1993)

In the early 1980s, pressures and disagreements grew within the government over
what the overall goal of economic reform should be. As part of this debate, Chinese
reformers looked outwards to draw lessons from the experiences of other countries.
While the Soviet model had been largely delegitimized within the government, officials
also studied the reforms in Eastern European countries such as Hungary and the
developmental experiences of government-led economies such as Japan, Korea and
Singapore. While the Japanese and Korean models came to be the most influential,
Western market economy models were also considered, particularly by those who had
been schooled in the US or Europe (Wu 2013, p.40-41).

In 1984, the Third Plenum of the 12th Party Central Committee adopted the
“Decision on Economic System Reform”, which clarified that the goal of reform was
to establish a “planning system that consciously applies the law of value, to develop
a socialist commodity economy” (CCP Central Committee 1984). By setting the re-
form goal to be building a “socialist commodity economy”, China’s leaders were able to
forge a compromise between a fully planned economy and one that operated on a mar-

2“Jianli zijue yunyong jiazhi guilü de jihua tizhi, fazhan shehui zhuyi chanpin jingji” 建立自觉运用价值规律的计划体制，发展社会主义产品经济.
ket economy with commodity exchange. In this Decision, several economic priorities were set out, including: reforming the price system; separating government-enterprise relations and strengthening government management functions; and establishing multiple ownership forms for enterprises (Wu 2013, p.40-41).

By formally introducing elements of market economy functions into the planned economy, the Decision allowed government policies to turn towards Japanese and Korean models of developmentalism. The 7th Five-Year Plan issued in 1986 made the first mention of the term “industrial policy” (Cornick 2014), marking an official shift towards a new strategy for economic growth. In the following year, the State Council’s Development Research Center (DRC) submitted a “Preliminary Study of China’s Industrial Policies” to the leadership for consideration (State Council 1987). In this report, the DRC pointed out the important role that industrial policy had played in the economic development of many countries. In particular, the report suggested that the goal of China’s reform of the planned economy was to enable a “dialectical unity between the plan and market, with the guidance of the plan as the main model, and a Chinese-style economic system that combines ‘competition’ with ‘intervention’, with the state guiding the market and the market fostering enterprises, in order to move towards a commodity economy”. As such, the report argued, “the experience of Japan and South Korea, as well as other countries and regions, in using industrial policy to achieve an economic system that combines ‘competition’ and ‘intervention’, is deserving of our serious attention.”

Also in 1987, an Industrial Policy Department was established in the State Planning Commission, reflecting the government’s growing interest in the use of Japanese-style industrial policy to develop the economy (Zhang 1997).

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3 See Chinese economist Xue Muqiao’s discussion of this in Xue (2010).

4 Author’s translation, as quoted in Wu (2017).
Reforms took place in the trading system as well. The success of the SEZs led the government to scale up its trade liberalization, allowing all cities along the Chinese coast to engage in export processing trade on terms similar to those enjoyed by the original zones. The number of state-trading enterprises was expanded widely beyond the original 12, and direct trading rights were also awarded to numerous enterprises (Naughton 2007a, p.384-386).

In April 1989, China’s State Council issued the country’s first Decision on Current Industrial Policy Priorities (State Council 1989). This document discussed the need to “organically combine planning with market” to “rectify” the industrial structure and rebalance activities away from heavy industry towards light industry and consumer goods, as well as to address weak capacities in agriculture. Another concern was to address regional imbalances in production and weak industrial concentration due to overly-dispersed production. In terms of targeting specific industries, the 1989 Decision emphasized a long list of priorities, from promoting transportation and telecommunications, machinery and electronics, agriculture industry, technology-intensive sectors and export industries that could earn foreign exchange such as textiles, to discouraging low-technology and high energy-consuming industries.

With regard to implementation, the 1989 Decision shifted away from a total reliance on planned directives towards credit, taxation and pricing policies, but retained a heavy emphasis on the role of the central government - in particular in approving the use of foreign exchange and guiding the flow of foreign capital. The document further touched on the importance of market regulations and signals, using terms such as “macro-control”, “market demand” and “economic efficiency” while combining traditional Marxist concepts such as “fields of social reproduction” and production targets.

5 Jihua yu jingji youjidi jiehe qilai, 计划于市场有机结合起来
6 "hongguan tiaokong, shichang xuqiu, jingji xiaoyi" "宏观调控, 市场需求, 经济效益"
In short, the 1989 Decision combined a range of contrasting approaches to economic governance, rather than a full embrace of Japanese-style industrial policy-making. The effects of this policy would never be seen, as the events of Tiananmen two months later would throw the country into a political crisis and introduce a period of stasis and even retrenchment in terms of economic liberalization, while intensifying debate within the party over the role and scope of reform. Growth would not be restarted until after Deng Xiaoping undertook his famous ‘Southern Tour’ in 1992 to urge localities to once again embrace reform and opening. Despite these incremental and sometimes halting trajectories of reform, and the heterogenous combination of economic governance concepts that guided policy-making, the Chinese economy underwent substantial transformations during this period. The share of the state sector in industrial output fell from 78% in 1978 to 43% in 1993, and over the same period over 90% of prices were liberalized, while the export-to-GDP ratio rose from 5 to 20% (Qian and Wu 2003).

**Establishing a Socialist Market Economy (1994-WTO entry)**

Deng’s Southern Tour cooled debates over reform and paved the way for a consolidation of policy direction. In October 1992, the CCP’s 14th National Congress affirmed that the goal of China’s reform was to establish a “socialist market economy”. At the 3rd Plenum of the 14th Central Committee in November the next year, the “Decision on Several Questions relating to the Establishment of the Socialist Market Economy” was issued, setting forth a new round of reforms that embraced market economy principles to a far larger extent compared to the past (CCP Central Committee 1992). The 1993 Decision explicitly laid out the need to build new institutions that would support the functioning of the market economy, from centralizing the central banking and fiscal systems to unifying the exchange rate and reforming the SOE
sector, signifying the “beginning of a rule-based system” for governing the Chinese economy (Qian and Wu 2003).

However, this Decision by no means represented a full embrace of market economy principles as understood in Western developed democracies. While setting out major changes to be implemented in the SOE sector such as enterprise modernization and a separation between government and enterprise, the document simultaneously affirmed state ownership as the “principal component” of the economy\textsuperscript{7} and noted that large SOEs held the position as “pillars”\textsuperscript{8} of the national economy.

Efforts to emulate Japanese and Korean models of industrial policy also continued. The State Council issued an “Outline of State Industrial Policies for the 1990s” in April 1994, setting out a revised framework for industrial development (State Council 1994). The Outline promised to “bring into full play the fundamental role of the market in resource allocation under the state’s macroeconomic regulation and control”\textsuperscript{9} and for the first time identified a set of “pillar” industries for support: electronics, machinery, petrochemicals, automobiles and construction. The ‘market for technology’ strategy was also articulated, setting out the policy of opening parts of the domestic market to foreign products “in exchange for key technologies and equipment”. In terms of policy instruments, the Outline lists various means of state support such as investment and loans, priority in stock and bond issuance, financial and material assistance in technology development, and infant industry treatment and protection. As was the case with the 1989 Decision, the 1994 Outline combined a range of approaches to economic governance, acknowledging the “fundamental role of

\textsuperscript{7}yi gongyouzhi wei zhuti” “以公有制为主体”

\textsuperscript{8}zhizhu” “支柱”

\textsuperscript{9}Congfen fahuizhichang zai guojia hongguan tiaokongxia dui ziyuan peizhi de jichuxing zuoyong” “充分发挥市场在国家宏观调控下对资源配置的基础性作用”
the market in resource allocation” on the one hand while specifying “pillar industries” that would enjoy special state support on the other. The Outline further betrayed a continued reliance on planned economy methods by including, in its Appendix, extensive lists of production targets for different industries. For example, the target for sedans read: “For new, expansion and reconstruction/expansion projects as well as technology-upgrading projects for automobiles with engine capacity below 1,600cc: at least 150,000 units”.

In the late 1990s, near the eve of China’s WTO entry, important policy changes were made that on the one hand strengthened the role of market forces in the economy, yet on the other also strengthened the role of SOEs. In March 1999, the Constitution was amended to formally recognize private ownership and the rule of law (Qian and Wu 2003). That same year, at the 4th Plenum of the 15th Central Committee, a “Decision on Major Issues Concerning the Reform and Development of State-Owned Enterprises” was passed, that not only re-affirmed state ownership as the “principal component” of the economy, but also that SOEs were its “pillar”, signalling policy continuity from the 1992 Third Plenum Decision. The 1999 Decision further clarified that the state-owned economy needed to retain control in a few main areas: industries with national security concerns, industries that were natural monopolies, industries providing public goods and services, “pillar” industries and the “backbone enterprises”\textsuperscript{10} of new high-tech industries (CCP Central Committee 1999)\textsuperscript{11}

On the one hand, the 1999 Decision seemed to reaffirm the important role that SOEs would continue to play in the economy. On the other hand, an important change began to take hold in the following year regarding the political status of

\textsuperscript{10}gugan qiye “骨干企业”

\textsuperscript{11}The exact phrase read: “国有经济需要控制的行业和领域包括：涉及国家安全的行业，自然垄断的行业，提供重要公共产品和服务的行业，以及支柱产业和高新技术产业中的重要骨干企业。”
private entrepreneurs. Starting in 2000, Jiang Zemin made a number of speeches to promote his new concept of the “Three Represents”\(^\text{12}\). Jiang delivered his most extensive discussion of this concept in a speech on July 1st, 2001 commemorating the 80th anniversary of the founding of the CCP, declaring that “the Party must always represent the requirements of the development of China’s advanced productive forces, the orientation of the development of China’s advanced culture, and the fundamental interests of the overwhelming majority of the people in China” (italics added) (www.china.org 2001). This speech was seen as an important turning point in Party ideology. The expansion of the Party to include representation of “advanced productive forces” indicated space within the Party for private entrepreneurs who, Jiang argued, represented a new component of the working class that had emerged through the past decades of reform (Shambaugh 2008, p.111-113). The concept was formally incorporated into the Party constitution at the 16th Party Congress in the fall of 2002.

2.1.1 Competing Modes of Economic Governance

Even as we can identify different milestones in China’s reform process, as the previous sections have done, it is fair to say that the co-existence of competing modes of economic governance has been a constant theme in China’s reform process. While specific political moments have served to clarify the goal of reform (such as moving from a “socialist commodity economy” to a “socialist market economy”), at no point in time has there been consensus within the top echelons of the party-state over the role of the state in governing the economy. Wu Jinglian, in his own assessment of the mixed messages emanating from the party and government’s reform policies, noted

\(^{12}\)Sange daibiao 三个代表
that “this lack of precision allowed different understandings of the objective of China’s reforms to persist” (Wu 2013, p.42).

Indeed, even as Chinese officials intensely studied Japan and Korea’s development experience, officials from different ministries came away with divergent conclusions on the lessons that China should draw from its Northeast Asian neighbors. For example, Huan Guoyu from the State Economic Restructuring Commission (SERC - a reformist outfit formerly headed by Premier and General Secretary Zhao Ziyang), studying Japan and Korea’s growth experiences, concluded in a 1996 article that under-developed countries needed a strong government and macro intervention to stimulate economic growth. However, he noted, government intervention should only be done in order to compensate for the market and to support it, not to destroy the market. Effective government intervention therefore required a transformation of government functions as well as enterprise reforms to encourage profit maximization under hard budget constraints and with independent operations (italics added) (Huan 1996). In contrast, Chen Bingcai from the conservative State Planning Commission, in an article that same year analyzing South Korea’s conglomerates, noted that the key benefits of supporting conglomerates were that large enterprises could diversify risks, undertake long term plans requiring large economies of scale and heavy capital concentration, and – crucially – that these enterprises could be relied on to effectively implement government policy (italics added) (Chen 1996). Hence while one official saw in the Japan/Korea experience the necessity of separating enterprise-government relations and establishing enterprise autonomy, another saw the benefits of deploying enterprises as a tool of government policy.

Given the scope for such varying governance approaches to persist over time, efforts by the central government to focus and clarify the objective of reform were not necessarily successful. Hence, as Wu Jinglian points out, “(a)lthough the goal
of reform was clearly to establish a “socialist market economy”, there were different interpretations of what a “socialist market economy” actually was” (Wu 2013, p.54). Indeed, over the decades of reform leading up to China’s entry into the WTO, while significant efforts at liberalization had taken place, the reform process itself had been heterogenous and contested, with no consensus over the role of the state in economic governance. Instead, what existed within the Party-state was a mixed bag of approaches and accompanying policy instruments, ranging from heavy-handed administrative directives, to incentive-based tools such as tax breaks, to arms-length regulation.

Thus, the Chinese trade regime remained a dualistic one even by the late 1990s, with coastal cities engaged in export promotion and benefiting from special provisions from the state, while the rest of the country operated under a traditional “ordinary trade” regime with high tariff rates and multiple barriers to trade (Naughton 2007a, p.386). When China finally concluded its negotiations to join the WTO, the dominant expectation was that WTO entry would serve as a credible commitment to bind China irrevocably to a path of market reform, bringing much more uniformity to domestic economic governance. However, whether or not this convergence to liberalization would take place was far from given.

2.2 The Political Economy of China’s WTO Entry

This section examines the politics of China’s accession to the WTO, in order to highlight why the terms and commitments that China signed on to represented such an external “shock” to the domestic system and why we might expect bureaucratic resistance to WTO-led liberalization. In the analysis, I start with an overview of the main events before highlighting the role that the interests of China’s foreign trading
partners – in particular the US – played in shaping the specific commitments that China agreed to in its Protocol of Accession. I then explain how the terms in the Protocol went above and beyond the ordinary commitments held by existing WTO members, and the domestic resistance that China’s leaders faced within their own bureaucracy over how high a price to pay for entry.

2.2.1 Overview

Detailed accounts of the events and political dynamics leading up to China’s WTO entry can be found in a number of scholarly works (including Pearson (2001); Fewsmith (2000); Feng (2006); Lawrence et al. (2006); Brahm (2002)). This section will therefore provide only a brief summary, followed by a discussion of the political interests of the US and Chinese governments and the specific terms of accession. I focus on US interests and the politics surrounding the signing of the US-China bilateral agreement in 1999 because the US was the most important “gatekeeper” to China’s entry into the WTO, and of all existing WTO members would set the highest standards, shaping the major terms and conditions for accession. Hence once China came to an agreement with the US, negotiations with other major trading partners (e.g. the European Union and Japan) proceeded much more smoothly.

GATT Years: 1986 to 1994

China had been an original signatory of the General Agreement on Tariffs and Trade (GATT) when it was formed in 1948. After the Kuomintang (KMT) was defeated by the Communists in 1949, the KMT fled to Taiwan and from there announced China’s withdrawal from the GATT. In 1986, the CCP government sent a notification to GATT to begin the process of resuming its membership.
The challenge of membership at that point in time centered on how to integrate China, a developing country rooted in the planned economy, into a club mostly comprised of developed market economies (Interview with Jeff Bader, April 15, 2016). The Tiananmen crackdown in June of 1989 brought negotiations to a halt, and talks did not resume until the early 1990s, where much time was spent trying to come to an agreement on how to characterize the Chinese economic system. In the early 1990s when the Chinese government still described its system as a “socialist commodity economy” (see Section 2.1), the term led to a degree of confusion amongst China’s trading partners on how to treat China within the GATT system that was difficult to overcome. The declaration in 1993 at China’s 14th Party Congress that China’s goal was to become a “socialist market economy” brought negotiations forward, as China now could use the common term of “market economy” in its talks with its foreign counterparts. According to China’s chief negotiator Long Yongtu, six years were spent just in negotiations over four characters: “market economy”, or shichang jingji (市场经济) (Feng 2006, p.201). Even then, further disagreement lay in whether China would be given a developing country status (which was China’s position) or that of a developed country (which was the US’s position, given China’s size and potential economic import) (Interview with Jeff Bader, April 15, 2016).

**Stalemate: 1995 to 1998**

When the GATT was superseded by the formation of the WTO in 1995, China then applied to join the WTO as a contracting party. The process of WTO accession would be substantively more difficult, given the difference in scope between GATT rules and WTO rules (see Chapter One). Negotiations would now have to cover not just tariffs and non-tariff measures in manufactured goods, but also services, intellectual property, dispute resolution, transparency and investment measures (Pearson
In late 1995, Deputy United States Trade Representative (USTR) Charlene Barshefsky presented a “road map” to accession to Chinese Trade Minister Wu Yi. This document set out the major commitments that China would have to undertake in order to join the WTO, including substantive liberalization in sensitive areas such as agriculture and services (banking, telecommunications and insurance) (Lawrence et al. 2006, p.263). While the Chinese studied this road map carefully, progress between 1995 and 1998 was halting and slow, due in no small part to the internal disagreements generated within the Chinese multi-agency consultation and decision-making process (Pearson 2001, p.349-350).

**Zhu’s Failed Visit and Aftermath: Spring - Fall 1999**

Between November 1998 and February 1999, then-US President Bill Clinton sent his counterpart Jiang Zemin a series of letters expressing his hopes that the US and China could reach an agreement on China’s WTO accession by the first quarter of 1999 (Lawrence et al. 2006). This outreach was accompanied by a flurry of high-level visits on both sides. When the Chairman of the Federal Reserve Alan Greenspan met with Premier Zhu Rongji in Beijing in January 1999, Zhu reciprocated by expressing his desire to conclude a deal during his planned visit to the US in April that year (Zhu 2015, p.131). In preparation for Zhu’s visit, the Chinese leadership (probably the Politburo) met to agree on the concessions that Zhu would bring with him to Washington DC, overriding the domestic inter-agency process that up to then had proved to be a major stumbling block to negotiations (Pearson 2001, p.345). Visits to China were also made during this period by Deputy Treasury Secretary Lawrence Summers, Secretary of State Madeleine Albright, USTR Barshefsky and Commerce Secretary William Daley (Lawrence et al. 2006, p.268).

In March 1999, NATO air strikes on Serbia added some strain to the bilateral
US-China relationship. Nonetheless, Zhu arrived in the US the next month bearing major concessions on US demands ranging from agriculture to telecommunications and insurance. Disagreements within the Clinton team over whether the terms of the deal would be approved by Congress led Clinton to reject Zhu’s offer, a decision that Clinton very quickly saw as a mistake that needed to be reversed (Pearson 2001, p.345). This rejection was a political blow to Zhu, one that was followed by an even deeper backlash in China when a summary of the Chinese concessions was posted on the USTR website. As the Chinese concessions had been negotiated in secret at the leadership level, the posting of the summary gave many quarters of the Chinese government their first look at the substantial and sweeping liberalizations that Zhu had offered to the US. Zhu was attacked as a “traitor” and the terms of agreement compared to the concessions that China had given to imperial powers in the early 20th century (Fewsmith 2000). In May, the US military mistakenly bombed the Chinese embassy in Belgrade, further damaging US-China relations and derailing any immediate prospects of an agreement on China’s WTO entry.

The US made efforts to mend bilateral relations in the ensuing months, efforts which intensified in September 1999 with a meeting between Jiang and Clinton at the sidelines of the APEC meeting in New Zealand, and which was followed by a phone call between the two in October. That same month, Treasury Secretary Summers met with Premier Zhu in Lanzhou city in China, where he handed over a letter from Clinton regarding China’s WTO accession. Summers was authorized to make a verbal concession, and the two sides then spent four to five hours going through the agenda items on the trade deal (Interview with Larry Summers, March 28, 2016). Momentum picked up after this meeting, and after another call between Clinton and Jiang in November, it was decided that Barshefsky and US National Economic Council Chairman Gene Sperling would visit Beijing that same month to try to conclude the
Concluding the Agreement: November 1999

In Beijing, the US delegation spent six almost continuous days negotiating with the Chinese team headed by Minister of Foreign Trade and Economic Cooperation (MOFTEC) Shi Guangsheng, without managing to resolve the outstanding issues. When Barshefsky decided that progress was not being made and informed the Chinese that the US delegation would be leaving, Zhu Rongji intervened and personally led the negotiations to resolve the more controversial issues. When Shi took over the negotiations thereafter, however, negotiations again reached a head as the Chinese side re-opened more issues for discussion (Cooper et al. 1999). This prompted the US delegation to again decide to leave and for Zhu to intervene once more. In the final negotiation between Zhu and Barshefsky, the remaining outstanding issues were resolved. The US agreed to give up their request for controlling rights and 51% equity shares in telecommunications and insurance, if China agreed to extend the period for which they would be treated as a non-market economy in anti-dumping cases from 12 years to 15. A deal was finally struck, paving the way for China to conclude its bilateral talks with other major trading partners such as the EU and Japan and to join the WTO in December 2001 (Lawrence et al. 2006, p.276-277).

13 The inclusion of Sperling, who had been against the deal in April, was meant to signal to the Chinese that the US was committed to successfully concluding the agreement (Lawrence et al. 2006).

14 Particular sticking points included foreign equity shares on telecommunications and insurance, automobile financing, and market access and equity shares for audiovisuals, among others.

15 A Chinese transcript of Zhu’s meetings with the US delegation on November 13 and 15 can be found in (Zhu 2011b, p.352-374)
2.2.2 The role of US interests in shaping China’s terms of accession

American interests in China’s WTO membership derived from a combination of commercial and broader geopolitical considerations. The commercial interests were grounded in the economic potential of China’s domestic market and exporting capabilities, while the political motivations were driven by a broader conviction that it was important to knit China closer into the international system, and that WTO entry would strengthen the hand of reformers in China (Interview with Larry Summers, March 28, 2016).

In terms of commercial interests, Barshefsky spent the first two years of the accession process explaining and reiterating to the Chinese that China had to accede to the WTO on commercial – not political – terms. The broad range of US commercial groups interested in gaining access to China’s market meant that every single tariff line came under intense scrutiny and discussion. The US negotiating team was under immense pressure to achieve deep and broad concessions on market access, such that the deal would not subsequently be blocked by Congress. On the protectionist side, the negotiators also had to incorporate concerns from textiles and steel groups that safeguards be built into the deal so that they would not be hurt by surges in Chinese imports (Interview with Jeff Bader, April 15, 2016).

As for broader geopolitical considerations, China’s WTO entry represented an opportunity to bind China to the rules of the international economic order. As a

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16 “I want them to understand two things,” she said. “First, we would like them in the WTO, but, second, the price is not cheap.” (Walsh 1996, p.90)

17 US business interests were represented by the US Chamber of Commerce, with major players coming from a broad swathe of industries, including AIG, Boeing, Motorola, General Motors, Walmart, General Electric and farm groups (Interview with Jeff Bader, April 15, 2016).
former US official put it, “(i)n the broadest form, the motivation was to ensure that China’s re-emergence would be constructive, not destructive to the global system of order” (Interview with former US official, April 21, 2016). This belief only deepened when the WTO was formed, since the WTO had stronger enforcement powers via its dispute settlement mechanism (Interview with Jeff Bader, April 15, 2016). Bill Clinton highlighted this point when drumming up domestic support for this deal, noting in a speech in 2000 that “(u)nder this agreement, some of China’s most important decisions for the first time will be subject to the review of international bodies with rules and binding dispute settlement” (Clinton 2000). Treasury Secretary Lawrence Summers reinforced these views during his testimony to the House Committee on Ways and Means in 2000:

For the first time, China’s compliance will be subject to multilateral enforcement under the WTO dispute settlement mechanism, which will force China to comply with WTO rulings or be subject to trade sanctions. . . . (WTO membership) will both support the cause of market reform within China - and provide an effective rule-based framework for future Chinese reforms to take place. . . . By learning to “play by the rules,” both internationally and domestically, China will strengthen the rule of law, which will enable it to become a more reliable partner and a fairer society (Summers 2000).

Driven by this combination of commercial and geopolitical considerations, the deal that the US concluded in November 1999, which served as the foundation for China’s resulting Protocol of Accession, was “the most specific out of all the deals that the US had done”, containing market access commitments that were “unprecedented” in the history of the WTO in terms of the breadth and depth of liberalization (Qin 2003). Tariff rates were bound at a low average level of 10%, with very little ‘water’ between the applied and bound rates, a commitment that distinguished China from

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18 Bound tariffs are the tax rates that WTO members have formally agreed to, while applied tariffs
the behavior of other large developing countries such as India. In addition, China’s liberalization of its services sector went far beyond that offered by other countries at the same and even higher levels of income (Qin 2003). Finally, the Protocol of Accession included detailed and wide-ranging commitments on how the state would govern key aspects of the Chinese economy, from state-enterprise relations to establishing processes for judicial review and limitations on how to conduct policy on issues ranging from subsidies to foreign investment.

The impressive scope and depth of this agreement was designed partly in due consideration for the weak legal institutions in China’s opaque and authoritarian political system, and also in light of the enforcement power of WTO rules: WTO rules would have the status of international treaty obligations in China, rendering them more effective than international rules are for other countries such as the US (Interview with former US official, April 21 2016). The next section highlights the key commitments that China signed on to as part of its accession protocol.

### 2.2.3 China’s Protocol of Accession

Ordinarily, developing countries are allowed some flexibilities and exceptions to WTO rules. However, in its Protocol of Accession, China not only agreed to give up many of the exceptions and flexibilities that would normally be accorded to a developing country, it also made a number of “WTO-plus” and “WTO-minus” commitments going beyond existing WTO rules: the former represents commitments that set a standard of behavior higher than that required by WTO rules, while the latter represents commitments that allow other trading partners to lower the standards they are the tax rates that are actually in use. In many developing countries, there is a large gap (or “water”) between bound and applied tariffs, giving these countries the ability to raise their applied tariffs without violating any WTO rules.
would normally apply in using trade remedies against Chinese exports (safeguards, anti-dumping and anti-subsidy measures). Together, these commitments added up to no less than a herculean undertaking to transform the functioning of the state in China’s domestic governance system. Qin (2003) conducts a detailed examination of the WTO-plus aspects of China’s Protocol of Accession, and this section draws heavily on her analysis. In brief, the WTO-plus aspects of the Protocol included commitments:

1. To let the market determine prices of all goods and services, with a few exceptions such as tobacco, pharmaceuticals and public utilities;

2. To grant trading rights to all entities, Chinese or foreign within three years – again with a few exceptions in specific categories;

3. Not to interfere in the commercial decisions of state-owned enterprises (SOEs);

4. Not to add conditions to FDI approval relating to technology transfer and R&D activities in China (which goes beyond the prohibition of local content requirements contained in TRIMS);

5. To expand the existing scope of national treatment\(^{19}\) by granting comprehensive national treatment to foreign investors in services, trading rights, and in the production and sales conditions of foreign businesses in China;

6. To implement transparency commitments such as establishing an official journal that would publish all measures related to trade; setting up information points where businesses can enquire about trade-related measures; to reply to requests for information within 30 days after receiving the request (up to 45 days for

\(^{19}\)Providing treatment to others that is the same as that accorded to one’s nationals.
cases that are exceptional); providing a reasonable comment period for all draft measures; and translating all trade-related measures into one of the official WTO languages;

7. To allow enterprises and individuals involved in judicial or administrative tribunals the opportunity for appeal under all circumstances, as well as to provide written decisions to the appellants and to inform them of any rights they might have to further appeal;

8. To nullify any subnational rules that are inconsistent with WTO rules and the Protocol of Accession, apply all laws and regulations related to WTO rules in a uniform, impartial and reasonable fashion, and establish a complaint mechanism through which non-uniform application of rules can be notified to the Chinese government; and

9. To accede to additional layer of scrutiny through a Transitional Review Mechanism (TRM). This TRM would monitor and assess China’s progress in implementing its WTO commitments on an annual basis for a period of eight years after accession, with a final review in the tenth year.

As Gao (2007) details, China’s “WTO-minus” aspects of China’s accession protocol included commitments:

1. That WTO members can treat China as a ‘non-market economy’ in calculating domestic prices in anti-dumping cases for a period of 15 years;\textsuperscript{20}

\textsuperscript{20}In other words, WTO members do not have to use Chinese domestic prices to establish if there is dumping behavior, but can use the prices of another surrogate country. This gives WTO members substantial discretion in choosing what prices to serve as benchmarks in establishing their dumping case.
2. That WTO members can use a similar non-market economy methodology in determining the existence of subsidies under the Subsidies and Countervailing Measures (SCM) agreement, with no expiration date;

3. That for a period of 12 years after accession:

   - WTO members can trigger safeguards against Chinese imports in cases where these imports cause “market disruption” (the existing Safeguards mechanisms requires imports to be “a significant cause of material injury”);
   - That China can only retaliate against these safeguard measures after a period of two years;
   - That these safeguard measures can be applied for any period of time (exceeding the eight-year limit under WTO rules); and
   - That members worried about a trade diversion effect caused by the triggering of a safeguard measure by another member against China can launch an investigation into triggering their own safeguard immediately.

4. That until the end of 2008:

   - Members can trigger special safeguards on Chinese textile imports as long as there has been “market disruption threatening to impede the orderly development of trade in these products”; and
   - that China cannot retaliate against these textile safeguards.

5. That unlike the treatment accorded to developing countries

   21Under WTO rules members can retaliate immediately.

   22It should be noted that under WTO rules, developing country status is self-designated rather than accorded according to any set of socio-economic standards. Hence China can ‘self-designate’ that it does not qualify for the flexibilities accorded to other developing countries in the WTO.
• China’s subsidies to SOEs will be treated as ‘specific’ subsidies - and hence will be actionable under the SCM agreement;
• China’s debt forgiveness programs would be actionable under the SCM agreement;
• De minimus support in agriculture would be capped at 8.5% of the total value of production of a particular product, lower than the average 10% held by developing countries.

The implementation of these commitments would clearly involve substantial and intrusive reforms in China’s domestic economic system and threaten to undermine the interests of existing bureaucratic actors. As the next section explains, the politics of signing this agreement were such that many of the commitments were agreed to over the intense objections of China’s domestic bureaucracy and industry interests.

2.2.4 Chinese Interests and Domestic Politics

Why did Chinese leaders agree to such a high price of entry to the WTO, and what were the domestic politics in China that led to this agreement being signed? The Chinese interests for seeking WTO entry were multifaceted. One historical reason was that China’s paramount leader, Deng Xiaoping, had made the decision to re-integrate China into the international system (Pearson 2001). Broadly, WTO entry would also represent a significant step forward for China’s efforts to being recognized as a legitimate and major power on the international stage, and bring credit to China’s leadership (Fewsmith 2000). But more crucially, a combination of economic factors made WTO entry a high priority for China’s leaders in the late 1990s. First, the 1998 Asian Financial Crisis meant that growth in the region would be weak for the foreseeable future, and China was worried about falling rates of foreign investment.
Second, Zhu Rongji’s goal of reforming and revitalizing the SOE sector was running into problems, and he came to see WTO entry has providing important external leverage and competition to force the Chinese economy (and its SOEs) to shape up. As Pearson points out, “the only way to break the hold of the “old” economy and its champions was to force change on it via the stringent requirements imposed by WTO rules” (Pearson 2001, p.364). Zhu’s public rhetoric on the benefits of WTO entry was consistent with these domestic considerations, and his public remarks repeatedly emphasized the importance of WTO membership in boosting investor confidence and forcing the economy to improve its competitiveness (Manthorpe 1999).

However, the leadership’s goal of WTO entry was heavily opposed by bureaucratic and industrial interests within China. Ministries in charge of industrial policies resisted the prospect of having their authority over industrial development curtailed by international rules, and did not welcome the threat that foreign competition would bring to the economic interests of the industries and firms under their charge. Given the sweeping liberalization that the US negotiators sought as a price for entry, the range of Chinese industries who resisted the deal was similarly broad: from agriculture and automobiles to telecommunications, chemicals, insurance and machinery (Pearson 2001, p.361). In late 1997, a number of central ministries, provincial representatives and industry managers appealed to the Chinese leadership to postpone WTO accession (Lam 1997). The automotive industry also petitioned President Jiang Zemin (who had spent part of his career into auto sector) directly not to make such concessions (Zhu 2011b, p.359).

The opposition of these entrenched bureaucratic and industry interests in China partly explains why the US-China bilateral negotiation frequently stalled. In the final rounds of negotiations in November 1999, the US delegation was unable to make headway when the Chinese side was headed by Minister of Foreign Trade and Economic
Cooperation (MOFTEC) Shi Guangsheng, who even tried a last minute attempt to re-open some issues right before the US-China signing ceremony on November 15 (Cooper et al. 1999; Lawrence et al. 2006). It was a “political war” on the Chinese side, and Zhu faced “enormous political resistance” (Interview with Jeff Bader, April 15, 2016).

The depth and breadth of opposition to WTO entry within the Chinese bureaucracy became visible after Zhu’s failed trip to the US in April 1999 and the posting of the summary of Chinese concessions on the USTR website. As pointed out in Section 2.2.1 that summary was for many within the Chinese bureaucracy their first look at the full details of their leadership’s proposed concessions to the US. One newspaper report at that time described how the negative reactions spread beyond the central bureaucracy and SOEs to local governments in inland rural areas that relied on agriculture for their local economies. The proposed liberalization in market access in agriculture would have generated big increases in imports of American wheat, fruit and meat, leading those local leaders to petition the central government against the deal (Lam 1999b). Proposed concessions in telecommunications, which included allowing foreign investors 51% ownership shares, reportedly led the Minister of Information Industry Wu Jichuan to offer his resignation in protest (Pearson 2001; Fewsmith 2000). Officials from MOFTEC came under attack from other ministries (including agriculture) demanding explanations for how and why these sweeping concessions were made (Lam 1999a). Zhu’s concessions were widely decried by his ministers for being excessive, leading some officials to declare him to be a traitor to his country (Kwang 1999; The Economist 2001b).

Indeed, opposition to liberalization was so entrenched that a more consultative approach taken in the 1980s and early 1990s had led to bureaucratic deadlock, causing chief negotiator Long Yongtu to argue for a more streamlined approach restricted to
only the top leadership (Pearson 2001). Given the breadth and depth of bureaucratic opposition, the only way for China to conclude the agreement was for the leadership to intervene directly over the objections of the bureaucracy. While MOFTEC was the lead agency heading the Chinese inter-agency process, it did not have the power to impose its will on the other ministries. Hence individual ministries would hold their ground during the negotiations until Jiang and Zhu stepped in to break the deadlock (Interview with Jeff Bader, April 15, 2016). While Zhu was not the only reformist within the government, the pro-WTO coalition within China was politically weak. As a result, Zhu Rongji’s interventions to pull the bilateral deal with the US together was founded on an extremely fragile coalition that could have easily fallen apart (Interview with former US official, April 21, 2016).

As a result of the political dynamics between the US and Chinese interests in China’s WTO entry, the resulting terms of accession were imposed by China’s top political leadership over the opposition of its bureaucratic and industry interests, with the specific concessions heavily determined by foreign (in particular US) commercial interests. As it was the Chinese who were seeking access to the organization, much of the leverage during negotiations naturally lay with the US (Interview with Jeff Bader, April 15, 2016). Even then, an assessment of the concessions agreed to in the US-China bilateral agreement on China’s accession noted that “US trade negotiators exceeded expectations” (Rosen 1999). Reports of the deal at that time noted that “(r)arely has the United States pinned down a trading partner on so many elements of business life” (Kahn 2000).

However, this is not to say that Chinese domestic interests – or the leadership – were completely unable to protect their industries, particularly in the more sensitive areas of services liberalization. During the final negotiation on November 15 before the signing of the bilateral agreement, Premier Zhu pushed back on the US request for
foreign enterprises to have controlling shares in movie theaters, saying that “everyone
knows that ideology is very sensitive, let’s leave the controlling share issue to be
discussed later!” (Zhu 2011b, p.367). He also reversed concessions made during his
trip in April for foreign equity shares in telecommunications and insurance to be as
high as 51%, justifying it by saying that China’s political situation had changed after
the US bombed their embassy in Belgrade. Zhu told the US delegation that he had
to reject the “two 51%” issue, in order to be able to account to the Chinese people
for the deal. Zhu also stood firm on the liberalization of international gateways
for telecommunications, saying that everyone involved, including military, would not
agree to this (Zhu 2011b, p.361). Finally, the Chinese also retained state trading
in specific products, including chemical fertilizers (which the US very much wanted
access to), tobacco, cotton, oil, grain and more (See Protocol of Accession Annex
2A1).

Nevertheless, the agreement went far beyond what the US thought they could
achieve. In most circumstances, after bringing back a deal to Congress, USTR nego-
tiators would be asked by domestic interests to return to their trading partner with
additional concession requests – but in the case of the China-US bilateral agreement,
not a single industry or Senator made that request, revealing the degree to which the
US negotiators had succeeded in their task (Interview with former US official, April
21, 2016).

2.3 Conclusion

This chapter began by stressing that China’s economic reform has been a process marked by incrementalism and heterogeneity. The questions of how best to move away from the Mao-era planned economy, and what the ultimate goal of reform would be, have never been clear. Even as the leadership has made important political decisions at important points in time (e.g. 1978, 1984 and 1993) to articulate the purpose and scope of reform, competing interpretations of these decisions and contrasting approaches to economic governance have persisted even up to China’s accession to the WTO.

While China’s leadership sought to use WTO entry as a credible commitment to push domestic reform forward, particularly in terms of the ailing SOE sector, political and economic interests on the US side made it such that the terms of accession were one of the most binding and detailed sets of commitments in the history of the WTO. These terms of entry are deeply meaningful, because they were negotiated and agreed upon over the strenuous objections of a bureaucracy that then was charged with implementing the agreement. Moreover, the commitments that China signed on to went far beyond market access issues to involve major changes to China’s entire economic governance system, requiring fundamental shifts in state-enterprise relations and the functions of government.

As such, it is not surprising that the potential impact of this “external shock” on the party-state’s governance was a topic of intense discussion within the CCP. In 2001 and 2002, several articles on the impact of WTO entry on Chinese governance and sovereignty appeared in journals published by the Central Party School such as the *Chinese Cadres Tribune* and the *Central Party School Journal*. In one article that interviewed the deputy director of the State Council’s Development Research
Center Chen Qingtai, Chen pointed out that “China’s entry into the WTO raises many challenges, amongst which the most direct and salient is the challenge it brings to the government’s administrative structure and behavior” (Li 2001b). Another article featured an interview with the Deputy Head of the Central Party School Li Junru. In it, Li explained this challenge in greater detail. He noted that WTO entry:

is an important strategic move for our country’s economic development, but also brings along with it a problem, which is how the Party, in its decision and policymaking process can defend China’s national interest and socialist principles while fulfilling international norms and WTO rules. The biggest “shock” of the WTO to China is aimed at our government, and we are a government governed by a single party, so in reality the ones who will feel the “shock” will be the Party’s administrative and leadership methods (Liang 2001).

What, then, explains variation in responses to WTO entry within the vast party-state? Why did some parts of the state adopt more liberalizing reforms than others? Why, in the years following WTO entry, did concerns over Chinese ‘state capitalism’ start to rise? And finally, given divergent responses to WTO entry by different state actors, why is the central state able to execute stronger ‘national champion’ policies in the some industries and not others? The next chapter presents my main theoretical framework for answering these questions.

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24 Author’s translation.

25 Author’s translation.
3 | A Theory of State Strategies under Global Rules

In this chapter I present my theoretical framework for explaining the patterns of policy responses emerging from China’s entry into the WTO. I propose that we first need to consider the diversity of relevant actors within China’s sprawling Party-state and the structure of policymaking in the Chinese context. After discussing the main channels through which WTO entry might alter the interests of bureaucratic actors, I then introduce the range of strategic options available to these actors in responding to WTO entry. I further propose two main variables driving the strategy choice of different actors within the state: the uneven likelihood of being sanctioned for deviating from WTO rules; and the varying prospects for bureaucratic advancement. Finally, I present a set of hypotheses predicting how the specific choice of strategy in response to WTO entry varies across administrative levels, across agencies within the central state and across industries.

3.1 Policymaking in China’s (Dis)unitary State

3.1.1 Diverse Actors

The first challenge in analyzing the Chinese state’s response to WTO entry is the question of how to take into account the multiplicity of actors within the Party-state
who have a stake in the consequences of China’s accession to the WTO. I approach this issue by focusing on the divergent incentives faced by two sets of actors. The first is the set of actors found across different administrative levels in China’s vast bureaucracy, i.e. the central and subnational governments. These administrative units are analytically distinct because China’s decentralized governance structure delegates policy responsibilities downwards to provincial and local levels, leaving subnational actors with substantial autonomy and discretion. The second set of actors is comprised of the political leadership of the CCP and the major agencies within the central state in charge of economic governance. These agencies are highly relevant because they are in charge of setting policies for the development of various industries and often compete with each other for influence. Together, these various actors adopted divergent postures with respect to WTO entry, driven by the highly fragmented yet competitive process of policy-making in the Chinese context, as the next two subsections will describe.

3.1.2 Fragmented Accountability

One consequence of China’s decentralized governance structure, which devolves decision-making over many socio-economic matters down to subnational states, is that accountability relations are highly fragmented within the state. I define accountability broadly in this dissertation as a set of principal-agent relations, where the ability of the principal to align the agent’s actions towards completing the delegated tasks is determined by the monitoring, enforcement (punishment) and incentives that the principal can provide (Bovens et al. 2014). In China, varying socio-economic conditions across administrative levels generates differences between central and subnational priorities (Zheng 2010, Huang 1996, Chung 2001), while weak monitoring by
the central state means that subnational policies often deviate from national goals (Fitzgerald 2003; Chung and Lam 2004). Central state enforcement abilities are weakened by the fact that functional units at subnational levels report not just to central agencies (who set policies), but also to the leadership of the local state at the level where they operate (who provide resources and make promotion decisions), creating dual and conflicting authority relations (Lieberthal and Oksenberg 1988).

The uneven nature of accountability within the Party-state comes into play not just across administrative levels, but also at the top echelons of governance – specifically between the party leadership and the central state. As Shirk (1993) points out, there is a “reciprocal accountability” between party leaders and the rest of the bureaucracy because while the party leadership appoints government officials at lower levels in the bureaucracy, those same officials – specifically those in the Central Committee – are the ones authorized to select or ratify appointments to the leadership. As such, instead of a strict top-down hierarchy that one might expect to exist in an authoritarian regime, “(g)overnment officials are both the agents and constituents of the party leaders ... Officials hold their positions at the pleasure of the party leadership, but party leaders hold their positions at the pleasure of the officials in the selectorate” (Shirk 1993, p.83).

The main implication of these fragmented and shifting accountability relations is that despite single-party rule in China, policy implementation does not flow in a top-down direction. Instead, state actors can deviate from the policy goals set at higher levels (e.g. the WTO, the party leadership or the central state) in order to pursue their own objectives.
3.1.3 Bureaucratic Competition

Despite China’s authoritarian structure, single-party rule does not imply that members within the party-state share the same political goals. Instead, political competition is almost entirely internalized within the vast party-state apparatus. In order to be selected into one of the top positions in the party leadership (e.g. the Politburo Standing Committee), cadres have to start at the bottom ranks and work their way up the bureaucracy. As a result, officials compete intensely with each other for advancement within the administrative hierarchy. The cadre evaluation system, on which promotion decisions are made, places disproportionate weight on economic growth figures achieved by individual officials. Consequently, government officials in various townships, counties and cities are highly incentivized to maximize the economic growth rates in their jurisdiction (Landry, 2008; Yao and Zhang, 2014).

In addition, bureaucratic competition is fierce not just across different administrative levels, but also at a single level – particularly within the central state. In China’s authoritarian governance system, bureaucratic actors cannot be said to have (or even seek) autonomy in the same sense as in developed democracies (Carpenter 2001). Nonetheless, different central agencies engage in protracted contests for policy influence (Shih 2008, p.54). As Chapter Five documents, responsibilities over economic policy are split across a number of agencies, from the Ministry of Commerce to the National Development and Reform Commission, the Ministry of Industry and Information Technology, the State Assets and State Supervision Commission as well as regulatory agencies such as the People’s Bank of China, the State Administration for Industry and Commerce, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission. While the functional scope for each agency appears clearly delineated on paper, in
practice policy responsibilities overlap, leading powerful agencies to compete with each other for influence and control over the economic agenda.

Consequently, this internalization of political competition within China’s single-party system means that various actors – governments at different administrative levels and different central agencies – are constantly looking for ways to improve their performance and influence in the bureaucracy, and are willing to deploy all sorts of measures to achieve their goals. The fragmentation of accountability relations further means that individual actors often have the scope to adopt policies which deviate from those desired by leaders or officials at higher ranks. While these features of policymaking in China have always been pertinent to shaping economic outcomes, WTO entry introduces new economic and bureaucratic conditions that have the effect of altering the political calculus of various state actors, as the next section will discuss.

3.2 New Conditions of Policy-making under WTO Rules

China’s entry into the WTO in 2001 involved a set of commitments that had the potential to dramatically transform the Chinese economy and state-market relations. As I noted in Chapters One and Two, these commitments involved a dramatic reduction of tariff rates in manufacturing and agriculture, and substantial market access concessions in services. The terms of accession included not just a ‘single-undertaking’ to implement existing WTO rules, but also a set of “WTO-plus” and “WTO-minus” obligations setting out additional conditions for entry. Moreover, the package of concessions that China agreed to was negotiated over the vigorous objections of a bureaucracy that would now be in charge of the implementation process.
What would the main concerns of these bureaucratic actors be as they approached the task of WTO implementation? Broadly, I divide the WTO-related concerns of the bureaucracy into two categories: economic effects stemming from trade liberalization; and bureaucratic effects stemming from new external rules on state behavior.

3.2.1 Economic effects from WTO-led liberalization

As has been well established in the literature, trade liberalization generates winners and losers, creating export opportunities for some and import competition for others, raising overall economic welfare but also introducing threats to industry-specific activity and employment [Gawande and Krishna 2003]. The standard literature on the political economy of this liberalization focuses on how these repercussions affect economic interests, delineated in terms of export promoters versus import competitors, or capital versus labor [Mussa 1974, Samuelson and Stolper 1941]. When it comes to the state’s interests in the political economy of trade, the dominant approach is to model the government as maximizing its welfare through a balance between contributions from protectionist groups who stand to lose from liberalization and the overall welfare of its voters (which would generally be enhanced from liberalization) [Grossman and Helpman 1994]. However, such models are grounded in democratic frameworks and may not be easily extended to authoritarian states. In the absence of electoral pressures, what determines an authoritarian state’s interests in the economic effects of trade liberalization? Thus far, this question has remained relatively neglected in the literature.

I propose that in the context of China, the state’s interests in the economic repercussions of trade liberalization can be broadly conceived of as comprising three aspects. The first is that in the absence of an electoral mandate, authoritarian regimes
seek to gain popular support and legitimacy by producing results through economic performance (Zheng and Lye 2005; Zhu 2011c; Yang and Zhao 2014). Therefore to the extent that trade liberalization enhances growth, there are reasons for the Chinese state as a whole to be pro-trade. Second, as Section 3.1 discussed, economic performance is a critical determinant of promotion prospects for Communist Party cadres – and therefore a key component of political competition within China’s authoritarian system relates to competition to increase economic growth. The extent to which these cadres would be pro- or anti-liberalization therefore depends on whether their specific jurisdictions stand to benefit from trade liberalization. Third, the share of state ownership in China’s economy was still relatively high in the pre-WTO period, despite efforts to privatize, merge and shut down many unprofitable SOEs from the mid-1990s onwards (Lardy 2014, p.45). Therefore many state agencies at all levels of government remained direct owners of substantial sections of the economy, and would be opposed to liberalization for industries that stood to lose from import competition.

### 3.2.2 Bureaucratic implications of WTO rules on state behavior

In addition to these economic considerations, WTO entry introduced a set of external rules to the process of economic policymaking in China, specifying the scope of government conduct surrounding issues ranging from tariffs and quotas to subsidies, intellectual property, technology transfer, the rule of law, information disclosure and more, accompanied by the threat of punishment via the Dispute Settlement Mechanism. China’s Protocol of Accession added yet more commitments over issues such as

\[1\] While trade liberalization can generally be expected to produce a one time level increase in output levels, the empirical relationship between trade and growth rates is contested (Rodríguez and Rodrik 2000; Wacziarg and Welch 2008).
the conduct of relations between the government and SOEs, information disclosure and judicial review. The introduction of WTO rules therefore generated new pressures on state actors to alter their existing governance approaches. Such pressures for adjustment are arguably more strongly resisted by authoritarian states compared to their democratic counterparts, given that authoritarian bureaucracies, used to operating in relative opacity and without democratic checks on their behavior, would be less willing to cede their discretion over policymaking to an external organization.

However, not all parts of an authoritarian government would be opposed to the new rules introduced by WTO entry. China's WTO commitments included demands on the one hand for building a new set of institutions and formulating new types of state-market regulations, and requirements on the other for the elimination or restriction of a series of policy measures. As such, WTO rules have the potential to both undermine and advance bureaucratic interests. Rules on behavior that has to be eliminated or restricted threatens the influence and autonomy of bureaucratic agencies by curbing their discretion over how to govern specific aspects of the economy. Yet other rules focused on the creation of new institutions or regulations increase the demand for regulatory and legal agencies, and for a technocracy well-versed in a range of issues from standards setting to intellectual property and international trade law. Therefore, bureaucratic actors oriented towards regulatory, technocratic and legal affairs would perceive WTO entry as generating opportunities for them to expand their influence over policymaking.

Given these cleavages and the economic and bureaucratic channels through which ‘deep integration’-style trade agreements directly affect the interests of state actors, how can we conceptualize the range of potential responses that these actors might adopt to WTO entry?
3.3 Competing State Strategies

For the reasons I noted in Chapter One, we can more fruitfully understand China’s responses to WTO entry by shifting beyond the framing of outcomes in terms of binaries such as compliance or constraint. Instead, I propose to examine how WTO rules alter state approaches to governing the economy. Specifically, I argue that Chinese bureaucratic actors can choose from a range of different state strategies in responding to WTO rules, where a state strategy is defined as a set of policy instruments adopted in response to external rules in order to further a state actor’s economic or political objectives. For China, its overarching economic goal since the start of post-Mao reforms in 1978 has been economic growth. This objective permeates through the entire bureaucracy due to the cadre evaluation system that makes promotion decisions largely based on economic growth figures achieved by individual officials (Landry 2008; Yao and Zhang 2015). Within the central bureaucracy as well, individual agencies compete intensely with each other for control over the economic agenda (Zheng 2004). In other words, political competition within the Chinese party-state is closely intertwined with economic growth and influence over economic policy. Consequently, state actors are willing to adopt a wide range of strategies to advance their interests when formulating their responses to WTO entry.

At the same time, the state strategies that government actors can choose from have expanded over time. As I noted in Chapter Two, China’s economic reform process has not been propelled by a single, coherent, strategy for growth. Rather, it is the product of a combination of gradual adjustments and bold trials, drawn from competing approaches to economic governance. This gradualism is characterized by: (a) incremental reforms at the margin; (b) decentralized economic experimentation by localities; and (c) dual-track rules, where new policies (such as deregulated pric-
ing) are adopted in areas (both geographic and in terms of economic activity) that are more amenable to reform. One implication of gradualism is that old rules (and accompanying policy measures) remain in areas where change would be administratively and politically difficult. Naughton (2007a) describes this as a process where distortions in the economy are allowed to remain, but resources are channeled into ‘pockets’ of unregulated activity (Naughton 2007a; Lau et al. 2000; Rawski 1999). This heterodox approach to reform therefore means that new policies have had to find ways to work around, rather than replace, established modes of governance.

As such, policy gradualism has led not just to uneven trajectories of change, but also institutional diversity within the state. New reforms have tended to be driven and accompanied by the creation of new agencies or elite Leading Small Groups working around rather than replacing existing agencies that may hold different approaches to reform. These ministries and departments do not fade away, and indeed can rise to recover some of their policy influence at opportunistic moments (Heilmann and Shih, 2013). This ‘layered’ pattern of institutional change (Mahoney and Thelen, 2010) has therefore led to policy heterogeneity and potential conflicts within the government over which types of measures to deploy in governing the economy. I propose that we can conceptualize this diverse range of policy measures into three types of state strategies. While these strategies share a common objective of fostering economic growth, each is premised upon different state-market relations and involves a distinct set of modalities, as explained below:

1. **The directive strategy** refers to a set of policies adopted by policymakers rooted in a planning mentality. This strategy relies on state command and

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2 These are informal bodies formed to oversee specific tasks, that often report directly to the Politburo or its Standing Committee or the State Council, giving them status and influence higher than that of ordinary ministries.
control over resource allocation and eschews the use of market mechanisms. Measures issued using a directive strategy will therefore be *market-replacing* in nature, involving administrative measures such as production targets, directives to shut down factories below a certain scale or directed mergers to form larger production units. Under market conditions, such decisions would be made by private actors responding to market signals.

2. **The developmental strategy** in its ‘classic’ sense is associated with a depoliticized and technocratic bureaucracy that drives a nation’s industrialization (Johnson 1982). Japan and Korea are considered typical examples. In the Chinese context, the developmental strategy is employed by agencies trying to emulate the Japanese and Korean models, using state intervention to promote the growth of specific industries, but in ways more amenable to open economy competition. Developmental policies hence include *market-shaping* measures designed to draw firm activity to a particular sector while setting terms and conditions for firm entry in order to harness benefits such as foreign technology. Examples of developmental strategies include equity limits on FDI, tax incentives or subsidies for certain types of investments. These policies are not market-replacing in that firms are still allowed to make key decisions, but are market-shaping in that the state provides substantial incentives to influence these decisions.

3. **The regulatory strategy** involves an arms-length relationship between state and business, where the role of the state is to facilitate the functioning of market mechanisms and address market failures. Regulatory policies therefore involve a redeployment (rather than reduction) of state activity towards *market-enhancing* measures to strengthen price signals and competition on a level play-
ing field. Examples include standards-setting and monitoring, anti-monopoly rules and property rights protection (Polanyi 1944; Stiglitz 1996; Rodrik 2011). In the WTO context, examples include the Sanitary and Phytosanitary Measures (SPS) governing standards for food safety and animal and plant health. From one perspective, such standards-setting regulations might be deemed a form of non-tariff barrier or impediment to market competition. However, these WTO rules are market-enhancing in that they establish a common set of rules for firm competition that are more even-handed and transparent compared to the domestic regulations that would be set in the absence of the WTO. For example, SPS regulations require that national standards should be based on science, and that they “should not arbitrarily or unjustifiably discriminate between countries” (World Trade Organization nda). SPS rules further require members to adhere to principles of transparency, such that members are to send notifications of any changes in their domestic SPS requirements and allow other states to scrutinize the scientific basis on which such standards are set. These principles aim to guard against protectionism, and by having all member states adhere to such guidelines, WTO rules on standards arguably enhance the contestability of markets for all members. The regulatory strategy, therefore, is most consistent with the principles embedded in the WTO’s various agreements, which in broad terms advocate a government role that is minimalist and non-interventionist.  

3 China’s Protocol of Accession further specifies regulatory commitments such as the impartial application of rules (Section 2A), transparency (Section 2C), independent judicial review (Section 2D), non-discrimination of foreign entities (Section 3) and regulatory independence in services (Annex 1A Section V(d)).
3.3.1 Other Types of State Strategies?

The strategies described here capture the main options available to states for pursuing the common goal of economic growth. They are by no means mutually exclusive in their deployment, and as Chapters Four through Six will show, policies issued by various actors within the state will commonly contain a mixture of strategies. WTO entry, however, has the potential to change the relative emphasis that different actors place on their choices across strategies. This dissertation does not consider state strategies that might be deployed in pursuit of other goals. Examples include policy goals – such as security or education – that might be on the national agenda but are not directly relevant to WTO entry and hence would not be expected to shift as a result of trade liberalization. Additionally, this dissertation does not focus on the important issue of corruption within the state (i.e. predatory state strategies). This is not to say that there might not be ways in which trade liberalization might either curb or encourage corrupt behavior. For example, the transparency and legal requirements embedded in WTO rules might circumscribe opportunities for state predation. On the other hand, WTO-led liberalization might also lead to an increase in the flow of foreign capital into a country, thereby increasing the opportunities for rent seeking (particularly as foreign investment is weakly regulated in WTO rules). Nevertheless, the main reason for setting predatory behavior outside the scope of inquiry is that WTO rules themselves are not targeted at changing state behavior related to corruption, whereas this dissertation is focused on the question of how WTO rules on economic governance alter state strategies for growth.
3.3.2 Ideological Belief or Strategic Choice?

The question also arises as to whether these three state strategies reflect ideological beliefs or strategic choice. While there is of course an ideological dimension to the scope and content of each of the state strategies presented here, I argue that ideologically-driven policy proposals are more likely to prevail amongst leading thinkers who offer their advice to the government, rather than central agencies or the rank and file cadres that by and large are focused on surviving the political competition within the bureaucracy. For most cadres in the system, the intense competition to generate economic growth means that they are driven pragmatically rather than ideologically, and are therefore willing to deploy any strategy as long as it promises to boost their economic performance. As for central agencies, an agency’s approach to economic governance tends to be largely fixed over time. This is due to China’s process of reform described at the start of Section 3.3 where reform initiatives are implemented by the creation of new bureaucratic bodies working around other existing ministries. As such, the specific modes of governance associated with a set of reforms tends to be embedded within individual agencies, and to persist over time (as Chapter Five will explain in greater detail). These agencies therefore come to see the deployment of a particular set of state strategies as synonymous with the advancement of their bureaucratic interests.

4See, for example, the public debate that broke out in the fall of 2016 between influential Peking university economists Justin Lin and Zhang Weiying over the efficacy of industrial policy in promoting growth. A video of the debate is available online at: http://www.xinhuanet.com/fortune/caiyan/ksh/193.htm (Accessed April 18, 2017.)
3.4 Explaining Strategic Responses to WTO Entry

Since bureaucratic actors can choose between the three state strategies for economic governance described above, why does an actor adopt one strategy over another in response to WTO entry? In order to take into account the vast size of the Chinese party-state and the complex political relationships between various state actors within it, I focus on three dimensions of variation in state strategies: across administrative levels, within the central state and across industries. In the next sections, I propose a theoretical framework explaining why some actors choose one particular strategy over another in responding to WTO entry, based on two broad explanatory variables: the likelihood of sanction and prospects for bureaucratic advancement.

3.4.1 Likelihood of Sanction

Membership in the WTO places obligations on nation-states to conduct their economic policies in ways consistent with the WTO’s Articles of Agreement. Members keep track of each others’ policies on an individual basis, while the WTO itself publishes periodic trade policy reviews of individual members. The Transitional Review Mechanism included in China’s Accession Protocol further allowed member states to monitor China’s WTO implementation performance for a period of ten years. Perceived violations of WTO Articles can be brought to the body’s dispute settlement mechanism, thereby generating demands on member-governments to account for their domestic economic policies to the international community.

However, as I noted in Section 3.1.2 internal accountability relationships within the Chinese party-state are highly fragmented, such that the likelihood and burden of

\footnote{In this dissertation I refer to “state strategies” and “strategic responses” interchangeably – that is, a strategic response is a choice of state strategy.}
sanction for violating WTO rules falls unevenly across different bureaucratic actors – both across administrative levels and between the party leadership and the central state. This varying probability of punishment in turn generates different likelihoods that a state actor will respond to WTO entry with a regulatory strategy (which would be consistent with WTO rules), or a non-regulatory response (i.e. developmental or directive strategies).

**Likelihood of sanction by the WTO**

Due to the Chinese bureaucracy’s decentralized structure, some parts of the state are more susceptible to WTO sanction than others. With decentralization, the responsibility of representing one’s nation to a broader international community falls primarily on the central state. In the event of a trade dispute, it is the central (rather than subnational) state that is responsible for filing or responding to a complaint, and who bears the burden of implementing the resulting panel decision. Subnational states, by contrast, are relatively sheltered from the immediate demands of international economic diplomacy, and do not have to bear the direct costs of any action that might result in a WTO dispute (though they would still have to deal with second-order effects stemming from the implementation of a panel ruling or possible retaliation). For example, if the city of Wuhan implements a number of policies that generate a complaint at the WTO regarding unfair practices, it is the central state, and not the Wuhan city government, that has to undertake the process of representing China at the WTO dispute process. Therefore, under conditions of decentralization, an actor at a higher administrative level is more likely to be sanctioned for WTO violations, and as such is more likely to adopt a regulatory rather than directive or developmental response to the WTO.
Likelihood of sanction by the central state

Why would the central state not be able to directly discipline subnational actors who deviate from WTO rules? As discussed in Section 3.1.2, the weak accountability between central and local states stems in part from decentralization that has delegated authority over many aspects of economic policymaking down to subnational levels. While WTO entry has increased the pressure on the central state to ensure national compliance with WTO commitments, the center’s ability to do so is hobbled by imperfect monitoring and weak enforcement mechanisms (Lieberthal and Oksenberg 1988). The central state’s weak enforcement powers are a function of several factors, from the sheer size of China and of the party (which has over 80 million members), to the policy autonomy delegated to subnational levels, and the layered governance system where each administrative level is in charge of appointing and managing officials “one level down” (e.g. the prefecture is managed by the provincial government directly above it and not by the central government). From 2002 onwards the central state tried to strengthen its supervision and enforcement powers by introducing a new rule that local officials would be “held to account” for failing to implement central policies. However, as Mei and Pearson (2014) point out, the central government simply does not have the capacity to implement such a system on an institutionalized or sustained basis, leading enforcement actions to be conducted in an ad-hoc manner. As a result, subnational officials have calculated that the probability of being sanctioned by the center is small and defiance of central policies is widespread.

6“下管一级”，“xia guan yiji”
7“问责”，“wenze”
Likelihood of sanction by the party leadership

In addition to considering the varying probabilities of being sanctioned across administrative levels, we also need to examine who within the party-state disciplines the central state. Given the size of the Chinese bureaucracy, the central state itself is extremely large, and has overall responsibility for implementing China’s WTO commitments. One study estimates that in 1998, there were over seven million people working in the central government alone – the size of a small country (Ang 2012). While the central bureaucracy is functionally responsible for implementing decisions made at the political level (and should therefore act as an agent of the party), we cannot assume that the state will always be equally motivated to carry out leadership goals. Different political decisions (e.g. WTO entry) can generate winners and losers within that bureaucracy, leading to both support and resistance.

As I noted in Section 3.1.2, relations between the party leadership and the central state can be described as one of “reciprocal accountability”. What, then, determines when the party leadership can effectively deploy the central state as its agent, and when is the state instead a constituent of the leadership? I address this question by assessing the degree to which leadership ties are embedded within the central bureaucracy. By embeddedness, I refer to the degree to which the network of support for a particular party leader has been built up through a career spent primarily within the central bureaucracy in Beijing rather than in various prefectures and provinces across China. When the leadership’s ties are disembodied from the central bureaucracy, its network of political support and mutual obligations lies outside the bureaucracy. It can therefore effectively punish central state agencies who deviate from its policies.

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8While the state is enmeshed within the party in the Chinese system, I distinguish between the two by focusing on the Politburo Standing Committee as the party leadership, and central state ministries as the bureaucracy.
without inflicting those punishments on members of its own network. As a result, the party leadership is able to effectively discipline and deploy the central state as its agent for implementing political goals. In contrast, when leadership ties are *embedded* within the central state, leaders cannot disentangle themselves from the obligations and ties that have enabled their rise through the bureaucracy. As a result, the party leadership cannot discipline central state agencies for deviating from their delegated tasks without also inflicting that same punishment on members of its own network. Instead, party leaders have to rely on the central state as a key constituent for shoring up their political strength.

Depending on this degree of embeddedness, the party-state relationship that dominates (agent versus constituent) therefore affects whether responses to WTO entry are driven by the party leadership or the central state. This distinction is consequential because while the party leadership in general was supportive of regulatory reforms, the central state was split between agencies supporting regulatory and developmental strategies.

In sum, while new rules for state behavior generated by WTO entry raises the costs of deviation, the degree to which WTO entry would alter state behavior is mediated by China’s fragmented internal structure, thereby generating varying probabilities of being sanctioned – either directly via the WTO dispute system, or indirectly via the top party leadership or central state. These varying probabilities therefore create scope for different state actors to adopt divergent (i.e. non-regulatory) responses to the WTO.
3.4.2 Prospects for Bureaucratic Advancement

Chinese state actors balance the probability of being sanctioned by WTO rules with the equally important calculus of how best to improve their prospects for bureaucratic advancement, defined broadly as the attainment of greater influence and/or rank within the party-state. I propose that in order to understand why state actors might choose different strategies in response to WTO entry, we need to consider two channels through which international trade rules enhance or undermine a state actor’s prospects for bureaucratic advancement. First are new economic channels introduced by liberalization that affect an actor’s ability to secure promotion up to higher ranks; and second are bureaucratic channels created by WTO rules that alter the ability of an actor to maintain or enhance their policy influence. That is, bureaucrats care not only about their influence over policy matters; the cadre evaluation system shapes incentives such that they also care about demonstrating positive results in their work so as to enhance their prospects for promotion. The next section explains the specific factors that feed into the economic and bureaucratic consequences of WTO entry, and how they alter an actor’s overall prospects for advancement within the bureaucracy.

Economic channels

With WTO entry, the factors affecting economic growth – and hence the prospects of promotion for bureaucratic actors – accordingly shifted towards the threats and opportunities generated by trade liberalization. That is, while in pre-WTO periods officials might adopt growth strategies suited to the context of fairly high tariff barriers, WTO entry alters their strategic calculus towards how to enhance economic growth under conditions of globalization. These new “open economy” factors affecting growth include: industry diversification, external resources that might enhance growth such
as FDI, export markets and foreign technology, and potential threats stemming from import competition such as unemployment and the loss of state assets.

**Industry diversity**

While the likelihood of WTO sanction affects whether actors across administrative levels adopt regulatory strategies in response to WTO entry, I propose that the choice between non-regulatory strategies (i.e. developmental or directive) depends on the diversity of the industrial base in a state actor’s jurisdiction: i.e., the degree to which the economy within a jurisdiction comprises a wide or narrow range of different industries. WTO entry introduces new economic conditions that state actors have to adjust to, and industry diversity shapes a state’s response to WTO entry by affecting the likely severity of import competition resulting from trade liberalization. On average, officials in charge of a highly diversified industrial base are likely to find that WTO-induced import competition is fairly *diffuse*, as any one industry tends to make up a relatively smaller proportion of the economy. A more diversified economic base further means that there is a higher likelihood that some of the industries in the jurisdiction will find that they have a comparative advantage in producing under open economy conditions. As a result, officials overseeing highly diversified jurisdictions are more likely to see WTO entry as providing export opportunities, and enact more developmental rather than directive policies to actively harness the potential benefits of trade liberalization to generate growth. Officials overseeing a jurisdiction with a less diversified industrial base are likely to find that WTO-induced import competition is more *concentrated*, as even a few negatively affected industries can make up a large share of the economy. As a result, officials in such jurisdictions are likely view WTO entry primarily as an economic threat associated with job losses and a decline in industrial activity. These officials are therefore more likely to enact *directive* policies to directly intervene and mitigate the economic dislocations associated
with import competition.

On average, states at higher administrative levels are likely to have a larger jurisdiction size and a more diversified industrial base. Hence I propose that states at higher administrative levels are more likely to adopt a more developmental response to the WTO, while those at lower levels are more likely to adopt a directive response.

External resources and threats

Competition for bureaucratic advancement also generates variation in the industries that state actors choose to focus different strategies on under conditions of liberalization. Here, we need to distinguish between two types of bureaucratic advancement sought by the central versus subnational state. While center-subnational tensions have always been present in the Chinese political economy, WTO-led liberalization introduces new external resources and threats that exacerbates the divergence between central and subnational goals. I argue that the central state as a whole is deeply concerned with the continued political durability of the CCP. Therefore it treats economic growth as a means to *regime promotion* and focuses on raising the long term viability of the economy by focusing on value-added growth while retaining state ownership over sectors considered to be strategic ‘lifelines’ of the economy.\(^9\) In contrast, the subnational state treats economic growth as a means to *rank promotion* and seeks to maximize short term growth rates in order to boost its chances of promotion up the CCP hierarchy (Yao and Zhang 2015). It therefore seeks to maximize economic output in the immediate term.

With WTO entry, the central state will seek regime promotion by maximizing access to new foreign technologies made available through the global economy, while

\(^9\)While in other parts of the theoretical framework I disaggregate the central state into the party leadership and central bureaucracy, or agencies within the central bureaucracy, here I am referring to the central state that includes the top party leadership.
protecting core state assets from being eroded by international competition. The central state will therefore focus its developmental strategies on industries that are technology-intensive, while deploying directive strategies to protect state ownership in sectors that represent ‘economic lifelines’ for the party. In contrast, WTO entry provokes subnational states to seek rank promotion by maximizing output through direct access to FDI and export markets, while protecting against unemployment in sectors exposed to import competition. Therefore subnational states are likely, in the WTO context, to adopt more developmental policies in sectors that provide greater access to foreign capital and export markets, while deploying directive strategies in industries threatened by import competition.

**Bureaucratic channels**

Bureaucratic actors seek not only to be promoted up the ranks, but also to enhance their influence over the economic agenda. This is particularly true if we disaggregate the central state to examine the individual agencies who were overall in charge of implementing China’s WTO commitments and who compete intensely with each other for influence over economic policy. WTO rules that specify how the state should behave in a range of economic policy areas have the potential effect of altering the strategies through which central agencies try increase their bureaucratic influence. These rules might directly oppose or undermine the discretion of some agencies, leaving them with more restricted options for expanding their policy influence. Yet the same rules might provide external leverage to other agencies to advance their policy agenda, providing them with more opportunities for bureaucratic advancement.

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10 In explaining variation in strategic responses within the central state, I assume that each agency’s approach to economic governance tends to be largely fixed over time, such that different agencies tend to prefer to deploy a particular set of state strategies when advancing their policy agenda (see section 3.3.2).
I propose that regulatory agencies in charge of standards setting are likely to support WTO-led reform, as the implementation of specific WTO rules oriented towards building a regulatory state would enhance their policy relevance and influence. They are therefore likely to respond to WTO entry with regulatory strategies. In contrast, agencies in charge of setting industrial policy are likely to be more developmental in orientation and hence would be opposed to WTO rules that threaten to circumscribe the set of policy tools at their disposal. They are therefore likely to seek opportunities to respond to WTO entry with developmental strategies.

What determines which of these sets of agencies will prevail in the contest for policy influence? My conjecture is that whether agencies oriented towards a particular state strategy were able to advance their agenda depends on the time-varying strength of WTO rules. China’s Protocol of Accession to the WTO specified a detailed timeline for which different commitments would be implemented by the Chinese government. As such, the pressure for implementing WTO rules was strongest in the years immediately following WTO entry and gradually declined over time as various reforms were put in place. Therefore, agencies supportive of regulatory reform are likely to be able to use China’s WTO commitments as leverage to push for greater influence over the reform agenda in the period immediately following WTO entry. As the strength of WTO leverage weakens over time, however, agencies supportive of developmental strategies are likely to be in a stronger position to push for their policy agenda.

In sum, China’s authoritarian state is riven by competing bureaucratic interests: across administrative levels; between the party leadership and the state; and between central agencies. WTO entry reconfigured the alignment of ‘winners’ and ‘losers’ within this fragmented state by introducing new economic conditions and new rules for economic policy. The resulting responses that various state actors adopted to the
3.5 Predicting Strategic Responses to WTO Entry

The effects of WTO entry on state behavior are mediated through domestic institutions in China that combine fragmented accountability relations with intense bureaucratic competition. As a result, the probability that different state actors will be sanctioned – either directly or indirectly – for violating WTO rules, varies unevenly within the state. Additionally, WTO entry introduces new economic and bureaucratic channels through which various state actors can compete for advancement. Drawing on these two variables of the likelihood of sanction and the prospects for bureaucratic advancement, the following section summarizes the predicted strategies that different state actors will adopt in responding to WTO rules. I present my hypotheses as they relate to three dimensions of variation: across administrative levels; across central agencies; and across industries.

3.5.1 Strategic responses across administrative levels

State actors at a higher administrative level face a stronger likelihood of sanction for violating WTO rules, and are therefore more likely to adopt regulatory responses to WTO entry. States at lower administrative levels, facing a lower likelihood of sanction, are more likely to adopt non-regulatory responses to the WTO. The choice between non-regulatory strategies (directive or developmental) then depends on the
industry diversity of the jurisdiction governed by a state actor. State actors at a higher administrative level are more likely to govern a jurisdiction with a more diversified industrial base that can benefit from export opportunities brought by trade liberalization. Such actors are therefore more likely to adopt developmental responses to WTO entry. State actors at a lower administrative level are more likely to govern a jurisdiction with a less diversified industrial base that is vulnerable to import competition brought by trade liberalization. Therefore these actors are more likely to adopt directive responses to WTO entry.

As such, the central state, which faces the highest likelihood of sanction, and oversees the most diversified industrial base, could adopt either regulatory or developmental responses to the WTO. The provincial state, which is one level removed from WTO sanctions, but still oversees on average jurisdictions with relatively diversified industrial bases, is likely to adopt a largely developmental response to the WTO. The local state (e.g. counties and cities), has the lowest likelihood of facing sanctions from the WTO, and on average oversees jurisdictions that are poorly diversified. It is therefore likely to adopt a largely directive response to WTO entry.

3.5.2 Strategic responses across central state agencies

When the party leadership’s network of support is largely disembedded from the central bureaucracy, central state agencies face a high probability of sanction by the pro-reform leadership. Under such conditions, central state agencies are more likely to adopt regulatory strategies in response to WTO entry in line with leadership preferences. When the party leadership’s political ties are largely embedded within the central bureaucracy, central agencies face a low likelihood of sanction by the leadership. Under such circumstances, economic policy would then largely be driven

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by central agencies rather than the party leadership.

In predicting which strategies will be deployed by central agencies, we need to consider the time-varying effects of WTO entry. Agencies supportive of regulatory reform are likely to deploy China’s WTO commitments as leverage to push for greater influence over the reform agenda. This strategy is more likely to be effective in the years immediately following WTO entry, when the pressure for implementing WTO rules was strongest. As the strength of WTO leverage weakens over time, however, agencies supportive of developmental strategies are likely to be in a stronger position to push for their policy agenda.

3.5.3 Strategic responses across industries

In general, the central state’s ability to discipline subnational states is hobbled by imperfect monitoring and weak enforcement mechanisms, allowing subnational governments to deploy divergent strategies for their own political purposes. The central state, seeking long term regime promotion that emphasizes technology maximization and asset protection, is likely to adopt more developmental strategies in sectors that are intensive in advanced technology. It is likely to adopt more directive strategies to protect state assets in ‘economic lifeline’ sectors that are considered core to the party’s interests.

The subnational state, seeking short term rank promotion that emphasizes output maximization and employment protection, is likely to adopt more developmental strategies in sectors that are intensive in foreign capital or have the largest export markets, in order to maximize short-term growth. It is likely to adopt more directive strategies in sectors that are threatened by import competition.
3.6 Conclusion

In sum, this theory provides an explanation for why WTO entry did not result in a monolithic convergence towards liberalization within the Chinese state. Instead, different state actors responded strategically to WTO rules to advance their political interests, based on their likelihood of being sanctioned and how WTO entry altered their prospects for bureaucratic advancement. The result is a divergence of policy responses to a set of external rules that was designed to bind China more tightly to the international system.

The next three chapters test the hypotheses presented here systematically, drawing on both quantitative and qualitative methods that will be explained in detail in each chapter. Chapter Four explains why we observe varying strategic responses to WTO entry across administrative levels, while Chapter Five looks within party-state relations to explain why an institutional dualism emerged over time at the central state level. Finally, Chapter Six explains why center-local tensions led to varying strategies being adopted across different industries in the post-WTO era.
In setting down the terms for China’s accession to the WTO, China’s trading partners were careful to address the country’s internally heterogenous and decentralized governance structure. Section 2 of the Protocol addresses the need for uniform administration of China’s trading regime, committing the government to implement the terms of the protocol across all sub-national levels of government as well as regions that would have enjoyed preferential treatment such as Special Economic Zones, development zones and coastal cities (which are usually run by sub-national governments). In addition, China agreed to set up a complaints mechanism where either individuals or enterprises would be able to alert the central government of any inconsistencies in domestic trade regulations.

That China’s trading partners included these clauses into the Protocol reveals their concerns over how subnational governments would respond to the WTO agreement. Indeed, data from an American Chamber of Commerce survey of firms in 2005 reveals sharp differences in American firms’ assessments of central versus sub-national government implementation of WTO rules. 20.5% of respondents thought that the central government was “willing, able, and prepared to implement changes in the spirit of the WTO agreement”, while only 10.5% of respondents thought that local governments held the same attitude. In contrast, 21% of respondents thought that local governments were “actively seeking loopholes in the requirements to avoid
or delay implementation”, whilst 11% thought that the central government held the same attitude (see Figure 4.1). These assessments clearly support this dissertation’s focus on the distinction between central and subnational responses to WTO entry.

![Figure 4.1: American firm perceptions of Chinese government’s WTO implementation](chart)

This chapter explains why the Chinese policy response to WTO entry has been divergent rather than monolithic, and why policy responses vary at different administrative levels. I show that the uneven process of transitioning from the planned economy has provided Chinese governments at different levels with a choice of policy responses embedded in three types of economic strategies that I characterize as market-replacing, market-shaping and market-enhancing. Whether one type of policy strategy dominates over another depends on two variables: a government’s likelihood
of sanction by the WTO and the diversity of that jurisdiction’s industrial base.

4.1 Explaining Strategic Responses across Administrative Levels

As I proposed in Chapter Three, Chinese bureaucratic actors can choose from a range of state strategies in responding to WTO rules: The directive strategy refers to a role of the state rooted in a planning mentality that is *market-replacing* in nature; a developmental strategy based on *market-shaping* measures designed to draw firm activity to a particular sector while setting terms and conditions for firm entry; and a regulatory strategy involving an arms-length relationship between state and business that is *market-enhancing* in nature.

In considering which of these three strategies will dominate in response to WTO entry, this chapter focuses on the divergent incentives faced by the central, provincial and local (i.e. sub-provincial) states within China’s vast bureaucracy. Within the subnational level, this chapter further distinguishes between the actions and interests of provinces and local states. In terms of geographic size and population, individual provinces are comparable to countries around the world (The Economist, 2011). Administratively, central-level directives are not binding on provinces as provinces are of the same rank as central ministries. The political and economic interests of provinces, therefore, tend to differ from those of much smaller local states (Goodman, 1980; Shirk, 1993; Donaldson, 2009).

Given this decentralization, two factors drive the policy responses of central, provincial and local states to WTO entry: a jurisdiction’s likelihood of sanction by the WTO, and the diversity of its industrial base.
4.1.1 Likelihood of Sanction by the WTO

Membership in the WTO places obligations on nation-states to conduct their economic policies in ways consistent with WTO Articles of Agreement. Members keep track each other’s policies on an individual basis, while the WTO itself publishes periodic trade policy reviews of individual members. China’s protocol of accession further included a Transitional Review Mechanism allowing member states to monitor China’s WTO implementation performance for a period of eight years. Perceived violations of WTO Articles can be brought to the body’s dispute settlement mechanism, thereby generating demands on member-governments to account for their domestic economic policies to the international community.

However, the likelihood and burden of sanction for violating WTO rules varies within a country, which then shapes the probability of a state actor choosing a regulatory versus non-regulatory (directive or developmental) response to WTO entry. A higher likelihood of sanction raises the probability of a state actor adopting a regulatory response. For large countries with decentralized domestic structures, the responsibility of representing one’s nation to a broader international community falls primarily on the central state. In the event of a trade dispute, it is the central (rather than subnational) state who is responsible for filing or responding to a complaint, and who bears the burden of implementing the resulting panel decisions. Subnational states, in contrast, are relatively sheltered from the immediate demands of international economic diplomacy, and do not have to bear the direct costs of any action that might result in a WTO dispute. Therefore, states at higher administrative levels will tend to face a higher likelihood of sanction by WTO rules, and are more

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1The US Trade Representative’s office, for example, publishes annual reports on China’s WTO compliance.
likely to adopt a regulatory rather than directive or developmental response to the WTO.

4.1.2 Diversity of the Industrial Base

A government’s choice between a directive or developmental response is in turn affected by the pursuit of bureaucratic advancement that permeates the system, as Chapter Three discussed. I propose that one important economic channel through which WTO entry affects China’s domestic politics of bureaucratic advancement is through the diversity of the industrial base at different administrative levels. By industry diversity, I refer to the degree to which the economy of a jurisdiction comprises a wide or narrow range of different industries. Industry diversity shapes a state’s response to WTO entry by affecting the likely severity of import competition resulting from trade liberalization. On average, officials in charge of a highly diversified industrial base are likely to find that WTO-induced import competition is fairly diffuse, as any individual industry tends to make up a smaller proportion of the economy. A more diversified economic base further means that there is a higher likelihood that some of the industries in the jurisdiction will find that they have a comparative advantage in producing under open economy conditions. As a result, officials overseeing such jurisdictions are more likely to see WTO entry as providing export opportunities, and enact more developmental policies to harness the potential benefits of trade liberalization and generate growth. Officials overseeing a jurisdiction with a poorly diversified industrial base are likely to find that WTO-induced import competition is more concentrated, as even a few negatively affected industries can make up a large share of the economy. As a result, officials in such jurisdictions are likely view WTO entry primarily as an economic threat associated with job losses and declines in in-
dustrial activity. These officials are therefore more likely to enact directive policies to directly intervene and mitigate the economic dislocations associated with import competition.

States at higher administrative levels are likely to have a larger jurisdiction size and a more diversified industrial base. This means that states at higher administrative levels are more likely to adopt a more developmental response to the WTO, while those at lower levels are more likely to adopt a directive response. While it is possible that industry diversity is endogenous to government capacity, I argue that jurisdiction size imposes an upper bound on the effects of government policies on industry diversity, such that on average, states at lower administrative levels will tend to have a lower industry diversity (Figure A.2 in the Appendix shows that the industry diversity of provinces is on average persistently higher than that of prefectures). I further control for government capacity in the estimations in Section 4.3.2 testing the effects of industry diversity. Figure 4.2 illustrates the predicted policy responses likely to result from WTO entry depending on a state’s likelihood of sanction by WTO rules and the diversity of its industrial base.

4.1.3 Predicted effects on the central government

For large countries with decentralized domestic structures like China, the WTO’s demands are likely to fall more heavily on the central compared to subnational states. As the central state bears the burden of representation at the international level, it also faces a higher threat of sanction from violation of WTO rules, and is therefore more likely to respond to WTO entry with regulatory policies. At the same time,

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2This argument is similar to research on how constituency size in the U.S. affects politicians’ trade orientations via an electoral-lobbying mechanism, such that politicians overseeing smaller constituencies will tend to be more protectionist as these constituencies are likely to be part of a more homogenous local economy (Rogowski 1987b; Schiller 1999; Karol 2007).
given that the central government’s jurisdiction is over the entire country, its policies are also informed by governance over a highly diversified industrial base. From its perspective, the threat of import competition resulting from WTO entry is likely to be fairly diffuse compared to export opportunities. High industry diversity means that the central state is more likely to adopt a developmental response to the WTO.

Which of these two competing pressures will dominate the central government’s response? I pose this question as an empirical test of the strength of WTO rules on the Chinese central government. A dominant regulatory response would suggest that WTO rules have a strong disciplinary effect in driving central government policies towards a regulatory strategy. If the effect of WTO rules were weaker, it would be possible that WTO entry induces a strengthening of both regulatory and developmental policies driven by different agencies within the center, or a largely developmental response.
4.1.4 Effects on the provincial government

Provincial governments do not have to directly account for their actions at the international level. Nonetheless, provincial leaders do hold a high rank (provincial governors are the same rank as central ministers) and participate in central-level bodies such as the National People’s Congress and the Central Committee. Provincial states would therefore be involved in passing new legislation and policy decisions enacted in order to comply with China’s WTO obligations. Given that provincial leaders are competing with each other for promotion to higher positions, they could also be expected to be more responsive to the preferences and concerns of the central government relative to local states. Therefore the provincial state’s likelihood of sanction by WTO rules can be said to lie in between the central and local state, rendering it more likely than the central state to adopt a non-regulatory response to WTO entry.

In terms of industry diversity, provinces are on average much larger than local states and hence are likely to have a more diversified industrial base. For example, Guangdong province has a population of over 100 million, making it larger than Germany. As such, while the share of industries threatened by WTO-induced import competition will be somewhat larger at the province relative to the central state, the industrial bases of provincial states are likely to be still diversified enough to be able to absorb the impacts of import competition and to allow their governments to pursue export-driven growth by ‘picking and choosing’ winners across different industries.

Therefore, given their relatively diversified industrial base, provincial states are likely to respond to WTO entry with developmental rather than directive policies. The provincial state’s relatively more indirect exposure to WTO rules and disciplines also means that its regulatory responses to WTO entry will tend to be smaller
compared to the central government. Indeed, since the provincial state is one level removed from WTO sanctions and yet enjoys a highly diverse industrial base, it is likely to adopt a predominantly developmental response to WTO entry.

4.1.5 Effects on the local government

Local states are characterized by weak exposure to WTO rules. Not only are local leaders far removed from international economic negotiations and diplomacy related to the WTO, they also report to the provincial or sub-provincial governments directly above their jurisdiction rather than the central government. This weak accountability means a low likelihood of facing direct sanctions from violating WTO rules, and hence fairly diffuse pressure on local states to respond to the WTO’s regulatory demands. The smaller size of local states further implies that on average, local states also have a less diversified industrial base and are likely to face more concentrated losses from WTO-induced import competition compared to provinces or the central state. Therefore, local states are on average likely to respond to WTO entry with directive measures aimed at mitigating the negative effects of trade liberalization.

4.2 Research Design

One of the core challenges of this study is how to measure the main outcome of interest, namely the three state strategies described in Chapter Three (regulatory, developmental and directive); across industries, across different parts of the state (central agencies and subnational governments) and over time. While some studies have documented the competing schools of thought and major debates over economic governance within China (Wu 2013; Ma 2015; Leonard 2008), no one has yet tried to measure this contestation quantitatively, nor tested the various factors that might
affect the adoption of different economic governance strategies by different state actors.

This dissertation measures variation in strategic responses to WTO entry using textual analysis of an original dataset of Chinese industry regulations. The language in these regulations is revealing of varying strategies because disagreements persist within the party-state over the appropriate role of the state in economic governance, and these disagreements are likely to show up in policy documents. For example, in national documents such as the Five-Year Plan, which sets out the overall policy priorities for the economy, the words used to describe state-market relations have changed over time. The 10th Five-Year Plan (2001-2005) noted that “market mechanisms are playing, increasingly markedly, a basic role in the distribution of resources”, while the 11th plan (2006-2010) stated that China was “giving more play to the fundamental role of the market in allocating resources under guidance of macro regulation and control”. The 12th plan (2011-2015) gave “full play to the socialist mechanism as well as to the market in terms of allocating resources” (italics added). A 2013 Central Committee communique further noted that the market should play a “decisive role” in resource allocation (Xinhua News 2013).

While these changing statements reflect a gradual expansion of the official role of the market, differences over state-market relations have persisted, as seen by accompanying policies that have reaffirmed a strengthened role for the state in specific areas or sectors. In December 2001 (the same month of China’s WTO accession), then vice-premier Wu Bangguo announced the need to create 50 large SOEs with international competitiveness, noting that it was “an important strategy to cope with the impacts brought about by the country’s accession to the WTO” (Fu 2001). The 11th plan also introduced a focus on “indigenous innovation” and in 2009 a new policy focus was placed on “strategic emerging industries”, heightening state activism in
technology innovation and in industries such as new-energy vehicles, high-end equipment manufacturing, biotechnology and information technology. Also in 2006, the head of SASAC (the agency in charge of managing central SOE assets) announced that the state would retain “absolute control” over seven core “strategic sectors” and maintain a majority control over nine other “pillar” sectors.

The benefits of collecting policy data at the level of industry regulations are three-fold. First, I collect and analyze the content of all publicly available policies related to a particular industry, from city and county governments to the full array of central agencies that can be involved in governing an industry. In contrast, existing studies of industrial policies tend to focus on major national or sectoral policies issued by a few central bodies that lay out the main policy objectives and targets for industrial development (for example the State Council, NDRC, MIIT). To the extent that local-level deviation from central policy is examined, this is typically done through in-depth case studies of select cities. In contrast, my approach is able to capture the policy content of all players large and small, central and subnational, involved in governing an industry, and this is important because some agencies not formally in charge of industrial policy for a sector can nonetheless have a substantial impact on its development. In the automotive industry, for example, formal industrial policy has been the purview of the State Council, NDRC or MIIT. However, the Ministry of Transportation is also involved in automotive governance in terms of regulating traffic flows, while the Ministry of Public Security is involved in overseeing traffic safety and the Ministry of Environmental Protection is in charge of setting emissions standards in vehicle production.

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3 Armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation and shipping.

4 Coal, aviation, shipping, machine building, steel, automobiles, non-ferrous metals, construction and information technology.
National policies are also often broad enough that subnational governments in turn are able to issue their own local-level policies that may deviate from the intentions of central agencies. The corpus of policies that I have collected therefore captures much fuller variation in policy content for the governance of an industry both within the central government, and across different administrative levels, compared to what has been done in existing studies of Chinese industrial policies.

The second benefit of this data-collection method is that I am able to merge the industry-specific text data with available data on industry and province-level characteristics. This then allows me not only to have a consistent measure of industrial policy content over space and time within the Chinese state, but also to test how policy content is affected by changes in various industry and regional socio-economic and political conditions.

Finally, this data has the merit of combining policies – which are of direct consequence – with discursive practices. Variation in economic language reveals disagreements over state strategies for economic growth, and as such texts of industry regulations can potentially tell us more about a government’s preferred economic strategy than data such as subsidies or taxes. Observing high levels of subsidies, for example, does not reveal whether a state is trying to protect a declining industry, or engage in developmental policies, thereby potentially conflating two different types of strategies, both of which involve substantial state intervention, but which are driven by distinct conceptions of the state’s role in the economy. In addition, economic data is arguably a more accurate measure of policy outcomes, which can be the result of a combination of conflicting policy intents put forth by different actors, as well as the result of distortions introduced through the process of policy implementation. In contrast, the words found in policy documents are a more accurate measure of the outcome of interest in this study, which is policy intent.
4.2.1 Data collection and pre-processing

This analysis uses an original dataset comprising laws and regulations from all arms of the central and subnational states governing manufacturing industries from 1978 to 2014. I use an unsupervised learning method in text analysis (the Correlated Topic Model (CTM) [Blei and Lafferty 2007]) to generate clusters of words (“topics”) that are likely to belong together based on their co-occurrence across the corpus of documents. I then select a subset of topics most reflective of the three strategies described in Chapter Three and test how WTO-induced tariff reduction across industries affected these strategies as reflected in the proportion of different topics occurring in policies at central, provincial and local levels. Topic proportion is a meaningful measure of relative policy importance in the Chinese context because when it comes to official documents, as Kennedy and Johnson (2016) point out, “the more an issue is discussed or a word is used, the more important it is”.

The corpus of regulations comprises 43,069 documents across 128 manufacturing sectors, of which 14,832 are central-level documents, 15,673 are provincial documents and 12,564 are local (sub-provincial) documents. These regulations were collected by web-scraping the results of search requests in www.pkulaw.cn, a comprehensive repository of Chinese laws and regulations. The search process was automated using a list of industry names matching the 4-digit China Industry Code (CIC) for manufacturing. Therefore the regulations collected are highly specific in that only those documents for which the sector name appears in the title of the regulation were collected. This approach enabled the merging of industry-specific language data with industry co-variates. Higher-level policies, such as Five-Year Plans, or national-level industrial

5The sectors are diverse, ranging from food-processing to textiles, steel, aircraft and medical equipment manufacturing etc.
policies covering multiple sectors, are not included in this dataset.

Figure A.1 in the Appendix shows the number of regulations in this dataset at the 2-digit industry level. The sector with the most regulations (across all three levels of administration) is that of transportation equipment, which includes automobiles and auto parts, motorcycle, railway equipment and aircraft manufacturing, all key strategic sectors for the government. The regulations range from legislation approved by the National People’s Congress to State Council and central ministry regulations, legal interpretations issued by the Supreme People’s Court, and legislation and regulations issued by subnational governments. The substantive issues in these regulations are wide-ranging, including taxation, standards supervision, labor management, certification, financial supervision, environmental protection, enterprise management, government procurement, public safety, customs affairs, and more. Tariff data was collected from the World Integrated Trade Solution (WITS) and sectoral data generated from a firm-level dataset from the National Bureau of Statistics covering all manufacturing sectors from 1998 to 2007 of firms with sales exceeding 5 million RMB.

The documents were processed using standard pre-processing steps in text analysis. This included removing all punctuation, numbers, English letters and commonly occurring words (such as ‘and’ and ‘the’). In addition, agency and industry names as well as technical terms associated with a particular sector were filtered out, as these are not relevant to the outcome of interest in this study (economic strategies). Finally, words occurring in less than 1% of the regulations were filtered out, leaving a vocabulary of 2,798 unique words. Using CTM, the analyst sets the number of topics ahead of time and the algorithm exploits co-occurrences of words in the vocabulary to cluster words most likely to belong to a single topic, as well as calculate probabilities.
that each document belongs to a topic.\textsuperscript{6}

There are a variety of data-driven approaches to picking the appropriate number of topics, and scholars have noted that there is no fixed rule to identifying the “correct” number (Roberts et al. 2014). This dissertation uses a combined criteria of semantic coherence and exclusivity, thereby maximizing the degree to which topics chosen are both internally coherent (semantic coherence) and distinct from one another (exclusivity) (Roberts et al. 2014). Using this approach, the number of topics chosen for this analysis was set at 41 (Section 2 of the Appendix provides a detailed discussion on selecting the optimal number of topics, as well as alternative approaches). A table showing the top five words belonging to the generated topics can be found in the Appendix. The topics generated range from a focus on trade and anti-dumping to accounting, permits, development, science and technology, legality and rectification. Each topic was given a descriptive label after careful reading of the top 20 words and the top 10 documents in each topic.

\subsection*{4.2.2 Measuring the Dependent Variable}

The next step of the analysis involves identifying the topics most representative of each type of strategy. While there were 41 topics generated by the algorithm, not all would be relevant to the theory developed in this dissertation. Testing all the topics would also dramatically increase the potential number of false positives resulting from multiple testing (Benjamini and Hochberg 1995). I therefore take the more conservative approach of selecting a few topics most directly reflective of the outcome of interest (strategies) for subsequent estimation.

I start by defining the key features of policy language that would be most repre-

\textsuperscript{6}I adopted this unsupervised learning approach over supervised or dictionary approaches because I did not have strong priors as to what words should belong in each strategy category.
sentative of an ‘ideal type’ of each strategy, then identifying the topics that most fit these features. Some topics are more closely correlated to each other than others, in that they tend to co-occur in the documents. Having identified the ‘ideal types’, I then expand the selection to include topics directly correlated to each ideal type. In cases where a correlated topic is also linked to a topic in another strategy, I exclude that topic. This approach allows selection of topics within each strategy that are directly correlated with each other, but not to topics in other types of strategies. A visualization of topic correlations and the topics selected into each type of strategy can be found in the Appendix.

A group of undergraduates at leading universities in Beijing was recruited to independently validate that the documents in each selected topic accurately reflects a particular strategy. Each validator was given a definition of the three strategies, and asked to read through the top 3 documents belonging each of the 41 topics (a total of 123 documents) and then to classify the documents into the categories of “Directive”, “Developmental”, “Regulatory” or “Other”.\footnote{The validators were not given any additional information beyond the definitions and the documents. The documents were presented in a random order, and validators did not know which documents belonged together to a topic, nor how many underlying topics existed across these documents.} Validator scores were then averaged and converted to a 10-point scale, with 10/10 representing a unanimous classification for the documents within a topic. This exercise strongly confirms the author’s selection of representative topics, while topics which did not pass the validation exercise were dropped from the analysis (details are in the Appendix).

This process resulted in two topics being selected to represent each type of strategy, or a total of six topics. Documents in the directive strategy contain interventionist measures oriented towards reorganizing industry and a reliance on traditional tools of administrative guidance. The topic most representative of this strategy is labeled
“Rectification”, and documents in this topic frequently words such as “control”, “shut down”, and “put in order”. Documents in the correlated topic (“Crackdown”) similarly reflect state intrusion, with frequently occurring contain words such as “punish”, “rectify and improve” and “realign”. An example of a directive document is a Dalian city regulation ordering the shutting down of unlicensed mines and the consolidation of small unprofitable mines.

In contrast, documents in the developmental strategy are exhortatory in tone and explicitly discuss market development. The ‘ideal type’ topic is labeled “High-tech development” and documents in this topic frequently contain words such as “accelerate”, “encourage”, “innovation” and “technology”. The correlated topic is labeled “Agro-processing development” and documents in this topic contain words such as “develop”, “market”, “scale” and “build”, mostly focused on supporting the development of lower value-added industries. An example of a top document in the developmental category is a Nanjing city policy to vigorously develop and stimulate innovation in the semiconductor industry.

Documents in the regulatory strategy are neutral and technocratic in tone reflecting an arms-length approach to governance aimed at enabling, rather than replacing or shaping, market functions. The ‘ideal type’ topic is labeled “Standards” and top documents contain words such as “inspect”, “spot-check” and “quality testing”. Documents in the correlated topic (“Certification”) similarly contain regulatory words such as “certify”, “label” and “standard”. An example of a top document in the regulatory category is a central government announcement of mandatory certification regulations for certain toy and baby products as part of China’s WTO notification process.

Finally, I operationalize the dependent variable using the topic proportions of the six topics selected in Section 4.2.2, calculated as the proportion of each topic (k) occurring in regulations belonging to sector (i) in year (t) issued by the level of
government (j). Figures 4.3 to 4.5 below show trends in the relative prevalence of each strategy at central, provincial and local levels. The figures show a distinct divergence in policy trajectories of the central, provincial and local governments in the years after China joined the WTO. Figure 4.3 shows that whereas there was no clear trend in the pre-WTO years, policy language reflective of a regulatory strategy has become most prevalent in central level regulations in the post-WTO years, followed by provincial and then local regulations. In contrast, policy language reflective of a developmental strategy strengthened significantly in the post-WTO era at the provincial and local levels (see Figure 4.4). Finally, Figure 4.5 shows that language reflective of a directive strategy increased in both local and provincial levels in the post-WTO years, but much more strongly at the local level. These descriptive trends provide initial support for the hypothesis that WTO entry has been accompanied by divergent policy responses, with different strategies becoming more dominant at different levels in the post-WTO years.

4.2.3 Measuring WTO Entry

I operationalize WTO entry using changes in industry tariff levels across China’s manufacturing sectors from 1998 to 2007 (see Figure 4.6). The tariff data (which uses the HS code) is then merged with industry data (which uses the CIC code) using two concordance tables (HS-ISIC, and ISIC-CIC). Finally, I merge the tariff and industry data with the dependent variable (topic proportions).

I run two quantitative tests to address issues of endogeneity, as there might be questions over whether the pattern of tariff reduction reflects Chinese domestic interests rather than an externally imposed commitment to liberalization. To test if sectors that experienced a bigger cut in tariffs were already on a different strategic
Figure 4.3: Topic proportion of regulatory strategies in central, provincial and local regulations

Figure 4.4: Topic proportion of developmental strategies in central, provincial and local regulations
Figure 4.5: Topic proportion of directive strategies in central, provincial and local regulations

trajectory compared to sectors for which tariff reductions were smaller, I estimate the relationship between the size of WTO tariff reductions and the pre-WTO trend of state strategies across industries. The results show either no significant relationship between state strategy trends in the pre-WTO years and the subsequent size of tariff reductions, or where a trend was found to be significant, that it was for an outcome that did not have a statistically significant response to WTO entry in the main analysis in Section 4.3 (details in the Appendix).

To test if the pattern of tariff reduction was driven by domestic interests, I estimate the relationship between Chinese industry characteristics in the pre-WTO years (1998 to 2001) and the size of WTO tariff reductions. The results show no relationship between industry characteristics and the pattern of tariff reduction at the 5% significance level, and only a positive coefficient on the national share of an industry’s output at the 10% significance level. This weak relationship suggests that foreign na-
tions succeeded in negotiating larger tariff cuts for sectors representing a larger share of China’s domestic market (see the Appendix for details). Such a possibility is consistent with evidence that much of the leverage during negotiations naturally lay with the US, who pushed hard for China to join the WTO on commercial rather than political terms (Lawrence et al. 2006, p.245). Indeed, an examination of the concessions agreed to in the US-China bilateral agreement on China’s accession noted that “US trade negotiators exceeded expectations” (Rosen 1999).

Moreover, as I detailed in Chapter Two, the Chinese leadership deliberately kept its bureaucracy and industry interests out of the negotiations. A more consultative approach taken in the 1980s and early 1990s in China’s quest to rejoin the GATT had led to bureaucratic deadlock (Pearson 2001). Despite strong bureaucratic resistance to the prospect of WTO membership, the leadership, (in particular then-Premier Zhu Rongji) saw WTO membership as providing external leverage to advance domestic reform and pushed for the deal despite having little domestic political support (Fowles 2001; Feng 2006, Interview B18). Key concessions were therefore made at the highest level, over the objections of the bureaucracy (Zhao 2011; Zhu 2011a, Interview with Jeff Bader, April 15, 2016). For these reasons, I argue that the tariff reduction schedule is not endogenous to domestic government preferences, but rather imposed by China’s top political leadership, with the specific concessions heavily determined by foreign commercial interests.

The rationale for testing the theory presented in this chapter at the industry level is two-fold. First, the exact tariff reduction schedule was the subject of intense negotiation, in particular between China and the United States, and China and the European Union (Kahn 2000, Interview with Jeff Bader, April 15, 2016). Therefore even though the obligations of WTO entry went beyond tariff reduction, changes in tariff levels nonetheless represent a meaningful measure of the depth of liberalization
faced by each industry. Second, variation in tariff levels across industries and over time allows the use of a difference-in-difference estimation strategy to compare changes in policy language for industries experiencing varying tariff cuts over time.

4.2.4 Estimation Strategy and Alternative Explanations

I run difference-in-difference estimations to test the effect of WTO entry (industry tariffs) on state strategies (topic proportion). In order to improve the interpretability of the results, I reverse the sign on the tariff variable, such that a positive regression coefficient indicates rise in topic proportion in response to tariff cuts. I test three sets of dependent variables in turn: the topic proportion reflective of each strategy in central, provincial and local (sub-provincial) industry regulations. I further test for alternative factors that could account for variation of strategic responses to WTO entry, using the following variables:
• Industry export sales (RMB billions). Given China’s export-driven growth, there might be systematic differences in strategic responses for sectors that have high versus low export values.

• Industry output (RMB billions). Strategic responses might vary systematically for sectors with large output values, given the relative importance that such sectors hold for overall GDP growth.

• Industry employment (millions). Strategic responses might vary for sectors that employ large numbers of people, given the social consequences of unemployment in these sectors.

In addition, strategic responses might further be affected by firm ownership. Sectors with a high share of SOE output might be governed differently compared to those with high shares of foreign enterprise output. Therefore I also include variables capturing these ownership shares:

• State-owned enterprise (SOE) share of industry output.

• Foreign enterprise share of industry output.

Finally, I control for time trends and year-specific shocks using year fixed effects, and time-invariant industry characteristics using industry fixed effects, and further include the standard deviation of the industry tariff as a control, to account for the aggregation of tariffs for product codes up to the 3 digit industry level. Standards errors are clustered at the industry level.

---

8This includes both foreign-invested and Hong Kong, Macau and Taiwan enterprises. The base term omitted from the analysis is the private sector share of industry output.

9Due to changes in China’s CIC classification scheme at the 4-digit level in 2002, this analysis is done at the CIC three digit level to maintain consistency across the years. Tariff data at the HS 8-digit level also has to be aggregated upwards and averaged.
4.2.5 Predicted responses

This chapter argues that state responses to WTO entry are shaped by their varying likelihood of sanction by the WTO as well as their prospects for bureaucratic advancement as determined by the diversity of their industrial base. We should therefore expect to observe the following relationships to emerge from the estimations:

1. The central government faces a high likelihood of sanction by the WTO but also oversees a jurisdiction with a highly diversified industrial base. If WTO rules have a strong effect on central state behavior, then we would observe a dominant regulatory response from the center. If WTO rules have a weak effect, then we would observe either a dominantly developmental response or a dualistic response comprising both strengthened regulatory and developmental strategies.

2. Provincial governments, being relatively less exposed to WTO disciplines but still retaining a highly diversified industrial base, adopt a developmental strategy in response to WTO liberalization.

3. Local governments, facing weak probabilities of sanction by WTO rules and holding on average a poorly diversified industrial base, adopt a directive strategy in response to WTO entry.

4.3 Results

The estimation results are reported in Figures 4.7 to 4.8 below. Each figure reports the coefficient on the industry tariff variable with 95% confidence intervals, for each of the topic proportions of interest, grouped by type of strategy and labeled on the left.
Figure 4.7: Central government responses to tariff liberalization

hand side of the plot. Positive values imply that tariff liberalization for an industry is accompanied by a rise in policy content related to that particular topic. As tariffs are only being liberalized during this period of analysis, a negative coefficient implies that tariff liberalization is accompanied by a decline in policy content for that topic. The full regression output can be found in the Appendix Section A.1. As testing multiple outcomes raises the probability of getting false positive results, I adjust the p-values upwards in each set of regressions using the procedure explained in Benjamini and Hochberg (1995).

Figure 4.7 shows that the central state strengthened its regulatory policies in
response to WTO entry, suggesting that WTO rules had a strong effect in changing central government behavior. Substantively, the average WTO-induced decline in tariffs is associated with a 35 to 39% increase in regulatory language in central policies compared to pre-WTO means, depending on the topic. Indeed, the years surrounding China’s WTO accession were marked by substantial legal and regulatory overhauls. Amendments were made to the Product Quality law, the Standardization law, and an overall effort led by the Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) to harmonize Chinese standards with those set by international bodies. An assessment of over 21,000 technical standards by the government led to an effort to revise over 40% of these standards and abolish over 1,400 standards (OECD, 2009).

Figure 4.8 shows that provincial states have responded to WTO entry with a strong increase in developmental strategies. Substantively, the average WTO-induced decline in tariffs is associated with a 73 to 95% increase in developmental language in provincial policies compared to pre-WTO means, depending on the topic. The average large size of a province means that provincial states each oversee a fairly diversified industrial base in their jurisdiction, and are therefore able to pursue a wider range of developmental strategies. While provincial governments face a lower likelihood of WTO sanction compared to the central government, the results nonetheless show a statistically significant increase in policies related to certification. However, the increase in certification policies is marginally larger at the central level (0.0014) compared to the provincial (0.0012). This regulatory response may be driven by the fact that the prospect of further promotion raises the responsiveness of provincial leaders to the central government’s regulatory preferences, and also that provincial leaders participate in central level bodies (such as the National People’s Congress) and hence are involved in legislative efforts to comply with WTO rules.
Figure 4.8: Provincial government responses to tariff liberalization
Figure 4.9 shows that in contrast to provincial and central governments, local states have responded to WTO entry with an increase in directive strategies related to crackdowns and a decline in regulatory strategies, underscoring the central state’s challenge of policymaking in a decentralized polity. Substantively, the average WTO-induced decline in tariffs is associated with a 26% increase in directive language and a 26 to 29% decrease in regulatory language in local state policies, depending on the topic. Since it is the central state that has to represent and defend China’s economic policies to WTO members, the average local state does not need to take into account any negative spillovers from its policies on the international stage. At the same time, the less diversified industrial base in local states generates greater pressure on them to respond to the dislocations of import competition with greater intervention.

While these results are consistent with the theory presented in Section 4.1, the next section tests if the outcomes are indeed driven by key variables of sanction likelihood and industry diversity rather than by alternative mechanisms. For example, the observed divergence in policy responses to WTO may be driven by a functional division of responsibilities between the central, provincial and local governments. That is, it is possible that policies related to standards-setting and regulation are largely the responsibility of the central government, while provincial governments have greater authority over policies to develop the economy. Alternatively, the divergence might reflect a tacit coordination of behavior between the central and subnational levels of government, where the central government adopts a more regulatory response.

While there is no significant correlation between changes in the “rectification” topic and tariff reduction, the increase in the prevalence of the “crackdown” topic is nonetheless significant. In addition, the Benjamini-Hochberg adjusted p-values take into account the fact that there is no significant result in the “rectification” topic, and the p-value for the “crackdown” topic is significant at 0.034, even after that upward adjustment.
Figure 4.9: Local government responses to tariff liberalization
due to greater scrutiny of its policies at the international level, but is happy to allow its subnational governments to deviate from its own policies in order to retain administrative control over the economy. In order to test the theory presented in this study against these alternative explanations, the next sections exploits subnational variation in provincial characteristics to test each causal mechanism in turn.

4.3.1 Testing the sanctioning mechanism

Having established that the central government responds on average to WTO entry with regulatory strategies, I now consider the degree to which the central state is able to discipline provincial states to also adopt regulatory responses to the WTO. It is in the interests of the central state to exert pressure on provinces to do so because any actions by subnational actors which trigger a complaint at the WTO generates new responsibilities – which fall disproportionately on the central state – to address the complaint and to deal with the possibility of new sanctions arising from the dispute panel. Therefore, the likelihood that any given province will heed the central state’s preference for adopting regulatory responses to the WTO depends on center-province accountability relations. As such, I use variation in this center-province accountability as a proxy for the mechanism of WTO sanctions.

I measure center-province accountability using the amount of time members in provincial party standing committees (PPSC) have spent working in the central government, the province they are currently posted to, or another province.\footnote{I am grateful to Kyle Jaros and David Bulman for sharing this data.} The PPSC holds the strongest decision-making power within the provincial government. A member is coded as having in-province work experience if he or she has at least 10 years of work experience in that province, while a member is coded as having central work
experience if he or she has had at least 5 years of experience in the central government. Therefore, a provincial government whose standing committee in a given year is comprised largely of cadres with over 10 years of in-province work experience, for example, is more likely to act autonomously from (and hence be less accountable to) central government preferences, motivated by deeper longstanding ties with provincial interest groups and/or a deeper knowledge of provincial economic conditions. Using this data, I calculate province accountability as the share of committee members who have ten or more years of in-province work experience. Table 4.1 shows the summary statistics of this measure. In general, we can observe that there is significant cross-sectional variation in the measure each year. In addition, the average share of officials with provincial work experience has gradually fallen over time, from 72% in 1998 to 59% in 2007. This might be indicative of efforts over this period by the central government to strengthen its vertical governance.

Table 4.1: Summary statistics of center-province accountability

<table>
<thead>
<tr>
<th>Year</th>
<th>Min.</th>
<th>Mean</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>0.33</td>
<td>0.72</td>
<td>1.00</td>
</tr>
<tr>
<td>1999</td>
<td>0.30</td>
<td>0.69</td>
<td>0.94</td>
</tr>
<tr>
<td>2000</td>
<td>0.36</td>
<td>0.68</td>
<td>0.88</td>
</tr>
<tr>
<td>2001</td>
<td>0.25</td>
<td>0.65</td>
<td>0.88</td>
</tr>
<tr>
<td>2002</td>
<td>0.42</td>
<td>0.64</td>
<td>0.85</td>
</tr>
<tr>
<td>2003</td>
<td>0.38</td>
<td>0.64</td>
<td>0.83</td>
</tr>
<tr>
<td>2004</td>
<td>0.33</td>
<td>0.61</td>
<td>0.86</td>
</tr>
<tr>
<td>2005</td>
<td>0.36</td>
<td>0.61</td>
<td>0.86</td>
</tr>
<tr>
<td>2006</td>
<td>0.30</td>
<td>0.59</td>
<td>0.86</td>
</tr>
<tr>
<td>2007</td>
<td>0.42</td>
<td>0.59</td>
<td>0.86</td>
</tr>
</tbody>
</table>

Before using this variable in the estimations, I first invert the measure, such that a higher value implies higher accountability to the center (i.e. lower province autonomy). One additional consideration in constructing this measure is the disproportionate influence of a Party Secretary within a given PPSC (Goodman 1980). We
might expect a standing committee led by a Party Secretary with over ten years of in-
province experience, for example, to act more in that province’s particular interests.
However, it is unclear how much more weight the Party Secretary should be given.
As such, I run a series of estimations with weights ranging from 0.1 to 0.9 placed on
the Party Secretary’s work experience vis-a-vis that of the rest of the PPSC.

I test the effects of accountability in mediating province responses to trade open-
ness by running a difference-in-difference estimation with the topic proportions of
province regulations as the outcome of interest, and the key explanatory variable be-
ing an interaction term between the measure of provincial autonomy and a measure
of provincial trade openness (exports + imports as a share of GDP). In order to test
alternative explanations, I include a number of additional explanatory variables.

First, certain provincial economic characteristics might be systematically corre-
lated with certain types of strategies. I therefore include provincial GDP, log GDP
per capita and unemployment levels as variables, as provincial governments over-
seeing jurisdictions that are relatively poorer or have higher levels of unemployment
might be motivated to deploy more directive strategies in order to directly intervene
to ameliorate the poor economic conditions. I further include provincial fiscal bal-
ance levels, as the ability to adopt developmental strategies which involve measures
such as tax and credit incentives might be correlated with the health of government
finances. In addition, the ownership structure of firms in the provincial economy
might affect state strategies. Foreign firms might exert direct pressures on provincial
governments to adopt more regulatory policies in line with international practices,
while SOEs might lobby their governments to adopt more developmental or directive
policies aimed at protecting their sectors. I therefore include the share of FDI and
the share of state-controlled enterprise firms in provincial GDP as two additional
variables. Finally, I include a measure for industry diversity (described in the next
section) as this variable is part of the theoretical framework. As with previous estimations, I also include province and year fixed effects, with standard errors clustered by province. Province-level data is drawn from the CEIC database, and all data are for the 1998 to 2007 period.

Figure 4.8 showed that on average, provinces tend to adopt a developmental response to WTO entry. If higher accountability (i.e. lower provincial autonomy) restrains provinces from pursuing this developmental response, then we would expect to see that as trade openness increases, a strengthening of accountability is associated with a decline in the adoption of developmental strategies. In addition, if the work experience of the Party Secretary has a disproportionate influence on provincial state strategies, then we would observe greater developmentalism in policies when there is an increase in the weight placed on a Party Secretary’s in-province work experience.

Figure 4.10 shows the estimation results for all six topics. The y-axis shows how the coefficient on the interaction term changes as weights placed on the Party Secretary increases, with Benjamini-Hochberg adjusted p-values in parentheses. The two plots showing results for “High-tech development” and “Agro-processing development” provide evidence of a negative relationship between province accountability and developmental strategies, as trade openness increases. The figure further shows that the coefficient on the explanatory variable for the “High-tech development” topic is negative and significant at the 5% level for the full range of weights placed on the Party Secretary, while the coefficient on the accountability variable for the “Agro-Processing Development” topic is negative and significant when the weight placed on the Party Secretary lies between 0.1 and 0.8. The full estimation results are in Table A.4 of

12 For both topics (“High-tech development” and “Agro-processing development”), the size of the coefficient declines as the weight placed on the Party Secretary increases. This suggests that policymaking is not dominated by the Party Secretary, and that the work experience of the rest of the PSSC is consequential to the adoption of developmental responses to trade liberalization. Figure
the Appendix.

For a better visualization, Figure 4.11 shows the plot of the interaction effect when the weight of the Party Secretary is set at a fairly modest level of 0.2. The figure shows that at high levels of trade openness, there is a significant decline in development strategies when provincial accountability to the central state increases.

4.10 also shows that there is a negative relationship between provincial accountability and a greater directive response to trade integration for the “Rectification” topic. This is not inconsistent with my theoretical framework, which argues that higher accountability reduces the adoption of non-regulatory strategies, while the choice between developmental and directive strategies is driven by industry diversity.
Note: y-axis shows varying weights placed on Party Secretary, with Benjamini-Hochberg p-values in parentheses

Figure 4.10: Responses to trade openness when province accountability increases
4.3.2 Testing the industry diversity mechanism

In order to test whether subnational jurisdictions with a more diverse industrial base enact more developmental strategies relative to directive ones, I again exploit sub-national variation in provincial economic characteristics. I construct an “Industry Diversity” measure using a province-level Herfindahl index that captures whether a province’s industrial output is dominated by a few industries (poorly diversified) or evenly spread out across many industries (highly diversified). The index is then inverted such that high values indicate a highly diversified industrial base. Table 4.12 shows the summary statistics for this industry diversity variable. The variation across provinces is not large, but this is to be expected given that – as I have noted – provinces in China are large and fairly diversified compared to smaller sub-provincial units.

Figure 4.11: Change in developmental language when province accountability increases, across levels of trade openness (Party Secretary weight set at 0.2)

Figure 4.12 shows the variation in industry diversity across provinces in 2004. As
Table 4.2: Summary Statistics for Industry Diversity Variable

<table>
<thead>
<tr>
<th>Year</th>
<th>Min.</th>
<th>Mean</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>0.8176</td>
<td>0.9508</td>
<td>0.9831</td>
</tr>
<tr>
<td>1999</td>
<td>0.8150</td>
<td>0.9472</td>
<td>0.9832</td>
</tr>
<tr>
<td>2000</td>
<td>0.8024</td>
<td>0.9381</td>
<td>0.9823</td>
</tr>
<tr>
<td>2001</td>
<td>0.7982</td>
<td>0.9358</td>
<td>0.9823</td>
</tr>
<tr>
<td>2002</td>
<td>0.7468</td>
<td>0.9318</td>
<td>0.9820</td>
</tr>
<tr>
<td>2003</td>
<td>0.7205</td>
<td>0.9316</td>
<td>0.9812</td>
</tr>
<tr>
<td>2004</td>
<td>0.7284</td>
<td>0.9245</td>
<td>0.9814</td>
</tr>
<tr>
<td>2005</td>
<td>0.7424</td>
<td>0.9248</td>
<td>0.9805</td>
</tr>
<tr>
<td>2006</td>
<td>0.7890</td>
<td>0.9294</td>
<td>0.9804</td>
</tr>
<tr>
<td>2007</td>
<td>0.7981</td>
<td>0.9255</td>
<td>0.9809</td>
</tr>
</tbody>
</table>

would be expected, the most diversified provinces are those along the coast such as Shandong and Zhejiang. In contrast, the least diversified provinces include some of the poorest inland Western provinces, such as Gansu, Qinghai, Tibet and Xinjiang. Jilin, a northeastern province dominated by agriculture and a strong planned economy legacy in heavy industry such as automobiles and railways, also shows up as a poorly diversified province.

As Section 4.1 noted, the choice between developmental and directive strategies rests on the expected intensity of import competition. I therefore capture the varying degrees to which provinces with different industrial structures are exposed to import competition by constructing a province-level “WTO Exposure” measure, where the overall decline in tariffs across industries faced by a province is weighted by each industry’s share in provincial output. Hence a large decline in tariffs for a particular industry will be weighted more in a province where that industry takes up a dominant share of the economy, compared to where that industry is a minor component of a province’s overall economic base.

I then estimate the effects of industry diversity in mediating responses to WTO entry using a difference-in-difference estimation, where the key explanatory variable is
the interaction term between the industry diversity variable and WTO exposure variable, and the dependent variable is the topic proportion of various strategies. Controls include the same province characteristics as in Section 4.3.1 plus the province accountability measure, and all data are for the 1998 to 2007 period. Figure 4.13 shows the resulting coefficient on the Industry Diversity-WTO Exposure interaction term for all six topic proportion outcomes. The figure provides evidence that provinces with a higher industry diversity are more likely to respond to WTO entry with more developmental policies, while there are no statistically significant results for the regulatory or directive strategy outcomes. The full estimation results are in Table A.5 of the Appendix.
Figure 4.13: Responses of provinces to trade liberalization when industry diversity increases

Benjamini-Hochberg adjusted p-values in parentheses
Figure 4.14: Change in developmental language in response to increase in industry diversity, across levels of WTO exposure

To better visualize the relationship, Figure 4.14 shows the interaction plot of the relationship between industry diversity and developmental responses, across different levels of WTO exposure. The plots show a generally positive relationship, that is that as WTO exposure increases, an improvement in industry diversity leads to stronger developmental responses.

4.4 Conclusion

This chapter has shown that there is no consensus within the Chinese state over how to govern the economy. By applying text analysis methods to a new dataset of Chinese industry regulations, I have demonstrated three distinct “state strategies” to economic growth that are adopted to varying degrees across state actors and over time.

I have further shown a surprising divergence in the responses of central, provincial
This chapter demonstrates that counter to conventional expectations, WTO entry did not result in a uniform trajectory of liberalization in China. Rather, different state actors diverged in their responses to the common shock of WTO accession. I further explain this variation, showing that a state’s response to WTO rules is driven by its likelihood of bearing the burden of WTO sanctions and how trade liberalization affects its prospects for bureaucratic advancement as determined by the diversity of the industrial base within its jurisdiction. Greater exposure to WTO sanction provokes a more regulatory response, while greater industry diversity leads to developmental responses being privileged over directive ones.

Therefore, while the rules governing China’s accession to the WTO were designed to bind China more tightly to international rules grounded in liberal market-economy principles, I have shown that this approach was limited in its reach. Despite single-party rule, state actors within China’s vast governing apparatus adopted divergent strategies in their response to WTO entry, driven by the overriding quest of these actors for economic growth – and thereby bureaucratic advancement, and facilitated by a fragmented accountability structure that generated varying likelihoods of sanction.
The Politics of Institutional Dualism in the Central State

5.1 The Advance of the State

Around 2009, a phrase – *guojin mintui* – became highly popular in Chinese discussions about the economy. Meaning “the state advances while the private sector retreats”, the phrase captured rising concerns over the dominant role of the state and the increasingly powerful positions that SOEs were occupying in the economy. This phenomenon was widely discussed in Chinese and Western media, with headlines such as “Entrepreneur’s Rival in China: The State’ (Barboza 2011) and “Private sector battles march of Chinese state” (Rabinovich 2012). While most articles attributed the interventionist trend to the government’s response to the global financial crisis, other articles pointed out that the phenomenon had emerged much earlier. One article in *FT Chinese*, for example, argued that the period between 1992 to 2004 was the “golden age” for private enterprises in China and could be considered a time when the private sector was “advancing”, while the trend of *guojin mintui* really emerged from 2004 onwards (Huang 2009).

The growing concerns within China over this “advance of the state” can be seen in the number of times the phrase is mentioned in Chinese scholarly work, either in the title or body of the text, as shown in Figure 5.1 While the occurrence of this...
phrase peaks in 2010, suggesting that concern over the rise of statism was strongest around the time of the global financial crisis, mentions of *guojin mintui* were clearly already emergent in Chinese scholarly discourse prior to the financial crisis.

Concurrently, scholarly works in the West have started to refer to the rise of “Chinese state capitalism” ([Naughton and Tsai 2015](#)), the “rise of industrial policy” ([Heilmann and Shih 2013](#)), and the rise of “China, Inc” ([Wu 2016](#)), all pointing to a more nationalist and interventionist approach to promoting Chinese industries and a growing dominance of SOEs in key strategic sectors. How does the statist trend documented in these studies accord with the finding in Chapter Four on the central state’s regulatory response to the WTO? Indeed if we take a look at the change in different state strategies in central state regulations over time (Figure 5.2), we can observe a clear rise in regulatory strategies in the post WTO years, but no real change in the trajectory of developmental strategies. If indeed there has been a rise in Chinese state capitalism, where within the vast Chinese party state is it coming from, and
how has this change taken place *alongside* the rise of the regulatory institutions?

In this chapter, I show that the regulatory response from the central state to WTO entry (documented in the previous chapter) did not last. Instead, a consolidation of developmentalism within the central state had begun even in the early years of China’s entry into the WTO, but became more activist only in the latter half of the 2000s. One reason this trend may not have been picked up by the regression analysis in Chapter Four is that the rise in developmentalism became more marked only from around 2006 onwards (and in a non-linear fashion), whereas the regression analysis focused on the period prior to 2007 (as most of the tariff reductions were completed by 2006). Once we take into account this delayed growth in developmentalism, it becomes clear that the post-WTO period in China has been characterized by a growing activism of both regulatory and developmental agencies, but at different points in
What has emerged is an ‘institutional dualism’ and an overall strengthening of central activism. The broad liberalization of many sectors of the economy has been supported by the rise of various regulatory institutions: the creation of regulatory commissions (Pearson 2005, 2007), legal reforms to delimit the exercise of administrative powers (Qin 2007), new laws on competition policy (Owen et al. 2008) and administrative reforms to strengthen vertical supervision structures (Mertha 2005; Mertha and Zeng 2005). At the same time, agencies such as the State-owned Assets and Supervision Administration Commission (SASAC) oversee national SOEs and the National Development and Reform Commission (NDRC) and Ministry of Industry and Information Technology (MIIT) govern the development of priority sectors (particularly those in the high-tech industries).

That China’s entry into the WTO would have led to a rise in regulatory institutions, or institutional dualism, was never a straightforward or foregone conclusion. WTO rules threatened to circumscribe the administrative discretion of many economic agencies, subject their policy-making process to greater public disclosure and international scrutiny, and transfer judicial authority over trade disputes to the WTO dispute settlement board. Such changes would pose concerns to most bureaucracies, but to a far greater degree for an authoritarian bureaucracy used to operating in opacity and without formal constraints on its daily decision-making. Given the large “gap” between the Chinese economic governance system and the Western legal foundations of WTO rules (Zhao 2002), as well as the administrative discretion that the bureaucracy stood to lose from WTO accession, the resulting institutional response within the central state is a rather surprising one.

The emergence of this institutional dualism is the central puzzle of this chapter. First, why did the rise of regulatory institutions in response to WTO entry not constrain the belated rise of developmentalism? In some ways, this phenomenon seems to
go against arguments in historical institutionalism about the “lock-in” and “increasing returns” dynamics that accompany the growth of new institutions (Pierson 2000).

Second, what explains the uneven timing of this dualism?

In the next section, I address deficiencies in the dominant explanations that have been put forth for why we observe a rise in Chinese ‘state capitalism’ in the latter half of the 2000s. Section 5.2 lays out my theoretical framework for explaining the rise of institutional dualism, while Section 5.3 provides an overview of the emergence, first, of regulatory institutions and then developmentalism in the Chinese central state in the post-WTO period. Finally, I provide evidence for my explanation of the pattern and timing of this dualism, focusing on changes in the ability of the party to discipline the central state and how WTO rules altered the prospects for bureaucratic advancement of different central agencies.

5.1.1 Dominant Explanations

There are currently two dominant explanations for the rise of state capitalism in China: the first points to the 2008 global financial crisis and the second to a change in elite preferences when the leadership transition took place in 2002-3. In this section, I discuss why each is inadequate in addressing the post-WTO pattern of institutional change. The first argument posits that China’s turn towards greater state intervention was a result of the 2008 global financial crisis, which led the central government to apply a USD 586 billion fiscal stimulus to the economy, much of which was channeled through SOEs and local governments (Kurlantzick 2016; Breslin 2013). However, this argument does not accord with evidence (which I present in Section 5.3.3) showing the rise of state capitalism prior to 2008, particularly with the surge of industrial policies for high-tech innovation launched at the start of the 11th Five-Year Plan in
2006.

The second explanation argues that the change in leadership in 2002-3 from Jiang Zemin and Zhu Rongji to Hu Jintao and Wen Jiabao led to fundamental shifts in leadership preferences over economic governance. Proponents of this argument point out either that Hu and Wen did not believe in reform as strongly as Jiang and Zhu, or that Wen was a strong supporter of state planning, or that Hu and Wen simply had different policy priorities such as expanding social insurance and poverty reduction (Heilmann and Shih 2013; Zheng 2004). This view is succinctly expressed by the office of the United States Trade Representative (USTR), which releases annual reports on China’s compliance with WTO rules. The 2012 report explained the rise in government intervention in the economy as follows:

In 2003, when new leaders took over in China, the Chinese government continued to take steps to implement the WTO commitments that China had agreed to phase in over time, furthering China’s economic reforms. However, beyond these steps, China’s new leaders for the most part did not continue down the path pursued by their predecessors. Beginning with the creation of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003, China’s new leaders de-emphasized their predecessor’s move toward a greater reliance on market signals and instead set out to bolster the state sector (USTR 2017).

Heilmann and Shih (2013), in explaining what they call the “rise of industrial policy” in China, also point to the change in leadership as the critical turning point. In contrast to Jiang and Zhu, “(t)he Hu-Wen administration [laid] a renewed emphasis on active state guidance and multi-year programs in economic, social and technological development. As a consequence, many previously influential protagonists and brokers of economic liberalization were sidelined, whereas indicative planners and industrial policy protagonists merged into a “centrist” or “statist” advocacy coalition that became the dominant force in economic policy-making.” Wen Jiabao “put a
renewed trust in the planners” (Heilmann and Melton 2013) and the bureaucracy was restructured accordingly to reflect these new political priorities. Such views are broadly similar to the explanation in Zheng (2004) of the major changes in China’s economic institutions from the 1980s to the 2000s. Zheng argues that different bureaucratic agencies serve as a “power base” for CCP leaders. As such, the rise and fall of various agencies, as well as their changing functions, reflect the shifting balance of power and preferences among conservatives and reformers at the top of the Party structure.

There are three main problems with such preferences-based explanations. First, by assuming that the pattern of policy change derives mainly from leadership preferences, this logic deduces the cause of an outcome from the effect itself, implying that whatever type of change the leadership desires, can and will happen. Such a framework therefore does not address the role of the bureaucracy either in shaping the form and content of policies, or in resisting the goals of the political leadership. The bureaucracy plays an important role in generating proposals that shape the scope, trajectory and content of policy reform in ways that cannot be explained by leadership preferences. In addition, by leaving out the channels through which bureaucratic agencies resist change, it cannot explain, if leaders can create and destroy agencies in accordance with their economic agenda, why some agencies are only downgraded after restructuring rather than completely abolished. For example, while Zhu Rongji was able to abolish and subsume major industrial ministries under the State Economic and Trade Commission (SETC) in 1998 in his attempt to consolidate industrial policymaking, other industrial agencies remained untouched, such as the Ministry of Information Industry and the State Tobacco Monopoly Administration. Why were these left standing? Wen Jiabao’s 2008 bureaucratic restructuring established five
“super-ministries” to consolidate policy making across a number of spheres. Yet one proposal for a super ministry governing energy was never implemented, “due to strong opposition and lobbying from both the NDRC and energy firms” (Yeo 2009). In short, this framework cannot explain when and why the political objectives of leaders end up being circumscribed, partially successful or failures from time to time.

Second, this explanation places too much emphasis on differences in ideological leanings between the Jiang-Zhu and Hu-Wen administrations. Wen had reformist credentials from his time as the head of the Central Committee General Office for Hu Yaobang and Zhao Ziyang – two leaders who were both important drivers of economic liberalization. He was a crucial member of Jiang and Zhu’s economic team, and placed in charge of the Central Financial Work Commission in 1998. Wen was also said to have had Zhu Rongji’s support in replacing the latter as Premier (Naughton 2003a). If the ideological differences between the two were so large, it is not clear why Zhu would have endorsed Wen and risked having his reforms unravelled by his successor. In addition, the preferences-based explanation gives too much credit to Zhu Rongji as a driver of market liberalization and neglects other aspects of his economic agenda that were strongly developmental in nature (particularly in policies surrounding SOE management). It similarly downplays the regulatory reforms that took place under Wen Jiabao’s premiership. In particular, there are elements of policy continuity between the two sets of leaders, and crucially, the “seeds” or preconditions for the rise of developmentalism in the mid-2000s were actually sown during the Zhu Rongji era, as Section 5.4.1 will show.

Finally, by focusing only on the rise of state capitalism, explanations based on lead-

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1 Industry and information, human resources and social security, environmental protection, housing and urban-rural construction, and transportation (Xinhua News 2008).

2 This is a politically sensitive and important position to which leaders would only appoint officials whom they could trust to implement their policies.
ership preferences cannot explain more holistically why institutional *dualism* emerged within the central state in China. Why did the rise of regulatory institutions in the years immediately after WTO entry not constrain the subsequent rise of developmentalism? Why wasn’t the rise of state capitalism accompanied by the destruction or abolition of regulatory agencies? How did we end up, instead, with the time-varying emergence of “rival” institutions?

5.2 Institutional Change in an Authoritarian Regime

In attempting to answer this puzzle, I draw on the insights of Thelen (2004); Mahoney and Thelen (2010) and Pierson (1993) that institutional change is a conflictual process. While new policies can generate “positive feedback effects”, with incentives and resources for mobilizing supporters leading to self-reinforcing institutional change via “increasing returns” (Pierson 2000), these same policies can also generate “counter-mobilizations” – losers from new policies do not simply disappear, but can organize to regain lost ground. I apply these analytical tools in examining how the introduction of WTO rules created different ‘winners and losers’ within the bureaucracy (Moe 2005), which then shaped the shifting coalitions for different types of institutional consolidation in China. However, an account that examines institutional change through the lens of feedback effects and coalitions alone cannot explain the pattern of change.

Indeed, existing approaches to institutional change do not quite address the central puzzle of this chapter. Theories of “punctuated equilibrium” (Krasner 1988) are inadequate in that WTO entry, while an external ‘shock’ to the bureaucracy, was not such a disruptive event that it led to the breakdown of one set of institutions and a shift to a different equilibrium. Neither was the ensuing pattern of institu-
tional change something that resembled any of the forms proposed in Mahoney and Thelen (2010) (drift, layering, conversion or displacement). Instead, the pattern that emerged – and which has yet to be explained – is one of institutional dualism, and of the rise of rival institutions promoting competing types of economic governance (regulatory versus developmental).

5.2.1 Ability of the Party to Discipline the State

I argue that we need to situate the contestation over institutions in the context of China’s authoritarian regime and the power relations that structure its governance system. While Skocpol (1992) points out that new rules and policies have the potential to alter state capacities, I propose that changes within the state have to be understood in the context of the state’s relationship with its political masters – and crucially, whether party leaders have the ability to discipline the state.

One challenge in drawing such a clear distinction between the party and its state is that the dividing lines are in practice rather blurred in the Chinese context. While all top bureaucrats are Party members (i.e. the state is a part of, rather than separate from, the party), there is still a division of responsibilities between the party leadership, which makes the most important decisions, and the bureaucracy which is charged with supporting and implementing the policy process (Lieberthal and Oksenberg 1988). For analytical clarity, I define the “party leadership” as the members of the Politburo Standing Committee (PBSC), and the state as party members working in the central bureaucracy (ministries, commissions, etc).

Political leaders commonly rely on the state bureaucracy to implement their goals. Slater and Fenner (2011) have pointed out the important role that bureaucracies play in party-based authoritarian systems, arguing that “(s)tates are the ultimate
institutional weapons in the authoritarian arsenal.” By this, they mean that political parties require a state apparatus to implement their strategies and goals, and therefore the durability of authoritarian regimes depends on the “infrastructural power” of the state (Mann 1984). However, the range of relationships between the state and the party seems under-specified in Slater and Fenner’s concept. Their formulation of state power appears constrained to the question of how effectively the state apparatus can carry out the goals of authoritarian regimes. This assumes that the state will always be equally motivated to carry out the goals of the party. Such automatic obeisance to party decisions should be questioned, even in authoritarian regimes, since different political decisions (e.g. WTO entry) can generate winners and losers within the central bureaucracy, leading to both support and resistance.

Indeed when it comes to understanding changes in authoritarian institutions, we need to focus less on the effectiveness of the state apparatus and more on the political relationship between the party and the state. As Deng Xiaoping himself said,

> Once a political line is established, someone must implement it. Depending on who is in charge of implementation - those who support the party’s line, those who do not, or those who take the middle-of-the-road position - the results will be different. (quoted in Zheng (2004), p.93).

To capture the politics behind state-party relations, I build on Jung’s (2006) concept of “reciprocal reliance” wherein bureaucrats are “both the agents and the constituents of the top leaders” (p.132). In other words, while the bureaucracy is functionally responsible for implementing decisions coming from the political level (and is therefore an agent of the party), the party leadership nonetheless has to rely on the bureaucracy’s implicit support for these decisions in order to be assured that

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3See Koss (2015) for an alternative account which explains authoritarian performance based on party – rather than state – strength.

4Which in turn is based on Susan Shirk’s concept of “reciprocal accountability” (Shirk 1993).
its orders will be carried out. Therefore the party leadership also views the state as a critical *constituency* whose support it needs to actively court. This concept of a mutual “give and take” between the party and the state is important, but again seems underspecified. While the two roles (being an agent versus a constituent) are arguably constantly in tension and always at play, when is the state on balance predominantly an agent of the party and when does it largely play the role of constituent? How do policies change depending on where the balance of the relationship is?

I posit that one variable driving the balance of this relationship is the degree to which the support networks of the party leadership are *embedded* in the central bureaucracy. This embeddedness in turn affects the likelihood that the party leadership can discipline the state when the latter deviates from its delegated tasks. By embeddedness of networks, I refer to the degree to which the career of a particular party leader was primarily spent in the central bureaucracy in Beijing versus in various prefectures and provinces across China.

Leadership networks are an important component of governance in China because unlike in democratic regimes or even semi-competitive authoritarian regimes, political competition does not take place between parties and is not governed by formal electoral rules. Instead, political competition in China takes place *within* the CCP. While one aspect of this competition takes place, as I have noted earlier, through bureaucratic ranks in the cadre evaluation system, another aspect (particularly at higher political levels) arguably takes place through factional politics. That is, absent formal rules for political succession, elites compete for advancement via informal rival factions or networks (Shih et al. 2012). These lines of contestation might be defined in terms of conservatives versus reformers (Zheng 2004), princelings versus Communist Youth League members (Li 2009) or generalists versus technocrats (Shih 2008). In this chapter, I focus on leadership networks in terms of whether they are
embedded within the central state, or disembedded (i.e. rooted in the provinces outside of Beijing). The politics of reciprocity permeates these networks, where the leaders of a faction rely on members to advance their political agenda, but members also rely on leaders for political advancement. This dynamic leads to the following propositions:

- **Leadership ties are *disembedded* from the central bureaucracy when the leadership’s network of political support and mutual obligations built up over their career lies outside the central state. Under such circumstances, the leadership can effectively punish bureaucratic actors who deviate from its policies without inflicting these punishments on members of its own network. As a result, the party leadership is able to effectively deploy the central state as its agent for implementing political goals.**

- **Leadership ties are *embedded* within the central bureaucracy when leaders have risen through the political ranks largely through the positions within the central state. Under such circumstances, leaders can neither disentangle themselves from the interests of the bureaucracy nor from the obligations and ties that have enabled their political rise. As a result, the party leadership cannot punish the bureaucracy for deviating from its delegated tasks without also inflicting that same punishment on members of its own network. Instead, party leaders have to rely on the central state as a key constituent for shoring up their political strength.**

The politics of this reciprocity generates outcomes that are distinct from what one might predict by simply examining the work experience of various Chinese leaders.

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5 This is similar to Shih’s (2008) distinction between generalists and technocrats.
or by adopting a conceptualization of factions as operating in a top-down fashion. For example, a leader who has risen to the top through extensive years in the central state might be expected to have in-depth knowledge of how the bureaucracy works and therefore be *more* adept at achieving his or her goals. Or, taking a top-down view of factions, one might expect a leader whose faction is based within the central bureaucracy to be *more* effective, because his or her orders will be reliably carried out by faction members. However, viewed through the lens of reciprocity, the factional relationship becomes more complicated. This is because obeisance from members of a network cannot be assumed and the objectives of party leaders and the central state can diverge, even within a factional network. In cases where there is no conflict between the interests of party and state, we might expect a leader whose networks are embedded within the state to be highly effective in achieving his or her goals. However, in cases where a party leader wishes to adopt a policy that the bureaucracy resists, implementation requires the ability to discipline those within the state who deviate from their political instructions. The leader whose network is embedded within the bureaucracy becomes counterintuitively *less* able to achieve this goal, because any punitive action (e.g. investigation, demotion or removal of authority over policy issues) would have the direct effect of weakening his or her own network.

As such, depending on this degree of embeddedness, the party-state relationship that dominates (agent versus constituent) affects whether responses to WTO entry are driven by the party leadership or the central state. I argue that the Chinese leadership in the Jiang Zemin-Zhu Rongji era (1998 to 2002-3) was in a position of strength vis-à-vis the bureaucracy, as the political ties of Jiang and Zhu were largely *disembedded* from the central state. As such, even in the face of strong bureaucratic opposition [Pearson 2001], these leaders would be able to effectively discipline the state and be able to deploy the central bureaucracy as an agent to carry out their regulatory
reforms. In contrast, the succeeding era of Hu Jintao and Wen Jiabao (2002-3 to 2013) brought about a reversal in the political relationship between the party and the state. Unlike Zhu Rongji, Wen Jiabao’s political networks were deeply embedded within the central state. Therefore Wen would not be able to effectively punish the state for deviations from their policies, and instead would need to rely on the state as a constituency to shore up his political strength. This distinction is consequential because while the party leadership in general was supportive of regulatory reforms, the central state was split between agencies supporting regulatory and developmental strategies.

5.2.2 WTO Leverage and Bureaucratic Advancement

The question of what types of strategic responses were supported by which central agencies depends in turn on how WTO entry altered the prospects of bureaucratic advancement for these agencies. While Chapter Four assessed bureaucratic advancement in terms of hierarchical promotion through the ranks, bureaucratic advancement for central state actors refers to an expansion of agency influence over policy. Within China’s authoritarian governance system, bureaucratic actors cannot be said to have (or even seek) autonomy in the same sense as in developed democracies (Carpenter 2001). Nonetheless, different central agencies compete intensely with each other for policy influence (Shih 2008 p.54). I assume that each agency’s approach to economic governance tends to be largely fixed over time, such that different agencies tend to prefer to deploy a particular set of state strategies when advancing their policy agenda (see Chapter Three). For example, agencies in charge of standards setting are likely to support regulatory strategies, while those charged with setting industrial policy are likely to be more developmental in orientation.

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As I noted in Chapter Three, WTO entry affects prospects for bureaucratic advancement through two channels: economic and bureaucratic. While the previous chapter focused on how the economic channel of industry diversity affected the promotion prospects of state actors across administrative levels, this chapter explores the bureaucratic channels through which global trade rules alter the ability of an actor to maintain or enhance their policy influence. WTO rules that specify how the state should behave in a range of economic policy areas have the potential effect of altering the strategies through which central agencies try increase their bureaucratic influence. These rules might directly oppose or undermine the discretion of some agencies, leaving them with more restricted options for expanding their policy influence. Yet these same rules might provide external leverage to other agencies to promote their policy agenda, providing them with more opportunities for bureaucratic advancement.

I propose that regulatory agencies in charge of standards setting are likely to see benefits from supporting WTO-led reform, as the implementation of specific WTO rules oriented towards building a regulatory state would enhance their policy relevance and influence. They are therefore likely to respond to WTO entry with stronger regulatory strategies. In contrast, agencies in charge of setting industrial policy are likely to be more developmental in orientation and hence would be opposed to WTO rules that threaten to circumscribe the set of policy tools at their disposal. They are therefore likely to seek opportunities to respond to WTO entry with developmental strategies.

The question of which set of agencies is in a stronger position to advance their agenda in turn depends on what I term “WTO leverage”. I propose that in the early years of China’s WTO entry, regulatory agencies that were otherwise weak were able to use China’s WTO commitments as leverage to push for greater regulatory reforms, improving their prospects for bureaucratic advancement in the process. Importantly,
the strength of this leverage is time-varying due to the detailed commitments documented in China’s Protocol of Accession, which set specific dates by which various concessions and reforms would be completed (the period of implementation largely ran from 2001 to 2005). As such, WTO leverage was highest at the point of WTO entry but gradually faded over time as the implementation of China’s WTO commitments progressed.

I show in Section 5.4.1 that the institutional consequences of relying on external rules as a substitute for domestic support was that there were only weak ‘positive feedback effects’ supporting the strengthening of regulatory institutions as part of WTO entry. As a result, those regulatory institutions ended up being supported only by a narrow coalition within the bureaucracy. Importantly, the “losers” from WTO entry did not disappear. Regulatory agencies were established alongside rather than replacing existing agencies with more developmental orientations. Moreover, the strategy of relying on external rules to push domestic reform ended up generating negative feedback effects (i.e. active resistance to regulatory strategies) amongst these losers, with the result that a coalition within the bureaucracy emerged that became more anti-WTO and opposed to regulatory reform over time.

Therefore as the strength of WTO leverage weakened, “losing” agencies supporting developmental strategies would be able to consolidate their position and push for greater policy influence. As such, the implementation of WTO rules not only did not preclude, but may also have generated conditions that led to the strengthening and consolidation of “losing” central agencies advocating developmental approaches such the NDRC, resulting in ‘rival’ developmental institution-building that grew over time but really came into prominence from 2006 onwards after the implementation time-table in China’s Protocol of Accession was completed.
5.2.3 Predicting Central State Responses to WTO Entry

In sum, the embeddedness of party leadership networks affects the ability of the party to discipline the state; and hence whether responses to the WTO are driven by the party or the state, while WTO leverage affects which agencies were able to advance their policy influence at different points in time. Figure 5.3 shows how the two variables of party-state relations and WTO leverage combine to generate time-varying responses to WTO entry within the central state. I focus on regulatory and developmental strategies as the main potential responses that various agencies are likely to adopt, in line with the argument presented in Chapter Four that the central state is likely to respond to WTO entry with either regulatory or developmental strategies.

1. The period immediately after WTO entry (2001-2003) is associated with high WTO leverage and a strong ability of the party leadership to discipline the state.
As such, this period is likely to be associated with the strongest regulatory responses to WTO rules, driven by the leadership and bolstered by pro-reform agencies within the central state. This period is therefore likely to be associated with the active building of regulatory institutions.

2. From 2002/3 to 2005, the ability of the party to discipline the state weakened as Jiang Zemin and Wen Jiabao took over as leaders. However, WTO leverage was still relatively high during this period due to the schedule of implementation built into the Protocol of Accession. Therefore, while the party leadership would not be able to effectively drive liberalizing reforms, regulatory agencies within the central state would still be able to use the Protocol of Accession and WTO rules as leverage to advance their agenda. This period would therefore be associated not with institution-building, but the continued promulgation of regulatory strategies driven by the Protocol, or by WTO disputes.

3. The period of 2006 to 2013 is associated with a weak ability of the party to discipline the state, and low WTO leverage as the implementation timetable in the Protocol expired. As such, economic policy would be driven by the state rather than by the party, and specifically by developmental agencies within the central state as regulatory agencies lost their policy leverage. Consequently, this period would be associated with the strongest period of developmentalism, resulting in activist developmental strategies and rival institution building.

4. The final potential scenario of low WTO leverage and a strong ability of the party to discipline the state does not arise in the scope of this study, as the period of low WTO leverage (2006 onwards) does not overlap with the Jiang-Zhu era (1998 to 2002/2003). However, one might tentatively speculate that this period corresponds with the Xi Jinping era, since Xi has emerged as a
powerful leader determined to discipline the state through his anti-corruption crackdown. His network of support also lies largely outside the central state, since he has spent almost his entire career – 31 out of 38 years prior to being appointed to the Politburo Standing Committee – in various provincial positions (in Shaanxi, Hebei, Fujian, Zhejiang and Shanghai).

5.2.4 Methodology

I employ a mix of quantitative and qualitative methods to test the arguments put forth in this chapter. First, I track the changing intensity of state strategies deployed by different central economic agencies by measuring the changing topic proportions of different strategies found in their industry regulations. This allows me to assess which coalition of agencies is driving either the rise of the regulatory or developmental institutions at the central level. In order to identify the “turning point” of when regulatory institution-building was replaced by developmentalism, I measure the changing “activism” of various developmental agencies in issuing regulations, and further examine changes in foreign firm sentiments on the business environment using data from an annual survey of American firms in China.

I rely on qualitative analysis to identify the causal mechanisms through which institutional change took place and specifically the role played by the political relationship between the CCP leadership and the central state. In attempting to assess the top leadership’s approach to economic reform, I rely on speeches and records of meetings by the relevant General Secretaries and Premiers in the pre-and post-WTO periods: Jiang Zemin and Hu Jintao, and Zhu Rongji and Wen Jiabao. These speeches include their work reports at the National People’s Congress, as well as records of their meetings with Chinese and foreign officials and businesspeople (e.g. Zhu Rongji
On the Record. Other sources included newspaper reports (in English and Chinese), official CCP journals, and articles written by government officials in scholarly journals (e.g. Chinese Cadres Tribune, Academic Journal of the Central Party School, Economic Research Reference, Economic Worker Study Materials). In addition, I conducted interviews with current and former officials in the Chinese and American governments, as well as at the World Trade Organization, and with industry association representatives with experience in engaging various central economic agencies. These conversations enabled me to gather evidence of the bureaucratic politics of WTO accession and the factors driving institutional change at the central level. The interviews further provided evidence of how different agencies deployed WTO rules as ‘leverage’ to advance their bureaucratic positions, as well as the positive and negative ‘feedback effects’ resulting from implementing China’s WTO commitments.

The next section provides a short historical overview of the competition between major economic agencies in the bureaucracy in the pre-WTO period, before documenting the rise of the regulatory and developmental institutions in the immediate post-WTO era.

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6朱基讲话实录 Zhu Rongji Jianghua Shilu
7中国党政干部论坛 Zhongguo Dang Zheng Ganbu Luntan
8中共中央党政学报 Zhonggong Zhongyang Dangxiao Xuebao
9经济研究参考 Jingji Yanjiu Cankao
10经济工作者学习资料 Jingji Gongzuozhe Xuexi Ziliao
5.3 The Emergence of Institutional Dualism

5.3.1 Bureaucratic Competition in the pre-WTO era

As I indicated in Chapter Two, China’s reform path has been marked by periods of intense political and ideological contestation over the role of the state in economic governance. In each period of reform, political leaders needed economic agencies within the state bureaucracy to implement their policy agenda. Reforms reflecting new governance approaches were often carried out through newly established or re-formulated agencies, while old approaches embodied in pre-existing agencies did not necessarily go away, but often remained in the bureaucracy, sometimes in diminished form. The experimental and incremental nature of China’s reform process therefore meant that the bureaucratic landscape within the Chinese state was similarly varied.

Within the bureaucracy, therefore, authority over industrial policy has shifted over the post-Mao reform era. On the whole, this authority has moved between two main competing agencies: the State Planning Commission (SPC) and the State Economic Commission (SEC) – and that rivalry has persisted over time as the two agencies have been put through various restructurings under different leaders. Functionally, each agency had slightly different responsibilities: The SPC held authority over economic planning and approving new industrial projects, while the SEC was in charge of managing SOEs. This division inevitably generated competitive tensions because questions of economic reform and development could not be separated from questions of SOE governance (Interview B09). The division of responsibilities also meant that each agency tended to push for different approaches to development. Heilmann and Shih (2013) point out that when it came to learning from the Japanese growth experience, each agency extracted a different set of policy ideas to advance their bu-
reconruatic interests. The SPC saw Japanese-style industrial policy as “a defensive paradigm for maintaining core areas of government intervention” while the SEC focused on the state-enterprise relations aspect of Japan’s economic success, namely “founding quasi-regulatory business associations and establishing large-scale enterprise groups”. As the SEC was responsible for reforms introducing greater enterprise autonomy, it came to be seen as a leading reform agency while the SPC was seen more as a conservative agency rooted in the planned economy mindset (Jung 2006, p. 125).

In 1988, a round of administrative restructuring launched by then-Premier Li Peng led to the abolition of the SEC and the absorption of its functions into the SPC. When Zhu Rongji was put in charge of economic reform in 1991, he took over an outfit called the Production Office, which was upgraded to the Economic and Trade Office in 1992 and further elevated to the State Economic and Trade Commission (SETC) in 1993, in essence a reincarnation of the SEC (Zheng 2004, p. 102-106). The SETC was put in charge of industrial policy and SOE reform, advocating a developmental approach that was seen to be more reformist and market-friendly compared to the statist ways of the SPC.

In 1998, Zhu Rongji replaced Li Peng as Premier and immediately set about another round of bureaucratic restructuring, this time to substantially trim the size of the central bureaucracy in order to make it more rational and efficient. The number of ministries (including commissions) were to be cut from 40 to 29 and the number of personnel cut from 8 to 4 million (Zheng 2004, p.97). In this downsizing, ten different agencies were abolished and subsumed under the SETC. The SPC was downgraded

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11 The ministries of power, coal industry, metallurgical industry, machine building, chemical industry and internal trade, as well as the Textile Industry Council, the Light Industry Council, the General Company of Petroleum and Gas and the General Company of Chemical Industry (see Zheng 2004 p. 98)
to a research institute and its name changed to the State Development and Planning Commission (SDPC). The SETC gained the status of a “super-ministry” in charge of industrial development, and was informally referred to as the “mini-State Council”.

### 5.3.2 The Rise of the Regulatory State

In the pre-WTO period, agencies in charge of regulatory standards were weak and below ministerial rank, and did not play a significant role in economic governance. In the second half of the 1990s under Zhu Rongji’s watch, reforms were instituted to strengthen the regulatory functions of the central government. This section will only give a brief overview of the main developments, as detailed accounts can be found in Yang (2004); Zheng (2004) and Pearson (2005).

While WTO entry and the requirements of adhering to WTO rules was no doubt a strong driver of these regulatory reforms, it was by no means the only impetus. Domestic pressures for stronger regulatory standards were also building due to scandals involving workplace safety and consumer standards (Yang 2004, p.97). In 1999, the central government made changes to strengthen its vertical control over the State Administration of Quality and Technical Supervision (SAQTS). This agency was then upgraded to ministerial status and renamed the State Administration of Quality, Supervision, Inspection and Quarantine (SAQSIQ), consolidating within its ambit responsibilities for inspection and quarantine, certification and accreditation as well as regulatory functions that had previously been spread out across industrial agencies (Yang 2004, p.39, 98). The SAQSIQ’s broadened responsibilities over standards supervision, certification and quality control made it “one of the main arms of the regulatory state” (Yang 2004, p.98). Figures 5.4 and 5.5 shows the clear increase in the number of regulations issued by SAQSIQ, as well as an intensification of regula-
Figure 5.4: Number of sector-specific regulations issued per year by SAQSIQ

Source: Author’s dataset

The growing centralization of regulatory functions took place as well in other agencies, but with vertical administration streamlined only up to the provincial, rather than central level (see Mertha (2005) on “soft centralization” and Yang (2004), p.98). These included the State Administration for Industry and Commerce (or SAIC, in charge of business registration, trademarks infringements, business fairs and protecting consumer interests), the State Environmental Protection Administration (now the Ministry of Environmental Protection) and the State Drug Administration (later renamed the State Food and Drug Administration).

It should be noted that the establishment of these regulatory agencies did not lead uniformly to a rise in regulatory content in their policies. Indeed, some regulatory
Figure 5.5: Proportion of different strategies in SAQSIQ regulations (including CIQ and CNCA)

Source: Author’s dataset
agencies appear to be highly directive in their approach. For example the SAIC’s approach to oversight of trademark protection, fair trade and consumer protection seems to predispose it to adopt strongly directive approaches in shutting down businesses selling unsafe products or cracking down on trademarks violation. Figure 5.6 shows a sharp increase in the directive content of the SAIC’s regulations in the run up to China’s WTO entry, followed by a decline thereafter.

Notwithstanding these signs of “hidden” directive tendencies in some regulatory agencies, there was a broad strengthening of the regulatory state in other parts of the economy in response to WTO entry. Substantial reforms were implemented in the WTO accession period with an intensification of central state legislative activity in order to make China’s legal system compliant and consistent with WTO articles. Outside of sector-specific regulations, sweeping changes were made to the Foreign Trade
Law, Customs Law, Product Quality Law, the Copyright, Patent and Trademarks laws, the Pharmaceutical Administration Law, and more (see Yang (2004), p.103; and Qin (2007)). The domestic administrative and judicial systems were also substantially restructured to allow for greater transparency, channels for judicial review and more uniform administration (See Qin (2007) for an overview).

These changes added up to a reformed system for economic governance that was not only more liberalized in terms of tariffs and trading rights, but also more transparent, undergirded by a set of WTO-consistent laws and most importantly governed by a set of state-economy relations marked by less intervention and administrative discretion. Under such conditions, then, how and why did the “rise of state capitalism” come about a few years later?

5.3.3 The Rise of the Developmental State

One interviewee noted that the “turning point” in China’s reform trajectory seemed to be around 2006 and 2007, with the sentiments of China’s trading partners in the WTO turning more negative around then. Not only had there been no further liberalization in policies in recent years, but SOEs had become more dominant in the economy. SOE reforms had been limited to corporate governance, whereas there was no movement towards privatization or liberalization (Interview G01). As another sign of potential discontent against Chinese industrial policy, the number of complaints filed against China at the WTO’s dispute settlement board rose sharply in 2006, peaking at 5 in 2007 and 7 in 2012 (see Figure 5.7 below).

This rise in these WTO complaints could be interpreted as being symptomatic of a negative turn in the sentiments of foreign businesses in China around the same time. Figure 5.8 below shows how American firms in China have perceived the impact of
Chinese economic reforms on their business climate. The chart shows that American firm sentiments were highly positive between 2002 and 2004, with those saying that reforms had benefited the climate for US businesses “To a very great extent” or “To a great extent” ranging between 61 to 69%. 2005 onwards saw a sharp drop in those positive sentiments, with the same responses ranging between 30 to 44%. 2006 was the year in which sentiments were the most negative, with only 7 percent of respondents saying that American firms had benefited “to a very great extent” from recent reforms.

Moving in step with these increasingly negative sentiments, the USTR’s annual reports to Congress on China’s WTO compliance became sharply more critical from 2006 onwards, with the 2006 report quoting one trade association official noting that: “Over the past 12 months we have seen an upsurge in industrial planning measures as tools of economic development by central government authorities”. The 2007 re-
Figure 5.8: To what extent do you believe China’s recent economic reforms have improved the climate for US business in China?

Source: American Chamber of Commerce Business Climate Surveys, 2002-2010.
Note: “Not at all” category in 2006 included those who answered “Don’t know/No basis to judge”
port also quoted critical remarks from a trade official, noting that “(s)ome policy makers also appear to want to expand the [Chinese] government’s role in directing the economy and in developing internationally competitive Chinese enterprises, while also restricting the role of international companies in certain sectors. Designation of “pillar” industries, promoting “indigenous innovation,” and establishing “national economic security” criteria to review deals are troublesome signposts that do not imply full market access for U.S. companies” (USTR 2006, 2007).

The policy developments that the official in the 2007 USTR report highlighted came from China’s 11th Five-Year Plan and associated policies launched in 2006, which established “indigenous innovation” as a key development priority for the country, with particular focus on industries such as new-energy vehicles, high-end equipment manufacturing, biotechnology, information technology (see www.gov.cn (2006) and www.fdi.gov.cn (2007)). In 2005 and 2006, SASAC Chairman Li Rongrong listed seven ‘strategically important sectors’ that comprise “the vital arteries of the national economy” over which the state needed to maintain “absolute control”. Nine additional sectors were designated as “pillar” industries deserving of particular support, in which important “backbone” enterprises would maintain strong controlling power (Zhao, Huanxin 2006; SASAC 2005). The emphasis on “indigenous innovation” marked a turn in industrial policy towards what some have called “techno-nationalism” (Suttmeier and Yao 2008), reflecting a desire by the central government to push the Chinese economy up the value chain and beyond its traditional strengths in manufacturing, assembly and other types of processing trade. This new policy focus can be clearly seen in Figure 5.9, which shows how often the word “innovation” appears

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12 Armaments, power generation and distribution, petrochemicals and oil, telecommunications, aviation, coal and shipping.

13 Equipment manufacturing, automotive, electronic information, construction, steel, non-ferrous metals, chemicals, surveying and design, and high-tech industries.
Figure 5.9: Occurrence of the word “innovation” in central, provincial and local regulations

in industry regulations issued by the central, provincial and local governments. The central government’s use of the word in its regulations first “spikes” in 2006 (during the launch of the 11th Five Year Plan) and 2007 (when additional policies associated with the Five Year Plan were rolled out). Provincial and local governments followed suit with dramatic increases in the use of the word “innovation” in their policies from 2009 onwards.

The emphasis on the importance of this innovation being “indigenous” was accompanied by policies that appeared to discriminate in favor of domestic enterprises. In 2006, the Medium to Long Term Plan for the Development of Science and Technology (2006-2020) was issued by the State Council, which explicitly established the goal of cutting down the country’s dependence on foreign technology. Eleven different indus-
tries were identified for priority development. As an example of how this push for innovation was seen as discriminatory, the Ministry of Finance issued a number of policies in 2007 that required governments to give priority to “indigenous innovation” products when making procurements (Lardy 2014, p.54).

Two different ministries have come to be associated with the rise of these ‘techno-nationalist’ policies in the post-WTO era: the National Development and Reform Commission (NDRC) and the Ministry for Industry and Information Technology (MIIT) (Naughton 2009). Each was formed through a different round of administrative restructuring. While it was the SETC that dominated the developmental agenda during Zhu Rongji’s tenure as Premier, the agency was abolished in 2003 when Wen Jiabao took over the premiership and launched another round of administrative restructuring. The SETC’s responsibilities over industrial policy shifted back to its rival the SDPC, which also absorbed the functions of the State Council Office for Economic Restructuring and then was renamed the NDRC. The SETC’s functions for SOE management was carved out into the newly created State-owned Assets Supervision and Administration Commission (SASAC), while its responsibilities over trade were absorbed into the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) – which was then renamed the Ministry of Commerce (MOFCOM) (see Yang (2004), p.60-63; and Lardy (2014), p.49 for details). The consolidation of industrial policy authority in the NDRC can be seen in the changing content of the regulations issued by the SETC and its antecedents (see Figure 5.10).

The creation of SASAC in 2003 was an important milestone in SOE governance in China. In the 1990s, governance over SOE assets had been devolved to subnational governments. In the late 1990s, as part of the campaign to reform and streamline the SOE sector, asset management was re-centralized to the central government, but remained fragmented across five different commissions or ministries (Naughton and
The establishment of SASAC in 2003 therefore represented a major consolidation of authority over China’s SOEs. One of the organization’s objectives was to concentrate state assets into large holding companies by merging or restructuring smaller, less profitable entities. As part of this process, SASAC has gone from overseeing 196 central SOEs in 2003 to 102 in 2016 [SASAC 2017]. And as we can see from the large gaps in Figure 5.10, SASAC does not frequently issue industry-specific policies, as its governance function lies in the ownership and management of central SOEs. Although SASAC has arguably grown into a very powerful and consequential body, there are only five years between 2003 and 2014 in which SASAC was involved in issuing industry-specific regulations. Instead, SASAC’s influence is seen to be stronger in defending and maintaining the Party’s ownership of assets in what are considered key strategic or “lifeline” sectors of the economy [Lardy 2014, p.54].

Likewise MOFCOM has very little direct involvement over industrial policy. Instead, the content of MOFCOM regulations is highly dominated by trade-related issues (but which can overlap with industrial policy in the case of anti-dumping), as shown in Figure 5.11.

Therefore the “clearest winner” from this round of restructuring was the NDRC (formerly the SDPC and SPC) [Miller 2003], with newly consolidated powers over industry governance, and its old rival the SETC abolished. One important source of the NDRC’s strengthened influence comes from the authority that it gained over reviewing and approving large investment projects [Yeo 2009, Heilmann and Shih 2013]. In 2008, another round of administrative restructuring led to the creation of the MIIT, formed by merging several different agencies.\textsuperscript{14} The MIIT then became a

\textsuperscript{14}The Ministry of Information Industry (in charge of telecommunications and strategic electronics), the State Council Office on Informatization, parts of the NDRC in charge of technology and industrial management, and the National Defense Science and Technology Industry Office in charge of strategic military industries [Naughton 2008, 2009].
Source: Author’s dataset

Figure 5.10: Proportion of different strategies in SEC/SETC/SASAC regulations

Source: Author’s dataset

Note: Shows policy content for MOFTEC pre-2003 and MOFCOM post-2003

Figure 5.11: Proportion of different strategies in MOFCOM regulations

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“super-ministry” in charge of information technology development. Given the admin-
istrative complexity of these changes, Figure B.1 in the Appendix provides a summary
timeline of the major changes brought to these various economic agencies as a result
of different rounds of administrative restructurings.

Using text analysis, we can observe the changing intensity of developmental lan-
guage in the policies issued by the three main agencies in charge of industrial policy
over the reform period: The SETC (formerly SEC), the NDRC (formerly SDPC/SPC)
and the MIIT (formerly MII). Figure 5.12 shows this change over time, and there are
two striking aspects to the trends. First, while there is no clearly dominant agency
prior to 1995 in terms of which agency tended to be the most “developmental” in its
policies, the SETC stands out during the Zhu Rongji era as being the most strongly
developmental (in 1998 to 2003 when he was Premier, but also in the years prior to
1998 when he was Vice-Premier in charge of the economy). From 2003 onwards, we
can observe the locus of developmental policies shifting from the SETC to the NDRC
and MIIT.

Second, the developmental content of policies issued by these agencies tended
to spike in short “bursts” in the pre-2003 era. One possibility is that the central
government might give a strong push to developmentalism in industrial policy in one
or two particular years, but leaves it to the localities to implement or adopt its calls for
growth. From 2003 onwards, however, we observe not just the rise of the NDRC and
MIIT, but that their developmentalism is sustained and steadily growing over time.
This pattern of centralization is very different from that of the 1990s under Jiang
Zemin and Zhu Rongji, who focused on centralizing the levers of macroeconomic
control (fiscal and monetary policy).

Substantively, the post-2003 years are associated with a slew of new industrial poli-
cies, with updates released for the automobile and semiconductor sectors (see Chapter
Six), the afore-mentioned Medium to Long Term Plan for Science and Technology, the focus on “indigenous innovation” in the 11th Five-Year Plan, and the pinpointing of strategic “pillar” industries deserving of national support. In 2009, additional policy focus was placed on developing “strategic emerging industries”, heightening state activism in technology innovation and in industries such as new-energy vehicles, high-end equipment manufacturing, biotechnology and information technology (www.gov.cn 2009).
Figure 5.12: Proportion of developmental words in agency regulations

Source: Author’s dataset
5.3.4 Institutional Dualism

Therefore the economic institutional landscape in post-WTO China has been marked by two important trends. The first is a growing centralization of economic control, with strengthened vertical administration and ministerial status given to regulatory agencies such as SAQSIQ, as well as consolidated control and greater sustained activism in industrial policy by developmental agencies such as the NDRC and MIIT. The second important trend is that the strengthened developmentalism seems to have grown in parallel to, rather than replacing, the regulatory institutions. What has emerged, therefore, is an institutional dualism within the central state - giving rise to seemingly contradictory policy announcements from time to time.

This trend of dualism can be found at higher-level industrial policy documents such as the Five-Year Plan, which sets out the overall direction and priorities for the Chinese economy and is approved by the top leadership. The 10th Five-Year Plan (2001-2005), for example, noted that “market mechanisms are playing, increasingly markedly, a basic role in the distribution of resources, while the 11th Plan (2006-2010) stated that China was “giving more play to the fundamental role of the market in allocating resources under guidance of macro regulation and control. The 12th Five Year Plan (2011-2015) gave “full play to the socialist mechanism as well as to the market in terms of allocating resources”. A 2013 Central Committee communique further noted that the market should play a “decisive role” in resource allocation (Xinhua News 2013). These changing statements are indicative of a slow but growing expansion of the official role of the market.

Alongside this liberalizing trend, however, official policies and public statements over the same time period have reaffirmed a strengthened role for the state in specific areas or sectors. In December 2001 (the same month of China’s accession to the
WTO), then-vice premier Wu Bangguo announced the need to create 50 large SOEs with international competitiveness, and that it was “an important strategy to cope with the impacts brought about by the country’s accession to the WTO” (Fu 2001). Notably, the trend of emerging developmentalism did not happen in parallel with strengthening regulatory institutions, but rather was time-varying. As discussed in Section 5.3.3, 2006 was an important marker that marked the heightened role of the central government in pushing for greater developmentalism in Chinese industrial policies, with the designation of “indigenous innovation” as a new priority, as well as greater control over state assets in key “strategic” and “pillar” industries.

My interviews with scholars, government officials (active and retired) and industry representatives confirmed the presence of these competing approaches to economic governance within the central bureaucracy. There was broad consensus that the NDRC was the most ‘conservative’ ministry when it came to reform, with interviewees referring to how the agency’s roots in the SPC meant that NDRC officials still tended to apply a “planning mentality” to their work, issuing orders from on high and attempting to mould an industry into what they wanted to see (Interviews B30, B22). The MIIT was similarly described as a statist agency, that, while not rooted in a planning mindset, was nonetheless highly nationalistic and looked to the Japanese experience of growth to try to leapfrog into more advanced technologies and industries (Interview B30, T04). The most ‘liberal’ ministry was MOFCOM, whose staff tended to support greater marketization and liberalization in the economy, and for China to keep on implementing reforms and eventually to join the Trans-Pacific Partnership (TPP) (Interviews B22, B30). However, interviewees also noted that MOFCOM was weak compared to the NDRC and MIIT, as it had no approval authority and little control over the allocation of resources, unlike the NDRC’s very strong control over investment approval (Interviews T04, B09). These divisions over the role of the state
in economic governance have led to divergent approaches to implementing economic policy.

5.4 The Institutional Roots of Dualism

What, then, explains the pattern and timing of the emergence of institutional dualism in post-WTO China? I argue that changes in China’s economic institutional landscape need to be understood in the context of Party-state relations, and with attention to the positive and negative feedback effects that drive institutional change (Pierson 1993). As proposed in Section 5.2, the degree to which political leadership ties are embedded within the central bureaucracy determines the likelihood that the central state will be punished by the party leadership for deviating from party priorities. The party-state relationship that prevails under each leadership period (state as agent versus constituent) affects whether policy change is driven by the party or the state. In turn, the specific coalition of state actors that are empowered to drive policy change and the type of institution-building that results, depends on the strength of the leverage to be gained from WTO rules.

5.4.1 Jiang-Zhu era: State as agent under strong WTO leverage

In the Jiang Zemin and Zhu Rongji period (1998 to 2003), political leadership ties were relatively disembedded from the central state, and this position of ‘independence’ from state officials allowed Jiang and Zhu to deploy the bureaucracy strategically as an agent to achieve their political goals of using WTO entry to drive domestic economic
reform forward.\textsuperscript{15}

This degree of disembeddedness can be assessed by examining each leader’s career trajectory up to the point of their appointment to the party leadership (the five to nine person Politburo Standing Committee, or PBSC).\textsuperscript{16} Jiang Zemin joined the Communist Party in 1946, and after the Communists’ victory in 1949 spent five years in Shanghai in various positions in a food products factory, a soap factory, and the Shanghai division of the First Machine-Building Industry Ministry. He then trained for a year in 1955 at an automobile factory in Moscow, before spending six years in Jilin province in Northeast China in various positions at the First Automobile Works plant. From 1962 to 1980, he worked in the First Machine-Building Industry Ministry in Shanghai, Wuhan and as deputy director and director of the Ministry’s Foreign Affairs bureau. It is unclear how many of his years in this ministry was spent in local bureaus outside of Beijing, as the exact years are not provided in his official biography. I assess that at minimum he started out in Shanghai in 1962 (as it’s likely the positions are listed chronologically) and would not have been posted to the central ministry until after the Cultural Revolution ended in 1976 and those who had been “sent down” to the countryside could return to urban areas. In 1980, Jiang was appointed to the central bureaucracy at the State Administration Commission on Import and Export, and the State Administration Commission on Foreign Investment. From 1982 to 1985, he held positions in the Ministry of Electronics Industry as Deputy Party Secretary and Deputy Minister, and Minister and Party Secretary. For the next two years, he left Beijing to hold the position of Shanghai Mayor and returned to the capital in 1984.

\textsuperscript{15}This is not to suggest that Jiang Zemin was “strong” throughout his tenure. See, for example, MacFarquhar’s piece in Heilmann and Stepan (2016) pointing out Jiang’s weakness in the early years of his time as General-Secretary, and that he only managed to consolidate his position after Deng’s death in 1997.

\textsuperscript{16}Information here is largely drawn from the official biographies of Chinese leaders on the People’s Daily website. Additional sources are specified in parentheses.
1987 when he was elevated to the PBSC. Altogether, Jiang Zemin’s career prior to being appointed to the PBSC involved approximately 24 years outside the central bureaucracy and approximately 9 years in it.

Zhu Rongji joined the Communist Party in 1949 and after graduation from Tsinghua University spent a year in northeast China in the planning bureau, before moving back to Beijing from 1952 to 1958 to work in the central State Planning Commission. In 1958 he was targeted in the Anti-Rightist Campaign for criticizing Mao’s economic policies (Song 2013, p.429) and exiled to the remote northwest regions of China to teach at a Party school and then to work as an engineer in the Economic Integration Bureau (jingji zonghe ju) for twelve years. From 1970 to 1975 (during the Cultural Revolution years of 1966-76) he was sent down to the countryside to work in a cadre school. It was not until 1975 that he returned to the central state to work in the Ministry of Petroleum Industry for four years. Zhu was moved to the SEC in 1979 and rose through the ranks over the next eight years, ending up as deputy Party Secretary of the SEC before moving to Shanghai to serve as Mayor and Party Secretary from 1987 to 1991. He was appointed State Council Vice-Premier from 1991 to 1992 and elevated to the PBSC in 1992. Altogether, Zhu spent 21 years outside the central bureaucracy and 16 years in it before being appointed to the PBSC.

One consequence of Jiang and Zhu’s political trajectory is that neither of them had strong support networks within the central bureaucracy. Jiang Zemin’s network, built up over the years, drew from his years outside the central state – particularly in Shanghai (Shih 2008, p.188). Zhu himself, possibly as a result of his sixteen years in the political wilderness during the Anti-Rightist campaign and the Cultural Revolution that followed, combined with his abrasive working style, never built up a strong faction or following within the Party (Naughton 2003a). From one perspective, this lack of support ties might seem a political disadvantage. However, the mutual
obligations of support built into a network relationship means that having strong ties embedded within the central bureaucracy can actually turn into a handicap, as it is then difficult to discipline the bureaucracy without also imposing punishments on members of your own network.

While the observable implications of a state-as-agent relationship are difficult to measure, the strength of the Jiang-Zhu team can be seen not by their ability to embark in the centralization drive that bureaucrats in Beijing would have benefited from, such as the 1994 fiscal reforms that rejuvenated central revenues, but from their ability to undertake reforms that directly undermined the interests of the bureaucrats. The first instance of this was in Zhu’s 1998 administrative restructuring, where about half of the civil service was laid off and the number of ministries slashed from 40 to 29 (Zheng 2004, p.97). A second instance was SOE reform launched in 1995 to consolidate and corporatize large SOEs and relinquish control over small and medium SOEs. This led to a dramatic fall in the number of SOEs, from 127,600 in 1996 to 34,280 by 2003 (Lardy 2014, p.45). The third instance was the push for China to join the WTO, which threatened to severely limit the administrative discretion of powerful central agencies.

**Strong WTO leverage, weak positive feedback effects**

In the period running up to WTO accession, Zhu Rongji’s domestic support within the central government for liberalization was weak (Interview with former US official, 2016). However, as has been documented by other scholars and widely confirmed across my interviews, Zhu used the negotiation process and WTO commitments as external leverage to push domestic reform forward (Fewsmith 2001; Pearson 2001). In addition, the necessity of negotiating entry into a major international organization strengthened the otherwise weak position of those within the bureaucracy who
supported Zhu’s efforts (i.e. agencies such as MOFCOM and SAQSIQ who benefited from WTO-led liberalization).

The timetable specified in China’s Protocol of Accession for implementing its numerous WTO commitments provided additional leverage for pro-liberalization agencies in the years immediately following WTO entry. Many commitments, such as tariff reductions, services liberalization and the liberalization of distribution rights were phased in over a number of years, commonly to be completed by 2004 or 2005 (See Protocol of Accession). One interviewee noted that this external leverage was stronger in China than in the US, because in China international law was stronger than domestic law, while the opposite was true in the US (Interview B18). Over time, however, this leverage weakened. As another interviewee pointed out, with the commitments in the WTO accession protocol largely met (except for those dealing with subsidies and financial services liberalization), it was difficult to organize the motivation within the bureaucracy to continue with additional reforms (Interview B04).

In other words, the growth of regulatory institutions was achieved through a continual reliance on WTO rules as external leverage, with international rules serving as a substitute for domestic bureaucratic support. As a result, the “positive feedback” effects that reinforce institution-building were at best weak. One of the sources of positive feedback that might support institution-building is posited to be the channeling of incentives or resources to certain groups, which has the effect of generating new supporters of the policy reform (Pierson 1993). However, the (somewhat ironic) feature of reforms to build regulatory institutions in China is that these reforms were designed to remove the bureaucracy’s control over resource allocation. Supporters of regulatory reform in China, such as SAQSIQ and MOFCOM, are therefore weak precisely because they do not control substantial resources.
Another source of positive feedback to support institution-building might be the transformation of state capacities or skills (Pierson 1993). While the pool of technocratic knowledge and skills surrounding international trade institutions certainly expanded in the initial WTO period, the overall base of knowledge within the bureaucracy remains narrow and has arguably even declined over time. One interviewee explained that there has been a falling regard given to WTO-related issues in the training of new cadres, such that the new generation of local officials had neither knowledge nor appreciation for WTO rules. The interviewee pointed out that in part this was due to the marginalization of the WTO at the international level, which has led cadres to be more attentive to trade agreements such as the TPP and the Regional Comprehensive Economic Partnership (RCEP) (Interview B18). In contrast, the period running up to and immediately after WTO accession was accompanied by a minor “boom” in WTO-awareness training sessions and WTO-related academic events and publications. WTO Centers also were set up in Shanghai, Beijing and Shenzhen to provide technical support and services related to WTO legal and trade matters (Permanent Mission of China to the WTO 2011). The current state of affairs, however, was such that agencies such as MIIT and the NDRC did not take into account WTO rules or the need to comply with international obligations when setting industrial policies, and left MOFCOM to deal with any problems that might later emerge (Interview B22).

My interviews further highlighted the narrow support for economic liberalization and the continued reliance on external rules as leverage for reform. One interviewee noted that in the context of poor awareness and appreciation within the bureaucracy for WTO rules, dispute settlement cases were in a sense “good” for China as they prevented further marginalization of the WTO agenda within the government. Only when a complaint is filed at the DSM is there recognition of the WTO, and only
then can change be pushed via the implementing requirements after a panel ruling (Interview B18). Another interviewee explained that dispute and anti-dumping cases provided an opportunity for MOFCOM officials to engage in positive persuasion of other agencies on the importance of WTO rules, and to help spread the reform mindset within the bureaucracy. For example when a case is brought against China, it allows MOFCOM officials to engage with their counterparts in the industrial bureau of MIIT or the NDRC and make the case that WTO rules provide a level playing field for China to engage with its trading partners. These cases allow MOFCOM officials to stress to other agency officials that the WTO process is objective, and that those rules can in fact work in China’s interests because China can use the same measures against other countries, and in so doing protect its own interests (Interview B22).

Hence one important consequence of relying on external rules as a substitute for domestic support is that strategies to strengthen regulatory governance in China ended up being weakly supported domestically by a narrow coalition of actors such as SAQSIQ and MOFCOM. Because the main impetus for regulatory reform was external, the positive feedback effects that supported broader institutional reproduction within the central bureaucracy were relatively weak. As a result, support for regulatory governance not only did not spread, but other parts of the bureaucracy ended up becoming more opposed to, rather than supportive of, regulatory reform, as the next section will show.

**Losers and growing resentments generated from the WTO process**

Another dimension that fed into the rise of state capitalism is that the “losers” in each round of administrative restructuring did not go away. In the constant contest over shaping the rules of the game, these losers survive, and can rise again as circumstances change (Pierson 1993 Conran and Thelen 2016). There were many
such losers from Zhu Rongji’s 1998 round of government restructuring, chief among which were the industrial ministries that were subsumed under the SETC and the formerly influential SPC which was renamed the SDPC and “relegated to being a research institute” (Zheng 2004, p.97). Not only did the SDPC persist (albeit in diminished form), the developmentalist school of thought was actively being promoted and passed on to new generations of cadre members in economics curricula at places such as Renmin University, as Heilmann and Shih document in their 2013 study.

WTO entry further enlarged the group of “losers” within the bureaucracy. The substantial legal reforms that accompanied China’s WTO accession placed a new layer of legal constraints over what the bureaucracy could and could not do. In particular, the process of WTO implementation generated negative feedback effects that undermined the reform process by instilling grievances amongst important ministries in the central bureaucracy. As one interviewee recounted, Zhu Rongji’s approach of keeping negotiations restricted to a small set of people necessarily made agencies feel left out of the process. Yet when it came to having to implement WTO commitments, these same agencies were suddenly confronted with a set of substantial demands to execute (and which they had had no part in agreeing to). The fact that MOFCOM was in charge of the WTO implementation process further generated resentment among bureaucrats in those agencies that they were subservient to MOFCOM and had to work for MOFCOM (Interview B18).

An additional aspect of WTO entry that generated “negative feedback effects” and built up resentments among the losers of reform was the annual Transitional Review Mechanism (TRM) that assessed China’s WTO implementation process annually for eight years after accession and with a final one after ten years (WTO Protocol of Accession). This review mechanism was set up especially for China, and distinct from the WTO’s occasional Trade Policy Reviews of members’ trade and economic policies.
One interviewee pointed out that each TRM process generated many questions from China’s trading partners that the government then had to address. Hence agencies such as the Ministry of Agriculture, the SDPC/later the NDRC and the Ministry of Finance, usually used to operating domestically with absolute autonomy, suddenly found themselves having to account for their actions to an external audience. They were naturally unhappy with such “interference” and came to see the WTO implementation process as being opposed to their work, giving them more reasons to resist reform. The fact that the TRM was implemented just for China, combined with the other “WTO-Plus” commitments contained in China’s Protocol of Accession, generated grievances within the bureaucracy, as China’s “payment for entry” into the club was so much higher than for other countries. The interviewee pointed out that China’s bound tariffs were already much lower than most developing countries such as India and Brazil, and further China already had very little “water” in its tariffs (i.e. its applied tariffs are very close to its bound tariffs, unlike other developing countries). In short, the leadership-driven nature of China’s WTO accession combined with the large adjustment burden that the bureaucracy then had to undertake led to a backlash internally in the central government. Some even said that Long Yongtu (China’s chief negotiator for WTO accession) was a “traitor” and had sold out the country (Interview B18).

This hostility within certain quarters of the bureaucracy to international trade rules and scrutiny was further underscored by an incident recounted by an interviewee. He described how, when on an investigation visit to a coastal province in 2008 (seven years after WTO entry), the provincial head of the NDRC pounded his fist on the meeting table and said that MOFCOM was “selling out” the country, and that what

17See Chapter Two and Qin (2007) for a description of the “WTO-Plus” commitments that China signed on to.
he (the NDRC leader) said was what counted, that he (the NDRC) was in charge of the industry (and not anyone else) (Interview B22).

The process of joining the WTO and implementing China’s commitments, therefore, was one balanced on a very narrow set of bureaucratic constituents, pushed forward by leveraging on external rules as a substitute for domestic support. However, this very process generated the seeds for opposition in the future. The bureaucratic impetus to push back against reform only increased in the post-WTO era given that the agencies who were the ‘losers’ from the “double whammy” of the 1998 government restructuring and 2001 WTO entry did not go away, but in fact gained more reasons to mobilize through a series of negative feedback effects generated by having to adjust to China’s WTO commitments. The narrow base of support on which regulatory institutions was founded allowed strategic space for the “anti-WTO” coalition to build up rival institutions at a later point in time.

**Zhu Rongji’s developmentalism**

However, it would be a mistake to argue that stronger state intervention in the economy only arose after Hu and Wen took office, because the roots of this greater developmentalism were already being laid under Zhu Rongji’s premiership. Indeed, one of Zhu’s key achievements was in consolidating authority over industrial policy under the umbrella of the SETC. This allowed Zhu much more comprehensive control over what had heretofore been a piecemeal approach to governing China’s important industries, and established the SETC as “the most powerful coordinating organ in China” (Zheng 2004, p.105). As Barry Naughton pointed out, “Zhu has been a centralizer, as well as a reformer” (Naughton 2002). The purpose of this consolidation was to establish a Chinese equivalent to Japan’s MITI, to drive development forward and make state policy for development more coordinated, more efficient and more
effective (Zheng 2004; Heilmann and Shih 2013 p.105). The SETC’s stronger developmentalism (compared to the SPC/SDPC) in the years when Zhu Rongji was in charge of the economy (1993 to 2003) has also been previously shown in Figure 5.12 in Section 5.3.3.

The immediate task of the newly empowered SETC in 1998 was in making progress on SOE reform. Here, Zhu’s agenda needs to be carefully examined. His SOE reform agenda is commonly captured through the phrase of “grasping the large, letting go of the small” (zhudda fangxiao). This meant shutting down, merging or privatizing small and medium SOEs, while consolidating and modernizing the enterprise management systems of the large ones. Therefore on the “letting go of the small” side of the agenda, a great amount of reform and liberalization occurred under Zhu Rongji’s watch (Lardy 2014 p. 45 to 46). The SETC’s approach to governing industries also became more regulatory. As part of broader efforts to clarify state-enterprise relations, the SETC implemented reforms in corporate governance to grant more enterprise autonomy across the board (Yang 2004 p. 41). On the parallel goal of “grasping the large”, Zhu’s objective was to build up large, globally competitive “national champions” similar to those found in Japan and South Korea. In his report on the outline of the Tenth Five-Year Plan delivered in 2001 (the same year of China’s WTO accession), Zhu emphasized economic priorities that were to be implemented alongside WTO-driven reforms. These included encouraging the establishment of “large companies and enterprise groups” in major industries that would become “pillars” in industrial advancement, as part of a “going out” strategy to increase overseas investments and expand the international operations of Chinese enterprises (Zhu 2001). In other words,

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18See also Huang (2008), who argues that Jiang and Zhu reversed the trend of policy liberalism in the 1980s when they took over, reverting to policies that systematically favored the urban areas and industrial sectors, and which provided privileged terms for foreign investment at the expense of domestic entrepreneurship.
Zhu Rongji’s economic strategy was to establish a stronger, more coordinated and more effective developmental state *in parallel with* introducing greater market forces into the economy.

Hence Zhu Rongji’s SOE reform efforts are not easy to categorize, because they contain elements of both regulatory and developmental strategies. Part of the “grasping the large” agenda, after all, included regulatory reform such as the separation of government from enterprises to improve enterprise autonomy, improving management transparency and placing SOEs under greater pressure from market forces (Zhu 2015, p.203). Such reforms can easily be interpreted as initial steps on the path to eventual privatization. However, complete privatization of the economy was never an end goal in this reform effort (Naughton 2002). Jung (2006) has noted that Zhu was in fact an opponent of privatization, while Zeng Peiyan, head of the SDPC was in support of it (see Zeng’s statements in 2002 supporting private enterprises and declaring that SOEs and private enterprises ought to compete on a level playing field (Mao 2002)). As Naughton (2002) has pointed out, Zhu Rongji’s stance on economic governance has never been completely market driven nor completely statist: “Rather the two are seen to check and reinforce each other”.

In short, a more centrist developmental strategy was slowly being consolidated by Zhu Rongji even before the leadership change in 2003. While the formation of SASAC is often cited as an indication of the rise of Chinese state capitalism in the Hu-Wen era (see earlier quote from the USTR report earlier, as well as Lardy (2014); Milhaupt and Zheng (2014)), the agency was not born out of thin air. The bureau in the SETC in charge of SOE management was essentially carved out and formed into SASAC along with parts of other agencies such as the Ministry of Finance and the Organization Department, consolidating governance authority over SOEs that had heretofore been scattered across multiple agencies. The head of SASAC, Li Rongrong, was also the
head of the SETC immediately before it was abolished (China Vitae nd). Moreover, the policies enacted by SASAC to govern SOEs are broadly consistent with Zhu’s “grasping the large” strategy. This strategy aimed to improve corporate governance by clarifying the role of the government and to strengthen the efficiency of the SOEs by strengthening their profit function, while consolidating the enterprises to be globally competitive (Naughton 2003b; Brodsgaard and Li 2014). Hence, the succession of Wen Jiabao to replace Zhu Rongji as Premier and the administrative restructuring in 2003 to establish SASAC may not be a fully discontinuous “break” from policies in the Jiang-Zhu era. Why, then, did developmental policies become more overtly dominant only around 2006 and not during the Zhu Rongji era? Part of the reason was that the SETC’s immediate policy priority during the Zhu era was SOE reform that comprised of equal parts statism (“grasping the large”) and liberalization (“letting go of the small”). The other reason was the change in party-state relations in 2002-3, which the next section will discuss.

5.4.2 Hu-Wen Era: State as constituency under weak WTO leverage

The most important change that the transfer of leadership authority from Jiang Zemin and Zhu Rongji to Hu Jintao and Wen Jiabao in 2002-3 brought about was not a change in preferences at the top, but rather the shift in the political relationship between party and state.

In contrast to Zhu Rongji, who spent 21 years outside of Beijing and 16 in the central bureaucracy before being appointed to the PBSC, Wen Jiabao started his career with 15 years in Gansu province doing geological and survey work, slowly rising in the provincial Geological Bureau, before being posted to Beijing in 1982. From then
on, he spent a continuous 21 years rising through the central bureaucracy, moving from the Ministry of Land Resources to the politically important and sensitive Central Committee General Office, and then on to the Party Secretariat and Politburo, before being elevated to the PBSC in 2002. Due to his fairly low rank during his time in Gansu, Wen may not have developed very strong ties in that province, in contrast to other leaders who spent time in provinces as either governors or party secretaries. Notably, Wen was the only PBSC member during his time to have had no experience with heading a province (Naughton 2003a). As a result, most of Wen’s network of support would have been deeply embedded within the central state.

In contrast to Jiang Zemin, who spent only approximately nine of his career prior to the PBSC in positions in the central state, Hu Jintao spent between 15 to over 17 years in Beijing prior to being appointed to the PBSC. He began his CCP career in 1964 as a political instructor in Tsinghua University in Beijing, and then spent the next 15 years in Gansu province first in a local bureau of the hydroelectric power ministry, followed by various positions in the Gansu provincial government. He spent a year in Beijing in 1980 at the Central Party School, and in 1982 was appointed to leadership positions in the Communist Youth league. In 1985, Hu was appointed to the position of Party Secretary of Guizhou province, and then as Party Secretary of Tibet in 1988. According to reports, he spent only a year and a half of that four year posting physically in Tibet, and the rest of the time in Beijing (Brown 2012, p.17). In 1992, he was appointed to the Politburo Secretariat, and in 1997 to the PBSC. Altogether Hu Jintao spent between 15 to over 17 years in Beijing and between 18 and 21 years outside of the capital prior to joining the top leadership. Hu’s political networks, therefore are likely to be more evenly divided between the central bureaucracy and the provinces. However, he clearly rose to the General Secretary positions with far deeper networks in the central bureaucracy
compared to his predecessor Jiang Zemin.

Other scholars have pointed to features of the leadership transfer from Jiang to Hu at the 16th National Party Congress in 2003 as revealing of the latter’s political weakness. For example, while Hu took over two out of three of the top leadership positions in 2002 and 2003 (General Secretary of the Central Committee and President of the People’s Republic of China), Jiang held on to the party chairmanship of the Central Military Commission until 2004. The PBSC was further expanded from seven to nine members, with the two additional members said to be strongly allied with Jiang. Finally, the Congress marked a victory for Jiang rather than for Hu by formally endorsing Jiang’s “Three Represents” in the Party Charter (Fewsmith 2003; Mulvenon 2005; Duchatel and Godement 2009; Ewing 2003). More recently, scholars have pointed out that while Jiang Zemin and Xi Jinping (Hu’s successor) were both given the designation as being the “core” of the party’s collective leadership, that term was never associated with Hu. That Hu never attained “core” status has been taken to reflect his political weakness (Miller 2016).

In addition to these political vulnerabilities, the new leadership team of Hu and Wen were further hobbled by their deep networks embedded within the central state. These ties meant that they could not discipline the bureaucracy without simultaneously hurting members of their own network. Instead, they had to rely on the state as a key constituency for their political strength. While this concept of embeddedness is difficult to measure, one way to compare this aspect of the two leadership teams is to assess the degree to which each was able to carry out their administrative restructuring plans. On this score, Wen Jiabao’s 2003 restructuring was far less successful than that of Zhu Rongji. At the start of his premiership, expectations were high that, due to his deep experience operating in the central state, that Wen would be off to a “fast start” (Naughton 2003a). In early 2003, media reports on Wen’s restructuring
suggested that the number of ministries would be cut from 29 to 21 or 22. However, the restructuring that finally emerged only reduced the number of agencies from 29 to 28, suggesting that Wen Jiabao was unable to overcome bureaucratic resistance to his goals (Miller 2003).

Hence while both the Jiang-Zhu and Hu-Wen periods have been described as periods of centralization, the two periods were in fact different types of centralization. Under Jiang and Zhu, the party disciplined the state and pushed reforms to make the central state more efficient and streamlined. Under Hu and Wen, the party relied on the state, leading the central state to be able to strengthen its control over industrial policies through a period of sustained activism. One interviewee affirmed this view, pointing out that industrial policies were more coherent after 2003 because Wen Jiabao was weaker and therefore needed to work through central agencies (Interview B26). Wen Jiabao’s reliance on the state bureaucracy can been seen by his “consensual approach” to policymaking, which some have criticized as resulting in “diffuse and uncoordinated” governance (Naughton 2007b, 2008).

The shape and content of industrial policy in the Hu-Wen era, therefore, tended to be driven by the bureaucracy rather than by the political leadership. The change in party-state relations meant that the “losers” from WTO entry – faced with a low likelihood of sanction from party leaders and little opposition from rival agencies due to the weakening of WTO leverage – were able to consolidate their position and engage in rival institution-building, advocating for a more developmental approach to governing the economy. Not only were the seeds of this developmentalism already planted within Zhu’s SETC when it came to SOE reform, the backlash within the bureaucracy from having to implement China’s WTO commitments meant that these ‘losers’ were primed to advocate for and support alternative governing institutions when the opportunity arose.
Regulatory agencies were unable to push back against this due to the narrow base of support for liberalizing reforms, and the gradual decline in WTO leverage over time. One interviewee noted that in order to facilitate negotiations, a coordinating body headed by a Vice-Premier (who ranks above ministers) was established to overcome opposition from various quarters in the bureaucracy. This coordination body was abolished in the post-accession period, leaving pro-liberalization agencies such as MOFCOM without the higher-level authority needed to push reform forward. The interviewee noted that unlike the USTR’s office in the United States which has a direct reporting relationship to the President, MOFCOM was weak within the Chinese bureaucracy and did not have as much influence as the NDRC (Interview B18).

The heightened state of bureaucratic activism in industrial policies during the Hu-Wen era can be observed in Figure 5.13 showing the number of regulations issued per year in the main central agencies in charge of industrial policy: the SETC, NDRC and MIIT. The number of regulations issued each year by the State Council is also included as a benchmark. From the figure, we can observe that while the number of State Council regulations does not change too much over the years, the post-WTO period is associated with much more intense policy activity. In particular, there is a surge in NDRC regulations after 2003 when the administrative restructuring abolished the SETC and responsibilities over industrial policies shifted back to the NDRC. There is another, even more intense surge in policy activity after another round of restructuring in 2008 when the MIIT is formed to take charge of industrial policy in developing China’s information technology capabilities. These trends provide evidence in support of the argument that developmental agencies took on a much more activist stance in the Hu-Wen era.
Figure 5.13: Number of sector-specific regulations issued per year by agency

Source: Author’s dataset
The bureaucracy’s heightened activism in the Hu-Wen era can be seen another way. Figure 5.14 shows the summed up proportion of developmental language in the industry policies issued by all three developmental agencies (NDRC, SETC and MIIT) in the reform period. While the increases in developmental language pre-2003 have tended to be “spiky”, the Hu-Wen years ushered in an era of consistently, steadily increasing developmentalism. This trend indicates the presence of a much more active central bureaucracy, one that is steadily pushing its developmental agenda rather than responding to the decisions of the political leadership (which might produce more “spiky” trends in policy language).
Figure 5.14: Proportion of developmental words in regulations from NDRC, MIT and SETC

Source: Author's dataset
5.5 Conclusion

While trade liberalization is commonly expected to strengthen market forces, leading to a “retreat” of the state, this chapter has shown that WTO entry has led counter-intuitively to a strengthening of the central state and an enhanced dualism: the rise of both regulatory and developmental policies, at different moments in time. Rather than a uniform convergence to liberalization, WTO entry has intensified the contestation within the central state over how to govern the economy, leading to rival institution building.

I have shown that the efficacy of relying on external rules as credible commitment to reform depends on the political relationship between the party leadership and the state bureaucracy, and the durability of the leverage to be gained from the external rule. This explanation highlights the importance of placing the politics of responses to international rules within a broader context of power relations, particularly in authoritarian regimes. While developed democracies tend to have a more stable relationship between political parties and the state defined by formal institutions, the nature of the relationship between the political elite and bureaucracy can have important consequences for the pattern of policy responses to external rules in non-democratic contexts.

While recent literature on authoritarian durability has focused on the “infrastructural power” of the state, this chapter has demonstrated the importance of contextualizing the political relationship between party and state. One benefit of such a framework is that it allows us to observe patterns of politics different from those that usually characterize China. For example, one theory of institutional change in China is that the party-state cycles through periods of centralization, decentralization and re-centralization ([Skinner and Winckler 1969], [Perkins 2015], [Shih 2008]). This frame-
work has lost its utility in recent years, since the Jiang-Zhu, Hu-Wen, and current Xi Jinping eras have all been characterized as periods of centralization. This chapter has shown that the Jiang-Zhu and Hu-Wen eras actually consisted very different types of centralization, thereby raising the possibility of a different type of cyclicality in Chinese politics: that of whether the state acts as an agent or a constituent of the party.
6 | The Quest for National Champions

6.1 Introduction

While the previous chapters have explored the sources of variation in state strategies across administrative levels and within the central state, I turn now to variation in strategies for governing industries. One major implication of the findings presented in the last two chapters is that entry into the WTO has generated greater policy contradictions and incoherence in the governance of any given industry. In the post-WTO era, with various levels of government and central agencies adopting different strategic responses to the WTO, why is there greater policy divergence from the central government’s goals in some industries compared to others?

I propose that while WTO entry has strengthened the central government’s desire to foster globally competitive national champions, trade liberalization impedes the ability of the central government to achieve this goal. Although both central and subnational states seek to enhance economic growth, their divergent political interests lead the two actors to deploy different strategies within industries, thereby exacerbating policy incoherence. While this tension has always been present in China’s political economy, WTO-led liberalization simultaneously enhances the access of subnational states to external resources in the form of foreign direct investment (FDI) and export markets, thereby strengthening the ability of these subnational actors to
bypass central policy. This takes place precisely at a time when the center wishes to tighten its national policy coordination in order to consolidate the positions of its national champions.

I begin by discussing how the central government has responded to WTO entry with a renewed desire to foster globally competitive national champions across a range of industries. I then put forward an argument for why strategies enacted by the central and subnational states vary across industries, focusing in particular on how subnational access to external resources has generated greater divergence. In testing the factors driving policy divergence across industries, I first employ quantitative tests to examine why central versus subnational governments focus their policy activism on different industries. I then turn to a comparative case study of the automotive and semiconductor industries to unpack the causal mechanisms behind why the central government’s goal of technology transfer is thwarted by FDI liberalization. Finally, I turn back to two sets of quantitative tests to assess the factors that determine the success of the central government’s national champions policy, and whether this policy has been effective in enhancing productivity.

6.1.1 WTO Entry and the Renewed Push for National Champions

While China’s leaders sought to use WTO rules to drive regulatory reforms and liberalization in the domestic economy, they also decided that an important strategic response to this global engagement needed to be to foster a group of globally competitive ‘national champions’ (i.e. large conglomerates), across a range of industries. This

\[1\]While Chapter Four differentiated between three levels of government, this chapter simplifies the analysis by just comparing the interests of the central versus subnational (i.e. provincial and local) states.

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dual objective – of liberalization combined with building national champions – was articulated at the top levels of the state. For example, then-Premier Zhu Rongji was a key driver of China’s accession to the WTO and made critical liberalizing concessions in order to bring the US-China agreement on WTO accession to a close. However, in his report on the outline of the Tenth Five Year Plan delivered in 2001 (the same year of China’s WTO accession), Zhu emphasized the need to establish “large companies and enterprise group”, which would serve as “pillars” in China’s “going out” strategy (Zhu 2001). 

Importantly, Zhu emphasized that this consolidation exercise would not be possible without domestic reforms to curb excess investment at subnational levels. In his same report, he noted the importance of “oppos(ing) local protectionism” and eliminating regional barriers so as to build an “integrated national market system that is standardized and encourages fair competition”, as well as the need to “strengthen the mechanisms for restraining investment.” The pervasiveness of the tendency in the Chinese economy towards over-investment and excess capacity was such that the need to consolidate and restructure enterprises on the eve of WTO entry could be found across a diverse range of industries. To illustrate this point, I present in the Appendix of this chapter short examples of how the central government responded to WTO entry with similar consolidation drives to build national champions in three very different industries: tobacco, automobiles and textiles. Clearly, Zhu’s quest to restructure China’s industries and build national champions would require substantial cooperation from subnational governments. Yet the assistance of subnational governments could not be guaranteed, given the distinct factors driving their political behavior.
6.2 Explaining Policy Divergence across Industries

What affects the degree to which subnational strategies for industry governance deviate from those preferred by the central government to foster “national champions”? I argue that while WTO trade liberalization intensified the central government’s desire to consolidate and foster globally competitive national champions, WTO entry itself exacerbated the central government’s coordination problem. In general, the central state’s ability to discipline subnational states is hobbled by imperfect monitoring and weak enforcement mechanisms. This allows for subnational states to adopt divergent policies without being punished by the central state.

Moreover, competition for different types of bureaucratic advancement affects the strategies that central versus subnational states adopt across various industries. I argue that the central state as a whole is deeply concerned with the continued political durability of the CCP. Therefore it treats economic growth as a means to regime promotion and focuses on raising the long term viability of the economy by focusing on value-added growth while defending state assets in strategic sectors. In contrast, the subnational state treats economic growth as a means to rank promotion and seeks to maximize short term growth rates in order to boost its chances of promotion up the CCP hierarchy (Yao and Zhang 2015). It therefore seeks to maximize economic growth in the immediate term while defending shocks to employment and social stability. While these center-subnational tensions have always been present in the Chinese political economy, WTO-led liberalization introduces new external resources and threats that exacerbates the divergence between central and subnational

\[2\text{While in other parts of the dissertation I disaggregate the central state into the party leadership and central bureaucracy, or agencies within the central bureaucracy, here I am referring to the central state that includes the top party leadership.}\]
goals, leading to differing strategies being adopted across different industries. As I noted in Chapter Five, the growth of regulatory policies from the central state that immediately followed China’s WTO entry was eventually superceded (from around 2006 onwards) by more activist developmental policies. Accordingly, this chapter focuses on the state’s overt types of intervention to foster national champions, and specifically on what drives the adoption of developmental versus directive strategies by central and subnational governments.

(a) The central state: Growth as a means to regime promotion. The central state is made up of politicians deeply concerned about the continued political survival of the CCP. As a result, I argue that its deployment of state strategies across industries in the WTO era is driven by the following two concerns:

(i) Long-term view of growth via technological upgrading. The central state takes a long-term view of economic growth and sees technological advancement as a fundamental condition for the sustained vitality of the Chinese economy. It is therefore interested in harnessing advanced foreign technology made available by WTO entry, so as to move the Chinese economy up the value-added chain.

(ii) Securing the party-state via control over core assets. The central state also views control over the economy as vital to its long-term political survival. This means establishing ownership and consolidating party assets in sectors deemed to have national strategic value that are considered to be ‘economic lifelines’ and protecting such sectors from import competition.

Therefore with WTO entry, the central state seeks regime promotion by maximizing access to new foreign technologies made available through globalization, while
protecting core state assets from being eroded by international competition or privatization. The central state is therefore likely to focus its developmental strategies on industries that are technology-intensive, while deploying directive strategies to protect state ownership from declining in sectors that represent ‘economic lifelines’ for the party.

(b) The subnational state: Growth as a means to rank promotion. The subnational state is led by politicians (e.g. Party secretaries) who are deeply interested in outcomes within their jurisdiction that boost their chances of promotion up the CCP hierarchy. This focus on advancement up the ranks shapes subnational state strategies in the WTO era as follows:

(i) Short-term view of growth via investment and exports. The advancement imperative leads subnational states to adopt a short-term view of growth. Thus with WTO entry, subnational states aim to attract the largest amount of capital and export revenue that will produce the highest amount of GDP growth within the shortest amount of time. The potential specific benefits that FDI offers in terms of technology transfer and innovation are, in relative terms, less important. This bias arises partly because developing high-tech innovation capabilities with commercial applications entails higher risks and often longer times to secure profitability, and might also generate cross-jurisdictional spillovers that subnational leaders cannot internalize.

(ii) Securing social stability via employment maximization. For subnational officials, advancement also depends on demonstrated success at job creation (and conversely, at protecting social stability by defending against job losses). Hence, subnational states will concurrently seek to maximize
employment in sectors that have a comparative advantage in trade liberalization, while defending employment in sectors that are under threat from import competition.

Hence, WTO entry provokes subnational states to seek rank promotion by maximizing investment, export earnings and employment through direct access to FDI and export markets, while protecting against unemployment in sectors exposed to import competition. Therefore subnational states are likely, in the WTO context, to adopt more developmental policies in sectors that provide greater access to foreign capital and export markets, while deploying directive strategies in sectors threatened by import competition.

These divergent preferences over which industries to focus on and what strategies to deploy generate the potential for conflict with the central state over policy direction. While center-local relations have always complicated investment and industrial policies in China (Pearson 1991; Huang 1996), WTO entry led to a much more liberalized environment for foreign technology and capital, as well as direct access to export markets. Therefore in an age where policy coordination is more important than ever to the central state, it is thwarted in precisely the new economic conditions created by WTO entry.

The observable implications of this theory are as follows:

1. If the central state seeks to maximize access to foreign technology, it is likely to be more active in developmental strategies for industries for which FDI is being encouraged in its official policies (I show in Section 6.3.2 that the industries with the highest degree of FDI encouragement are all high-tech sectors).

2. If the central state seeks to protect state assets from import competition, it
is likely to be more active in directive strategies for industries for which SOE ownership is declining.

3. If the subnational state seeks to maximize foreign capital and export earnings, then it is more likely to be active in developmental strategies for industries with direct access to FDI or export markets.

4. If the subnational state seeks to maximize employment, then it is more likely to be active in developmental strategies for industries with increasing employment shares, and in directive policies for industries with falling employment or output shares.

6.2.1 Methodology

I combine quantitative and qualitative methods in testing the hypotheses presented in this chapter. In the quantitative section, I first test the observable implications of my claim that central and subnational governments pursue different strategies in across industries, by constructing a measure of relative policy activism between central and subnational states. I then examine how industry characteristics and access to external resources affects this relative policy activism.

In order to analyze the causal processes at work in the center-local politics of governing industries, I present two case studies of the deployment of FDI policies in the automobile and semiconductor industries. This is combined with the short case studies presented in the Appendix of the tobacco, textiles (and automobiles again) industries. The rationale for selecting these four industries is that they vary in terms of their level of technology and degree of trade liberalization (see Figure 6.1). In putting these case studies together, I relied on official speeches of government ministers and industry officials, annual reports from industry yearbooks that often summarized major
events and concerns of the industry, regulations and policies issued by various government agencies as well as articles from newspapers and industry-related journals. I further conducted interviews with Chinese and foreign industry managers, journalists on the business beat, industry association representatives, academics and members of semi-official think tanks such as the Chinese Academy of Science. Given the national scope of my study, most of the interviews were conducted in Beijing, where there are more industry associations and where firms tend to locate their government-relations managers. Additional interviews were held in Shanghai, Jiangsu, Guangdong and Yunnan.

In the final section of the chapter, I turn to an analysis of how policy divergence affects the success of the central government’s ‘national champions’ policy, using a Herfindahl index of industrial concentration for measuring the degree to which an industry is dominated by large ‘champion’ conglomerates. I then test the effectiveness of the national champion strategy by regressing industry characteristics on sectoral productivity.
6.3 Testing Sources of Policy Divergence

6.3.1 Measuring Relative Policy Activism

To assess the degree of policy divergence for a given sector, I construct a measure of relative policy activism using the data on topic proportions introduced in Chapter Four, where two topics from the set of topics generated using the dataset of industry regulations were selected to represent each of the competing strategic approaches to economic governance. I measure whether the central or subnational government is more active in deploying a particular strategy for an industry by first adding up the topic proportions of the two topics in each strategy, and calculating the occurrence of each strategy as a share of the sum of the topic proportions of all six strategies for each industry, for the central and subnational levels. Hence if the central government for example issued regulations for an industry in a year that was equal parts developmental, directive and regulatory, then the share for each of these strategies would be 1/3 for that industry that year. One important consideration surrounds whether the difference between central and subnational strategies in the same year represents a good measure of relative policy activism. To capture the possibility that subnational governments do respond to changes in central state policies, but with a time lag, I allow the difference between central and subnational policies to be lagged by one year[^3] Therefore the measure of relative policy activism is arrived at by taking the simple difference of the share of each strategy between the central government at time $t$ and subnational governments at time $t+1$.

[^3]: For analytical simplicity, I do not consider the scenario where the central state is also responding to changes in subnational policies.
tively more emphasis on a given strategy for that industry compared to subnational
governments, whereas a negative value means that the subnational state placed rela-
tively more emphasis on that strategy for that industry. Zero values or values close
to zero imply little difference between the two levels of government in their emphasis
on a strategy for an industry.

Figure 6.2 shows change over time in the relative policy activism in the develop-
mental strategies of two industries: tobacco and textiles. As described in the Ap-
pendix, the two industries are organized very differently. While the tobacco industry
is entirely state-owned and governed vertically by a national monopoly, the textiles
industry is highly decentralized and privatized. As such, we can observe in Figure 6.2
that subnational states are highly active in developmental policies in textiles relative
to the central state, reflective of the decentralized structure of the textiles industry.
In the centralized and state-owned tobacco industry, in contrast, the policy activism
measure is almost always higher than zero, indicating a persistent central dominance
in setting developmental policies for that sector.

6.3.2 Estimation and Explanatory Variables

Using this industry-specific measure of relative policy activism as the main out-
come of interest, I employ a difference-in-difference estimation strategy for 104 indus-
try sectors over 10 years (1998 to 2007) to test how changes in industry characteristics
affect which strategies central or subnational states employ to govern an industry, and
their relative activism in that governance. I include the following explanatory vari-
ables in the estimation:

Industry Characteristics:

• Industry tariff levels (inverse): In order to take into account the impact of WTO-
led liberalization, I include industry-specific tariff levels. In order to improve interpretability, the variable is inverted, such that a positive coefficient implies an increase in central policy activism in response to a decline in tariff levels.

- Industry share of output: Industries that represent a large share of the national economy are likely to be considered strategically important to the central government’s interests. If so, an increase in the size of an industry would be correlated with greater developmentalism from the center, while a fall in output would provoke the central government to deploy more directive strategies to that industry.

- Industry share of employment: This variable is included because maintaining social stability is important to the performance evaluation of subnational government officials. As such, a fall in industry employment is likely to trigger greater directive strategies from subnational governments relative to central
ones. In contrast, an increase in employment (reflective of a growing industry) might trigger subnational governments to deploy more developmental strategies to maximize the benefits to subnational growth in that industry.

- Industry share of SOE output: An industry’s share of SOE output is included as a proxy for the degree to which the central state desires to maintain state assets in a particular industry. Therefore a rise in the SOE output share might be correlated with an increase in developmental strategies on the part of the central government relative to subnational governments, while a decline in SOE output share might be correlated with a relative rise directive strategies on the part of the central government.

**Subnational Access to External Resources:**

- Subnational share of FDI: In order to measure the degree to which subnational governments gain direct access to foreign capital as a result of WTO entry, I construct a measure capturing the foreign capital share of total registered capital for firms registered at subnational levels of government (province, prefecture, county). If access to foreign capital affects the policy behavior of subnational governments, then we would expect an increase in subnational shares of foreign capital to be correlated with relatively stronger developmental strategies at the subnational level.

- Subnational share of exports: I capture the degree of subnational access to export markets by creating a measure of exports by firms registered at subnational levels as a share of national exports. If direct access to export markets leads subnational governments to intensify their developmental strategies, then an increase in this measure would be correlated with relatively stronger subnational
developmentalism, while a fall in subnational exports might lead to an increase in directive strategies at the subnational level.

Central Regulation over Investment:

The central government might also have policies in place to try to mitigate subnational deviation from its preferences. One way the central state tries to achieve this goal is via the Industrial Guiding Catalogue on Foreign Investment issued by the NDRC, which classifies various industries into different categories of FDI permisiveness, from “Encouraged” to “Allowed”, “Restricted” and “Prohibited”. In addition, specifications are made as to when FDI has to be in the form of joint ventures or when the Chinese side has to hold controlling shares of equity.

As such, I include two variables capturing measures through which the central government tries to exert policy guidance over the governance of industries it deems important to national interests. The variables are drawn from a new dataset quantifying the various investment classifications for all manufacturing industries listed in the NDRC’s Guiding Catalogue.

- Central FDI encouragement: this variable captures the degree to which an industry is categorized as one for which FDI is “encouraged” in the central government’s Industrial Guiding Catalogue for Foreign Investment. If subnational governments seek to maximize FDI to improve their promotion prospects, we would observe relatively stronger developmental strategies at subnational levels, for industries that have a higher central “encouragement” score (and for which the FDI environment would therefore be relatively more liberalized). Table 6.1 shows the top ten industries for which FDI is encouraged by the central government.

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4I follow the approach adopted by Zhu (2012) in measuring the degree to which the central government encourages investment in an industry.
Table 6.1: Top ten industries for which FDI is officially encouraged

<table>
<thead>
<tr>
<th>Industry code</th>
<th>Industry name</th>
</tr>
</thead>
<tbody>
<tr>
<td>261</td>
<td>chemicals</td>
</tr>
<tr>
<td>375</td>
<td>ship-building</td>
</tr>
<tr>
<td>376</td>
<td>aerospace</td>
</tr>
<tr>
<td>401</td>
<td>communications equipment</td>
</tr>
<tr>
<td>266</td>
<td>special chemical products</td>
</tr>
<tr>
<td>331</td>
<td>non-ferrous metal smelting</td>
</tr>
<tr>
<td>314</td>
<td>technical &amp; optical glass</td>
</tr>
<tr>
<td>368</td>
<td>medical equipment and devices</td>
</tr>
<tr>
<td>369</td>
<td>special equipment</td>
</tr>
<tr>
<td>412</td>
<td>special instruments</td>
</tr>
</tbody>
</table>

Source: Author’s dataset

- Central Controlling Equity Rule: this variable captures whether or not the central government, in the Guiding Catalogue, has additionally imposed a rule that the Chinese side must maintain a controlling equity stake for any FDI entering that sector. Higher values for this measure indicate a stronger desire on the part of the central government to protect state assets in a particular industry. Hence, we might expect this variable to be positively correlated with stronger directive strategies. Table 6.2 shows the top ten industries with the highest score for this controlling equity rule.

As I noted in Chapter Five, policy making within the central state is often riven by inter-agency divisions. A single industry might be governed at the central level by a multiplicity of agencies, leading to a fragmentation of strategies deployed by the government.

---

5 As these industries are coded at the 3 digit level, it includes equity rules for industries at the 4-digit level and even finer levels of specification. For example, not all aspects of the motorcycle industry are subject to the controlling equity rule. Rather, the rule applies to motorcycle engines, arguably the part of the vehicle with the most advanced technology.
Table 6.2: Top ten industries for which there is a controlling equity rule for FDI

<table>
<thead>
<tr>
<th>Industry code</th>
<th>Industry name</th>
</tr>
</thead>
<tbody>
<tr>
<td>376</td>
<td>aerospace</td>
</tr>
<tr>
<td>375</td>
<td>ship-building</td>
</tr>
<tr>
<td>401</td>
<td>communications equipment</td>
</tr>
<tr>
<td>372</td>
<td>automotive</td>
</tr>
<tr>
<td>373</td>
<td>motorcycle</td>
</tr>
<tr>
<td>152</td>
<td>wine</td>
</tr>
<tr>
<td>291</td>
<td>tire</td>
</tr>
<tr>
<td>271</td>
<td>drugs</td>
</tr>
<tr>
<td>331</td>
<td>non-ferrous metal smelting</td>
</tr>
<tr>
<td>251</td>
<td>refined petroleum products</td>
</tr>
</tbody>
</table>

Source: Author’s dataset

central state. An industry governed cohesively by a single agency, however, might more clearly be driven by central rather than subnational policy activism.

- Central cohesion: To assess if the degree of “central cohesion” affects the relative policy activism of central versus subnational states, I use the Herfindahl index to create a measure of the degree to which regulations for a given industry are issued by one dominant agency or a large diversity of agencies. If the involvement of multiple agencies in policy-making leads to incoherence, then we might expect an industry with stronger central cohesion in policy-making to have stronger central policy activism.

One challenge to consider in the estimation is that relative policy activism can both be a result of and have an effect on industry characteristics. For example, if more active central policies lead to faster growing industries, then the dependent variable might affect some of the covariates such as output and employment shares. To deal with this issue, the estimations are run with all the explanatory and control variables lagged by a year. All estimations additionally include industry fixed effects, to capture time-invariant industry characteristics that might affect policy activism,
as well as time fixed effects to capture year-specific shocks or trends affecting all industries over time that might have an effect on policy activism. Standard errors are clustered by industry, as the industry-specific observations are likely to be correlated over time.

6.3.3 Results and Findings

Table 6.3 below shows the regression results for the estimations with relative policy activism in the developmental and directive strategies. A positive coefficient on a variable indicates greater central government activism, while a negative coefficient indicates greater subnational government activism.

Factors affecting relative activism in developmental strategies

The first notable finding in column (1) is that an increase in industry output share is correlated with relatively more active developmental strategies from the central government. This suggests that the central government treats the largest industries in the economy as strategically important to promote.

Second, there is evidence that changes in industry employment shares are correlated with changes in relative policy activism. Column (1) shows a negative coefficient on the employment share variable, indicating that an increase in employment for an industry is correlated with a decline in the relative policy activism variable for developmentalism – in other words, a move towards greater subnational activism in developmental strategies. This finding indicates that subnational governments are active in promoting employment, revealing their concerns with managing social stability in their jurisdictions.

Contrary to one of the predictions made in Section 6.2, there is no evidence that subnational access to export markets has any effect in shifting relative policy activism
<table>
<thead>
<tr>
<th></th>
<th>Developmental Strategies</th>
<th>Directive Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Tariff (Inverse)</td>
<td>-0.0060</td>
<td>0.0088***</td>
</tr>
<tr>
<td></td>
<td>(0.0048)</td>
<td>(0.0043)</td>
</tr>
<tr>
<td>Industry output share</td>
<td>11.6465*</td>
<td>-1.4744</td>
</tr>
<tr>
<td></td>
<td>(6.5815)</td>
<td>(3.5796)</td>
</tr>
<tr>
<td>Industry employment share</td>
<td>-24.2307**</td>
<td>9.1729</td>
</tr>
<tr>
<td></td>
<td>(11.6199)</td>
<td>(7.1041)</td>
</tr>
<tr>
<td>Subnational exports share</td>
<td>-0.2398</td>
<td>0.1356</td>
</tr>
<tr>
<td></td>
<td>(0.3411)</td>
<td>(0.2579)</td>
</tr>
<tr>
<td>Subnational foreign capital share</td>
<td>-0.2766*</td>
<td>0.0491</td>
</tr>
<tr>
<td></td>
<td>(0.1451)</td>
<td>(0.1143)</td>
</tr>
<tr>
<td>SOE output share</td>
<td>0.7667*</td>
<td>-0.4624</td>
</tr>
<tr>
<td></td>
<td>(0.4369)</td>
<td>(0.3702)</td>
</tr>
<tr>
<td>Central FDI encouragement</td>
<td>-0.0143*</td>
<td>0.0166**</td>
</tr>
<tr>
<td></td>
<td>(0.0081)</td>
<td>(0.0075)</td>
</tr>
<tr>
<td>Central Controlling Equity Rule</td>
<td>0.0372</td>
<td>0.0020</td>
</tr>
<tr>
<td></td>
<td>(0.0715)</td>
<td>(0.0504)</td>
</tr>
<tr>
<td>Central Cohesion</td>
<td>-0.0401</td>
<td>0.1121*</td>
</tr>
<tr>
<td></td>
<td>(0.0647)</td>
<td>(0.0622)</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th></th>
<th>Developmental Strategies</th>
<th>Directive Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Year fixed effects</td>
<td>yes</td>
<td>yes</td>
</tr>
<tr>
<td>Industry fixed effects</td>
<td>yes</td>
<td>yes</td>
</tr>
<tr>
<td>Observations</td>
<td>361</td>
<td>361</td>
</tr>
<tr>
<td>R²</td>
<td>0.0614</td>
<td>0.1571</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.0466</td>
<td>0.1192</td>
</tr>
</tbody>
</table>

*Note:* *p<0.1; **p<0.05; ***p<0.01

Standard errors clustered by industry
All explanatory variables lagged by one year
either towards or away from the central or subnational states. However, there is evidence that subnational access to foreign capital has a consequential impact on policy activism. Column (1) shows that when subnational shares of FDI increase, the locus of policy activism shifts towards greater subnational activism in developmental strategies.

Next, the SOE share of industry output also shows up as an important variable correlated with changes in government policy behavior. Column (1) shows that an increase in a sector’s share of SOE output is correlated with an increased activism from the central state in its developmental strategies, suggesting that the central state is more active in promoting industries in which it has more state-owned assets. Finally, column (1) shows that there is a positive relationship between the central government’s designation of FDI encouragement for a sector and a more activism in subnational deployment of developmental strategies.

**Factors affecting relative activism in directive strategies**

Column (2) shows a positive relationship between tariff reduction and increased central activism in directive strategies. This indicates some degree of protectionism from the central state in response to WTO entry, which contradicts the finding in Chapter Four that it was the local state that primarily responded with directive strategies. In this case, the result might have arisen from the construction of the outcome variable, which combines provincial and local state responses. Since the provincial state on average adopted a developmental response to WTO entry (as shown in Chapter Four), the combination of both provincial and local strategies into a subnational response might have muted the relative directiveness of local state strategies.

Column (2) also shows a positive relationship between the degree to which FDI is encouraged into a sector and the central government’s deployment of directive strate-
gies. This finding appears puzzling initially, but may be related to the evidence in Column (1) that subnational states are relatively more activist in deploying developmental strategies to sectors for which FDI is encouraged by the central state. This subnational response might lead to cases of excess capacity that might trigger directive responses from the central state, a theme that will be explored in detail in Section 6.4.1.

Finally, Table 6.3 also shows a positive relationship between the cohesion within the central government in its policymaking and the relative activism of the central state in deploying directive policies. This might reflect the ability of the central state to deploy such policies when there are fewer “veto players” in the policymaking process. It might also reflect the tendency for more monopolistic sectors that have a generally stronger protectionist stance – such as tobacco – to be governed by a single agency or just a few agencies.

Together, these findings are consistent with the hypotheses that Chinese central and subnational states focus their attention on different industry characteristics when deciding what strategies to apply to which industries. The evidence here suggests that while WTO entry increased China’s potential access to foreign capital and technology, central and subnational states sought to deploy these external resources towards different political purposes. Subnational governments sought to deploy developmental strategies to serve their rank promotion imperative, by maximizing foreign investment and employment. The central government’s regime promotion imperative led it to focus on promoting the largest sectors and industries with high state ownership through developmental strategies. At the same time, the central state deploys stronger directive strategies in industries governed by fewer central agencies, as well as – counterintuitively – industries for which FDI is more encouraged in the NDRC guiding catalogue.
6.4 Deploying FDI for Growth: a Comparative Case Study

The results from Section 6.3.3 include one striking finding: that the one area where central and subnational strategies have the most direct conflict is sectors with higher FDI encouragement. Table 6.3 shows that subnational governments are relatively more active in deploying developmental strategies to industries for which FDI is more encouraged according to the central government’s Guiding Catalogue for Foreign Investment. This would appear to indicate that subnational states are abiding by the central government’s policy preferences. Why, then, would the central government intensify its directive strategies in those same sectors that have been designated by its own ministry for FDI encouragement?

This section uses two case studies to discuss why FDI liberalization generates policy conflict between the central and subnational states, leading the two actors to deploy contradictory policy strategies. FDI is an important issue to investigate because of the crucial role that foreign capital has played in China’s development trajectory (OECD 2003), and because WTO entry resulted in a resurgence of FDI inflows which had stalled during 1998 Asian financial crisis. Figure 6.3 shows the net inflows of FDI into China from 1980 to 2006. From the figure, we can observe that the first big increase in FDI occurs around 1992-3, when Deng Xiaoping made his famous “Southern Tour” to reignite economic growth. The FDI inflows then start to level out and even decline for the first time around 1997-1999, increasing again only in 2001, the same year of China’s WTO entry (see Walmsley et al. 2006 on the role of WTO accession in boosting FDI flows into China).

The topic of the political motivations for which different state actors seek to deploy
FDI remains an under-researched one in the literatures on both FDI and industrial policy. Thus far, research on the political economy of FDI has tended to revolve around the economic and distributive effects of FDI and factors affecting FDI inflows (See Pandya (2016) for a recent comprehensive review). A significant body of work, particularly in economics, has focused on the effects of FDI on economic performance (see Harrison and Rodríguez-Clare (2010) for an overview). Some argue that FDI has improved productivity through technological spillovers (Hu and Jefferson 2002; Du et al. 2014) while others point out negative effects (Cardoso and Dornbusch 1989; Brecher and Diaz Alejandro 1977). Yet others identify conditioning variables that need to be in place, such as human capital or financial markets - for FDI to have positive economic effects (see Balasubramanyam et al. (1996); Alfaro et al. (2004); Borensztein (2008) and Jefferson and Ouyang (2014)).

In terms of the distributional effects of FDI, existing literature has looked at how
FDI affects the welfare of elites (Evans 1979), of labor versus capital (Pinto 2013), and how particular types of FDI have differential effects on labor or capital (Mosley 2010). However, most research on the relationship between FDI and the state has been framed from the point of view of what factors affect the flow of FDI into a country. For example, important research has gone into the question of how political regimes affect FDI inflows (Dorobantu 2010; Li and Resnick 2003; Jensen 2006). Another set of literature examines the hold-up problem in FDI. Here, research has revolved around different types of credible commitment devices for solving this contracting problem, either at the domestic or international level (Simmons 2014; Büthe and Milner 2008; Henisz 2002). The focus, therefore, has been on how to constrain state behavior to effectively draw in FDI, rather than how politics within the state affects the types of FDI strategies that actually get deployed.

FDI has been central to China’s development strategy (Fu 2000). Yet, as I argue, the central and subnational states seek to attract foreign investment to meet different political objectives. I have proposed that the central state is motivated primarily by a regime promotion imperative, and seeks foreign investment in order to gain access to advanced technology that will enable Chinese industry to move up the value chain. The subnational state, in contrast, motivated by a rank promotion imperative, seeks foreign investment primarily in order to raise short term growth rates. This divergence in political goals generates problems for the central state that China’s leadership has repeatedly sought to redress. In a speech at the Central Economic Work Conference in December 1998, then-Premier Zhu Rongji pointed to the tension between the center’s emphasis on technology and state-asset protection.

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6 This refers to the problem where the state can renege on its promises and expropriate the foreign firm after the latter has made its investment.

7 Attended by leaders from provinces and municipalities, as well as central ministries and the People’s Liberation Army.
versus the subnational’s emphasis on short-term growth by noting:

We must study the markets and keep the overall picture in mind, rather than just consider the interests of one’s own locality. I don’t want you to engage in joint ventures that produce goods that swamp the market and lead SOEs in other provinces to collapse. That’s why in bringing in foreign investment, if it doesn’t really introduce new technologies and new product types, you shouldn’t engage in any joint ventures—they won’t do much good. ... I want to stress that enterprises need to pay attention to developing technologies and not simply expand production capacity—they should fund technology development. (Zhu 2015, p.111).

The need to resolve this tension was still on Zhu’s agenda three years later, as shown in a speech he delivered at a national working conference on foreign investment in 2001. There, he noted that:

[C]apital is no longer a prominent problem in economic operations. Hence we should no longer focus on simply seeking scale when attracting investments. Rather, we should work at raising quality and standards when utilizing foreign investment. ... If we continue to ignore technology and management quality and keep attracting investment just for low quality redundant construction, we will intensify structural contradictions and create greater difficulties and burdens. ... In order to attract business and investment, some locales are violating central policies, national laws, and regulations. They are following unauthorized preferential policies on tax reductions and exemptions, land use, disposition of state-owned assets, access to industries, and approval procedures. ... All locales must comprehensively clear up their own policies and methods for attracting foreign investment. (Zhu 2015, p.274-281).

China’s entry into the WTO some five months later only served to exacerbate this problem, due to the sharp increase in FDI inflows that WTO entry stimulated (Walmsley et al. 2006). The next section presents two case studies of the automobile and semiconductor industries. These case studies serve to highlight a source of central-subnational tension that the text analysis methods presented thus far have
not been able to capture. That is that even while both central and subnational states are engaging in developmental strategies in the automobile and semiconductor strategies, conflict nonetheless emerges in the type of development that each actor is pursuing. The cases focus on the foreign investment policies deployed by central and subnational states in these industries, to demonstrate how center-local tensions have been deepened by liberalization of FDI associated with the post-WTO era: a more open FDI environment in semiconductors in the post-WTO era led subnational governments to intensify their deployment of strategies to maximize the volume of foreign capital entering their jurisdictions. Consequently, the central state intervened in a directive manner to consolidate the industry and re-orient industrial policy for the sector towards technological upgrading for Chinese firms. In contrast, policy for the automobile industry has seen far less volatile swings, in part due to the strict controls on foreign investment imposed by the central government.

6.4.1 FDI Policies in the Automobile and Semiconductor Industries

While the automobile and semiconductor industries are different in several ways (e.g. the former is a final product while the latter is a component), they nevertheless share important characteristics. Both are capital intensive and require economies of scale in production, and both are high-tech and high value-added industries, with “pillar” or strategic status in the national economy. Specific industrial policy documents to develop each sector have also been released and revised over the years, allowing a close comparison of policy trajectories for the two industries.

Access to foreign technology – and hence FDI – played an important role in the development of each industry in China’s reform era. Specifically, the central government
deployed the strategy of “exchanging (the domestic) market for technology”\(^8\) for both industries and joint ventures were set up with selected state-owned ‘champions’ in the 1980s. From 2000 onwards, however, policy for the two industries diverged. While FDI in the automobile industry continued to be strictly controlled by central government policy with joint venture requirements and market entry restrictions, foreign investment in the semiconductor industry was liberalized, leading to large increases in wholly foreign-owned enterprises (WFOE) – attracted by favorable tax and credit incentives offered by subnational governments. Despite the loosening of FDI controls in the semiconductor industry, central goals for the two industries remained similar – to develop globally competitive national champions and to close the technology gap with developed economies. However, while auto industrial policy has remained fairly constant over the years, policy changes made after 2010 in the semiconductor industry appear to be aimed at re-centralizing control and reducing the dominance of foreign firms in that sector. The next two sub-sections will highlight the high degree of continuity in automotive industrial policies and contrast that with the swings for policies for the semiconductor industry.

**Automobile Industrial Policies: a consistent focus on national champions and technology upgrading**

In the late 1980s, the central government set out to consolidate the decentralized auto industry and work towards building a few national champions, by issuing the “Notice Regarding the Strict Control of Passenger Car Production Points”\(^9\) also known as the “Three Large and Three Small” policy. Through a strongly directive

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\(^{8}\)以市场换技术, *yi shichang huan jishu*

\(^{9}\)关于严格控制轿车生产点的通知, *guanyu yange kongzhi jiaoche shengchandian de tongzhi, State Council No. 82, 1988.*
approach, six SOEs were selected for national support.\textsuperscript{10} The focus on nurturing these selected ‘champions’ was strengthened with restrictions on market entry and prohibitions on investments outside of the official production points.\textsuperscript{11}

The 1990s saw a series of policy announcements signaling the development of a large and successful automobile industry as a core national concern. In 1990, the State Council’s national industrial policy and Eighth Five-Year Plan (1991-1995) emphasized auto development as a national priority, re-emphasizing many of the same policy measures and objectives from the 1980s (market entry restriction and consolidation, economies of scale and international cooperation for technology advancement). In 1994, the State Council released an industrial policy specifically on the automobile sector\textsuperscript{12} highlighting its status as a national ‘pillar industry’.\textsuperscript{13} The document retained strong directive elements by specifying production targets and setting the goal that by 2000, two to three enterprise groups would become large enterprises with “considerable capability”\textsuperscript{14} while six to seven enterprise groups would become domestic “backbone enterprises”\textsuperscript{15} A further target was to develop three to four large auto enterprise groups and three to four large motorcycle enterprise groups that would be globally competitive by 2010.

The 1994 policy further detailed rules on how foreign capital was to be utilized,

\begin{itemize}
  \item[\textsuperscript{10}] The “three large” firms referred to central SOEs First Auto Works (FAW), Second Auto Works (SAW) and Shanghai Automotive Industry Corporation (SAIC) while the “three small” referred to Beijing Jeep, Guangzhou-Peugeot and Tianjin Auto Corporation (TAC) (Huang 2002).
  \item[\textsuperscript{11}] These restrictions proved difficult to maintain, however, and in the 1990s “under pressures from the military” two more firms were added as official production points (Chang An and Guizhou Aviation Industry Corporation), making the policy “Three Large, Three Small and Two Minis” (Huang 2002).
  \item[\textsuperscript{12}] 汽车工业产业政策, qiche gongye chanye zhengce
  \item[\textsuperscript{13}] 支柱产业, zhizhu chanye
  \item[\textsuperscript{14}] 相当实力, xiangdang shili
  \item[\textsuperscript{15}] 骨干企业, gugan qiye
\end{itemize}
emphasizing the two core elements of the central government’s desire to maximize technology transfer while defending state assets. The policy set down conditions to consolidate the industry and channel resources towards a chosen few state-owned ‘champions’, transferring advanced technology through FDI while protecting the viability of its domestic firms. Through the strategy of ‘exchanging market for technology’, each foreign firm making an investment had to establish 50-50 equity partnerships with a Chinese state-owned firm, and was restricted to a maximum of two such partnerships. The joint venture also had to establish a research and development unit, utilize technology belonging to 1990 international levels, focus on exports so as to manage exchange balances, and to give priority to the usage of domestic (i.e. Chinese) auto parts. Tax incentives were further offered to enterprises that could meet specific levels of “nationalization”\(^{16}\) (i.e. produced by Chinese manufacturers) in their production.

This 1994 document, the first industrial policy ever issued specifically for a single industry \([\text{Anderson} \ 2012]\), was partly effective in that the 1990s saw the establishment of several more joint ventures.\(^{17}\) Into the late 1990s and up until the eve of China’s accession to the WTO, China’s industrial policy did not deviate far from the principles of joint venture partnerships for technological upgrading and favoring SOEs designated to be national champions.

In 2004, the NDRC released a new Automotive Development Policy to replace the 1994 Industrial Policy. Consistent with earlier policy themes, the focus on fostering a few “backbone enterprises” to become globally competitive national champions had not changed, betraying entrenched beliefs in the necessity of government support to

\(^{16}\) 国产化, guochanhua

generate market concentration and scale. The policy even set the goal of fostering enterprise groups that would join the Fortune 500 list by 2010. Joint venture rules similarly remained unchanged. If anything, the 2004 policy intensified the central government’s focus on technological advancement by introducing new priorities of indigenous innovation and developing independent intellectual property rights, the creation of indigenous brands and stimulating the development of electric vehicles (NDRC 2004). The 11th Five Year Plan (2006-2011) repeated that SOEs would be the “core” for the industry and reiterated the need to raise the competitiveness of SOEs, calling for foreign enterprises to support this overall goal. Despite some small changes in central policy towards private enterprises, the key characteristic of China’s automobile industrial policy has been its continuity, with a consistent focus on SOEs, joint ventures and national champions (Interview B31).

**Semiconductor Industrial Policies: decentralization and re-centralization**

The central government’s policies for the semiconductor industry in the 1980s and 1990s strongly resembled those for the automotive sector in the focus on directive measures such as production targets and a reliance on picking favored SOE ‘champions’ for partnerships into joint ventures in order to facilitate access to more advanced foreign technology. The policy for developing the semiconductor industry was issued in 1986, informally named the “531 Strategy”. The policy involved explicit technology and production targets, where the numbers “531” represented the goals to: universally promote 5mm integrated circuit technology, have “core” enterprises master the 3mm technology, and begin to develop 1mm technology (Chen 2005).  

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18 Against central policy, several successful private auto companies had emerged in the past decade, such as Great Wall, Geely and BYD. In 2007, the NDRC approved three private carmakers (alongside two local SOEs) to produce Chinese-branded passenger cars, possibly indicative of an emerging willingness to support private firms (Anderson 2012).
In 1989 a second set of policies was developed, focused around how to deal with underinvestment and scattered investment, backward technology and weak application links between integrated circuits and China’s traditional industries. Again, the central government’s challenge mirrored the automotive industry’s problem in the 1980s of overly-dispersed production and technological deficiencies. To deal with these problems, the new policies focused semiconductor development geographically in two coastal regions: Beijing in the north, and the Jiangsu-Shanghai-Zhejiang region in the south. Five “backbone enterprises” were identified where resources would be concentrated in industrial development (similar to the auto industry’s “Three Large and Three Small” champions). In another parallel with the auto industry policy, three of these five backbone enterprises were set up as joint ventures with foreign firms in the hopes that such partnerships would enable technology transfer.\footnote{Shanghai Philips Semiconductor in 1988 (with Philips NV), Shougang NEC Electronics in 1991 (with Japan’s NEC Corporation) and Shanghai Belling Microelectronics Manufacturing Corporation in 1994 (with Alcatel Bell). The other two ‘backbone’ enterprises were Huajing Electronic Enterprise Group based in Jiangxi (one of China’s largest semiconductor SOEs) and Huawei Electronics in Zhejiang \cite{Pecht2006}.}

Continuing with the joint venture strategy, an ambitious development named Project 908 was launched in 1990 involving a joint project between Huajing Group and Lucent Technologies. While this project ended up mired in delays, a similar effort named Project 909 was launched in 1995. This project aimed to mass produce .35-
.25μm 9-inch chips and engage in lab and trial production of more advanced .3μm and .5μm chips, as well as to develop capabilities in chip design. Again, a joint venture approach was adopted to try to achieve these technological goals, with a partnership between Huahong Group and Japan’s NEC Corporation \cite{Jefferson2014Pecht2006}.

The rationale for bringing in semiconductor FDI through joint ventures was simple
and congruent with that for automobiles: joint ventures were seen as a vehicle for the transfer of technology from advanced foreign firms, which would allow domestic firms to catch up and move towards the technology frontier faster than they otherwise could. At the same time, equity limits on these partnerships served to protect state-owned enterprises from being undermined by foreign competition.

In 2000, the central government’s strategy for semiconductor development shifted markedly. The State Council released the “Policy Encouraging the Development of the Software and Integrated Circuit Industries” (also called the “No. 18 document”). The changes enacted in this policy marked a turning point for the semiconductor industry (Interview B26). The policy noted the urgency of developing the industry in light of China’s imminent accession to the WTO, and went on to highlight several development goals. The main objectives were to draw capital and human talent into the industry, to meet domestic market demand while achieving some degree of exports, as well as to close the gap with developed economies in terms of research and production technologies. Most significantly, the No. 18 document called for drawing in FDI in all forms, not just through joint ventures but also wholly foreign-owned enterprises (WFOEs). These foreign firms would enjoy a range of policy benefits such as exemptions on VAT, tariffs and customs fees, particularly if the investment was of a large scale (over 8 billion RMB).

Figure 6.4 shows the corresponding change in the types of firms in the semiconductor industry after the issuance of document No. 18. Whereas SOEs and joint ventures were the main forms of registered firms in the late 1990s, the number of WFOEs increased substantially from 2001 onwards (particularly in 2003-2004) while the number of SOEs steadily declined. The number of domestic private firms also rose from around 2000 onwards, but there is still clearly a large gap between these
firms and the WFOEs who came to dominate the semiconductor industry.\footnote{The figure captures changes in the major types of enterprise registration, but is not exhaustive (there are 19 different registration classifications for firms in China). In addition the joint venture and WFOE firms include firms from Hong Kong, Taiwan and Macau as well as other foreign firms. See \cite{fu2000} for a detailed description of the various modes of FDI.}

In the automobile industry by contrast, the joint venture rule remained a firm pillar of industrial policy. Figure \ref{fig:fig6.5} shows that the biggest increase in the type of firm entering the industry post-WTO entry has been in joint ventures, while the number of SOEs has held somewhat steady, declining only marginally compared to the semiconductor industry. There have been limited increases in domestic private firms, while there are also almost no WFOEs in this sector (whole-car manufacturing).

Comparing the policy trajectories of the automotive and semiconductor industries, we can observe a striking difference in how the central government has tried to achieve its technology transfer goals. Automotive industrial policy has consistently placed an emphasis on upgrading technological capabilities in Chinese firms through
through joint venture partnerships, a 50% equity cap on foreign investment and the “exchanging market for technology” strategy. Globalization and WTO entry was seen as a potential threat to China’s automotive industry and the central state retained its control over FDI flows in order to protect state assets in the industry.

While policy for the semiconductor industry had been very similar to that for the automotive sector in the 1980s and 1990s, policies for the two industries diverged after 2000, with the liberalization and decentralization of FDI in the semiconductor industry. This liberalization took place at the same time as China’s entry into the WTO, which resulted in big increases in FDI inflows and particularly in the semiconductor industry. However, this did not mean that the central government had given up its goals of fostering national champions in the industry. Rather, the central state hoped that technological advancement in Chinese firms would occur through liberalization. Not only was technology improvement a stated goal of the No.18 policy, additional
benefits were set aside for investments of advanced technological standards (less than 250nm), and tax rebates were established to allow firms to re-invest their revenue into financing R&D activities.

Why did the FDI policy for these two industries diverge? One reason might be the relative dominance of SOEs in each industry around the time of China’s WTO entry. Two different interviewees suggested that the joint venture and 50% equity limit rules were retained in automobiles and abandoned in semiconductors because there were more central SOEs in the former industry, which hold more privileged status and who have reaped substantial benefits from being in joint venture partnerships with foreign firms (Interviews B26 and B30). Figures 6.4 and 6.5 also show that the relative dominance of SOEs was far higher in the automotive sector compared to semiconductors in the late 1990s. Therefore, to the extent that central SOEs are seen as core to the central state’s interests, or core to the protection of state assets, this might have held the central state back from liberalizing FDI conditions in the automotive industry. Another contributing factor might be the difference between the two industries and the role that semiconductors play as an input into a growing number of manufactured goods. Nonetheless, the central state’s goal towards the two industries for technological advancement remained the same – to be achieved through joint ventures in the case of automobiles, and to be achieved through a greater emphasis on explicit tax rebates and other incentives in the case of semiconductors.

The consequences of FDI liberalization

The post-WTO era was a period of great expansion for the semiconductor industry, with revenues increasing from $5 billion in 2000 to $89.3 billion in 2015. Like that of an eldest son in a family, or zhangzi (长子).
and major increases in wholly foreign-owned enterprises in the semiconductor industry, as shown earlier in Figure 6.4. This growth, however, was far from coherent. While document No. 18 set the overall direction of industrial policy, individual subnational governments were free to pursue FDI in their own ways and government policy during this period was characterized by a fair degree of dispersion or decentralization (Interview S05). Geographically, foreign firms were primarily drawn to three clusters in Shanghai, Suzhou and Wuxi in the Yangtze Delta. Local governments in these areas competed with each other to bring in FDI by offering tax benefits, preferential terms for land use and infrastructure support (Chou et al. 2014). Some development zones, such as the Suzhou Industrial Park were specifically designed to draw in semiconductor firms. This meant that the size and shape of each plot of land, as well as the design of infrastructure such as electricity and water supply, were specifically tailored towards the technical requirements of semiconductor production (Interview SZ02). In 2007 alone, drawn by such benefits, 2000 foreign-invested firms located into the Yangtze Delta (Chou et al. 2014). Some localities, such as Suzhou in Jiangsu province, became so dominated by foreign enterprises that they were criticized for being a “Western Suzhou” (Interview S06).

The surge in subnational activism for developing the semiconductor industry can be seen in Figure 6.6 showing the relative prevalence of language related to development in central and subnational government regulations in the auto and semiconductor sectors. The trend for the automotive sector, shown on the left hand panel, indicates that subnational governments tend to deploy more developmental language in their auto policies compared to the center. However, the difference is slight and fairly constant over time. In contrast, the trends in the electronic devices industry

22洋字州, “yang suzhou”
on the right hand panel (which includes semiconductors and integrated circuits), are far more stark. The figure shows a higher level of developmental language for both central and subnational states relative to the automotive sector, but a far higher (and increasing) frequency of developmental language at subnational levels relative to the central state. This trend is suggestive of a steadily rising fervor at subnational levels for promoting the semiconductor industry.

Why would such a trend be in contradiction with central government goals? I propose that the main source of policy conflict stems from the different political purposes for which the two types of state actors are pursuing growth, leading each to prefer a different type of developmentalism that text analysis alone does not reveal. The central state is focused on regime promotion by technological upgrading, while the subnational state is focused on rank promotion by maximizing foreign capital. That is, subnational FDI strategies were focused on simply drawing in capital rather than being oriented to the central government goal of using FDI to enhance technology transfer and innovation in domestic firms. The simultaneous globaliza-
tion of production chains during this period meant that many foreign firms started to located their foundry and semiconductor assembly and test services (SATS) operations in China, but not other parts of the production chain such as R&D and chip design (PricewaterhouseCoopers 2008, 2004). The explosion of foreign investment in semiconductor-related activities in subnational governments was therefore concentrated in just the lower value-added portions of the production chain, while technology-intensive portions remained outside of China (Interview B26).

One study examining local semiconductor policies in the Yangtze Delta pointed out that “successful FDI attraction and clustering does not automatically lead to the opportunity and capacity for technological learning and sustainable development by the local indigenous industries” (Chou et al. 2014). Instead, the authors found that “the major goal of government support for attracting FDI in Suzhou was overwhelmingly at facilitating exports and earning foreign reserves, rather than supporting the development of a domestic semiconductor industry”. Therefore, local government success in drawing in FDI actually led to the creation of FDI “enclaves” with strong networks among FDI firms that were difficult for domestic firms to penetrate, leading to the crowding out – rather than development – of domestic enterprises. One interviewee pointed out that FDI dominance had in fact suppressed rather than encouraged entrepreneurship, which was why very little innovation could be seen coming out from a place such as Shanghai (Interview S06). Indeed, cases of successful development of domestic semiconductor firms have occurred in places where FDI presence is weaker rather than stronger (Chou et al. 2011).

In sum, the liberalization of FDI to subnational governments in the semiconductor industry meant that the central government lost the ability to push its priorities on technological advancement forward. While the central state never deviated from its goal of harnessing foreign technology and closing the technology gap in this sector,
subnational governments, in seeking to draw in FDI, were oriented towards more short term goals of immediate economic growth and sought to deploy FDI strategies focused on maximizing capital and export revenues.

**Automotive policy: central reliance on FDI control**

In the automotive sector, by contrast, industrial policy over FDI has stayed fairly constant and was never liberalized in the same way as in the semiconductor industry. As a result, while the urge for subnational governments to try to maximize the flows of FDI into their localities is still present in the auto industry (Huang 2002), this tendency was restrained by the central government’s joint venture rule. The relative ability of the central state to retain policy control over this sector can be seen in the way in which the central government has *repeatedly* used its authority over FDI and loans in the automotive sector to meet its industrial policy goals, as the next two examples will illustrate.

One of the first cases launched against China at the WTO dispute settlement board was over automotive industrial policy. In 2006, the European Union, the United States and Canada jointly filed a complaint against China on tariffs imposed on imported car parts. The complainants pointed to three policies issued by the central government that they claimed violated multiple GATT articles. Specifically, China imposed tariffs on imports on auto parts equivalent to the tariff on a full vehicle (25%) instead of the normal 10% if the share of auto parts designated to go into a vehicle exceeded a certain threshold (World Trade Organization ndb). The complainants argued that this policy discriminated against foreign auto parts and amounted to

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23 Article II on the Schedule of Concessions, Article III on National Treatment, Article XI on the Elimination of Quantitative Restrictions and XIII on the Non-discriminatory Administration of Quantitative Restrictions, the SCM, TRIMS and the Protocol of Accession.
a subsidy of domestic car parts production, raising pressures on foreign auto parts companies to relocate their production into China. The DSB panel ruled in favor of the complainants, which led China to appeal the case. However, the Appellate Body upheld all but one of the original panel rulings, which the Chinese government then complied with. The NDRC and MIIT jointly issued a notice to halt this practice, and the relevant Customs decree (No. 125) was also repealed.

While this appeared to be a successful case of foreign companies using international trade law to constrain Chinese industrial policy, what happened next shows the leverage that the central government was able to wield using its control over FDI. One interviewee revealed that foreign automotive companies were “punished” after this case, because central government approval was needed for these companies to expand their capacity by building new plants. Approvals for these new investment were delayed for an extended period, and the central government ended up sending a “very effective message” to these companies about the repercussions of filing complaints at the WTO. The foreign companies involved changed their strategies for operating in China afterwards, and were no longer so vocal in their complaints about policies which they perceived to be cases of unfair discrimination (Interview B30).

In 2008, the NDRC again used its control over investment approvals to advance its industrial policy goals in the automotive sector. The national policy priority then was the creation of new indigenous brands. While no explicit policies were issued to require foreign companies in joint ventures to participate in this indigenization drive, the NDRC had an “unwritten rule” that approvals for investments in new plants would be contingent upon firms submitting a feasibility study or business plan to create and launch a new car model under a new Chinese brand (Interview B30). This strategy was repeated when industrial policy shifted to a focus on developing new energy vehicles (e.g. electric cars). Again, joint venture firms seeking financing approval for
new activities needed to first produce plans or models for new electric vehicles as an unwritten pre-condition (Interview B28). In each of these cases, the central state used its control over FDI and loan approval authority as leverage to push forward its industrial policy goals.

**Resurgence of central activism in semiconductors**

The dominance of subnational policy activism in the semiconductor industry was gradually met by increased intervention from the central state. The central government responded to the increase in foreign firms and the lack of technological development in the domestic semiconductor industry with a change in policy direction and a much more activist stance. Significantly, the new policy direction turned away from FDI promotion towards an emphasis on indigenous (i.e. Chinese) enterprises (Interview B26). This change emerged slowly at first. In an effort to reduce the economy’s reliance on MNC-produced microchips, the Chinese government set up an association in 2005 to promote smaller local enterprises (Interview SZ01). The following year, a national drive towards “indigenous innovation” was put forward in a “Medium and Long-Term National Plan for Science and Technology Development (2005-2020)” issued by the State Council (See OECD 2008 for overviews of this plan and the priority placed on indigenous innovation). The importance of developing the semiconductor industry in particular was highlighted a few years later in 2008, when the State Council issued its 12th Five-Year Development Plan for National Strategic Emerging Industries – which identified seven high-tech and high-value added industries as deserving of state support, ranging from new energy and high-end equipment to information technology and high performance integrated circuits (State Council 2012). These gradual policy movements towards a focus on the promotion of information technology and indigenous innovation were solidified for the semiconductor
industry in 2011 when the State Council issued the “Policy to Further Encourage the Development of the Software and Integrated Circuit Industries” (or the “No. 4 document”), the first major revision to official policy since the No. 18 document issued in 2001.

The general thrust of these new policies involved two major components working concurrently: centralization and indigenization. The No. 4 document enumerated a number of tax incentives for the development of more advanced and larger scale semiconductor plants, continuing the tendency for Chinese industrial policy documents to set specific technology and scale targets. In other respects, however, this new policy marked a significant departure from existing practices. The most notable change was a shift away from the focus on attracting FDI. Instead, the policy called for improving the domestic credit system so as to increase domestic capital access for enterprises. The policy further encouraged Chinese firms to embrace the “going out” strategy of overseas investments and exports. The one area where foreign resources still remained an aspect of the industrial policy was in human capital, with emphases placed on attracting people trained overseas back to China.

This new policy focus was accompanied by greater central government intervention to shape the industry as a whole, a trend observed by more than one interviewee (Interviews S05 and B26, T05). One component of centralization involved an effort to consolidate state support around a few key national champions. In January 2013, the Ministry of Industry and Information Technology (MIIT) announced plans to build major enterprises in the electronics industry via mergers and acquisitions. The stated goal was for China to have established between eight and five major companies with minimum sales revenues of USD$16 billion (RMB100 billion) by 2015 (Yap and Mozur 2013).

In 2014, the State Council put forward an “Outline for Spurring the Development
of the National Integrated Circuit Industry” reiterating the central government’s move towards harnessing domestic capital to develop Chinese capabilities in semiconductor production [State Council 2014]. This document stressed the importance of domestic innovation and warned of the security implications of China’s over-reliance on foreign imports in this strategic sector. It set numerous industry goals, including to have shrunk China’s gap with international standards, increased domestic sales revenue by over 20%, and to be producing 16 to 14nm chips at scale by 2020, among others.

In a sign of the central government’s more interventionist stance, a Leading Small Group for semiconductor development was also set up. A National Integrated Circuit Investment Fund was announced to support the development of large enterprises in all segments of the production chain. China’s major policy banks, from the Export Import Bank to the China Development Bank, were encouraged to increase their financing to the industry. The need to attract foreign capital, foreign technology and human talent was relegated to just three sentences at the end of the document.

Later the same year, the government announced the creation of an investment fund of over US$22 billion, part of which would go towards acquisitions (South China Morning Post, 2016). Since then, a number of high-profile sales have been made, many with government involvement to ensure the acquisition of the latest technology along the entire semiconductor production chain [The Economist (2016); Kim, Miyoung and Yamazaki, Makiko (2015), Interview T05]. Tsinghua Unigroup, for example, through a number of high-profile mergers and acquisitions, had emerged by 2016 into one of the largest semiconductor companies in the country worth US$2.8 billion (Bloomberg News, 2016). Another change resulting from the focus on indigenous innovation was that government procurement had become a more important policy tool in ensuring that locally-made chips had a ready-made market (Interview B26).

The focus on indigenization was further reinforced by the State Council’s an-
nouncement of its “Made in China 2025” policy in 2015, which listed semiconductor manufacturing as a key component of China’s goal of developing domestic strength in high-tech manufacturing (State Council nd). The effects of this increasingly active central policymaking backed by domestic rather than foreign capital could be detected in industry participants. One interviewee pointed out that from the perspective of some of the foreign companies being bought up, the acquisition drive offered some advantages in adapting to a new policy environment more hostile to foreign enterprises. That is, acquisition by a Chinese firm would offer them greater access to contracts from important Chinese companies such as Huawei that they otherwise would be shut out from. Realizing that ‘being Chinese’ would become increasingly important in the future, they decided to sell to a Chinese company and secure their access to the domestic market (Interview S11).

Another interviewee noted that with government policy now favoring what he called “Red enterprises” foreign enterprises had no choice but to find ways to adapt. One option was to cooperate with local enterprises who could provide the “Red hat” to meet official policies favoring Chinese firms (Tsai 2002). Underneath that hat, the enterprise could have many different “colors” (i.e. nationalities). Foreign enterprises would have to be more flexible and engage in hybrid arrangements where the core of the firm might be Chinese but the technology foreign (Interview S04). In 2015, the CEO of a Dutch firm was quoted in the media adopting just that attitude: “Over the next few years, it’s not going to be the same as it is today, where we just ship semiconductors into China . . . You’re going to have to do joint ventures and licenses” (King, Ian 2015).

In other words, through the concerted push by the central government to direct

\footnote{“红色企业”, “hongse qiye”}

\footnote{“红色帽子”, “hongse maozi”}
domestic capital and consolidation efforts towards national semiconductor champions, firm activity in the industry had swung back towards the joint venture mode of the 1980s. While there was no overt government policy mandating joint venture arrangements, foreign companies were proactively entering into such partnerships in order to maintain their foothold in China and to gain some access to the deep pool of national funds. In recent years Qualcomm, for example, entered into a joint venture project in Guizhou province, while Intel set aside US$3 billion to invest in local mobile microchip firms (King, Ian 2015).

These case studies have illustrated the pathways through which FDI liberalization intensified the center-subnational policy conflict in the semiconductor industry, driven by the divergent political purposes towards which central and subnational states sought to deploy FDI. As a result, semiconductor industrial policy has been marked by large swings, from a sharp liberalization and decentralization in 2000 with the No. 18 document, to a sharp re-centralization and indigenization drive in the late 2000s. The automotive industrial policy, in constrast, has been marked by relatively greater stability over time, with a consistent focus on joint ventures and “exchanging market for technology”. The ability of subnational governments to subvert central policy in this sector has been relatively weaker compared to the semiconductor industry (but not absent), as subnational states were not able to take advantage to the same extent of the increased access to FDI in the post-WTO era in automobiles.

Through these case studies, I have further highlighted a dimension of policy tension that thus far has not been illuminated through the sections relying on quantitative text analysis. That is that even in sectors where both central and subnational states appear to be deploying the same (developmental) strategies, policy conflict can emerge from the divergent political purposes to which each actor is deploying their developmental strategies. The substance of the developmentalism is geared towards
regime promotion for the central state, and rank promotion for the subnational state. This divergence is deepened by WTO liberalization, at exactly the same time when the central state has tried to intensify its ‘national champions’ policy.

6.5 Testing the Determinants of Success in National Champions

Having examined the sources and consequences of the fundamental contradictions between central and subnational objectives for industrial policy, and the role that globalization plays in deepening these tensions, this section turns to the question of why the national champions strategy is more successful in some industries and not others.

6.5.1 Estimation strategy

The findings from the previous sections gives us some hints as to what might determine greater success for the central state in its quest to build globally competitive national champions across a range of industries. To investigate this question quantitatively, I measure “success” by looking at the degree to which an industry is dominated by large “champion” enterprises. I do this by creating an industry-level Herfindahl-index measure of concentration, where a value of 1 represents the total monopoly of an industry by a single firm, and lower values indicate lower industry concentrations. My main hypotheses are as follows:

1. The central state’s national champions policy is less likely to be successful in sectors with stronger subnational policy divergence. This is likely to be in industries where subnational states have greater access to FDI or export markets.
2. The central state’s national champions policy is more likely to be successful in sectors where the central state has greater vertical control over firm behavior to reduce policy divergence, such as in sectors dominated by SOEs.

I employ a difference-in-difference estimation with the same dataset used in Section 6.2.1, with industry concentration as the outcome of interest. I include as explanatory variables the same variables included in the previous set of estimations. In addition, to test if the entry of foreign firms had a direct impact on industry concentration, I include the foreign firm share of output as an additional variable. Since industry concentration can both be a result of and have an effect on industry characteristics and government policy, I run the regression with all the covariates lagged by a year. All estimations additionally include industry and year fixed effects, and standard errors are clustered by industry.

6.5.2 Results

Table 6.4 shows the regression results. We see that an increase in industry employment is associated with a fall in industry concentration. This would be consistent with the hypothesis that the developmental strategies of employment-maximizing subnational governments end up subverting efforts to consolidate an industry (as such consolidation efforts often involve mergers and the laying off of workers). An increase in subnational exports for an industry is also strongly associated with weaker industry concentration. This provides evidence supportive of the hypothesis that WTO entry, by opening up export markets directly to firms at the subnational level, encourages subnational states to pursue strategies to meet their political imperative of rank promotion rather than abide by the center’s policy of creating national champions.

Finally, an increase in SOE output share is correlated with stronger industry
Table 6.4: Testing success in national champions: Estimation results

<table>
<thead>
<tr>
<th></th>
<th>Industry Concentration</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tariff (inverse)</strong></td>
<td>0.0002</td>
</tr>
<tr>
<td></td>
<td>(0.0003)</td>
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<tr>
<td><strong>Industry output share</strong></td>
<td>0.2674</td>
</tr>
<tr>
<td></td>
<td>(0.3312)</td>
</tr>
<tr>
<td><strong>Industry employment share</strong></td>
<td>−1.0947*</td>
</tr>
<tr>
<td></td>
<td>(0.6389)</td>
</tr>
<tr>
<td><strong>Subnational exports share</strong></td>
<td>−0.0602***</td>
</tr>
<tr>
<td></td>
<td>(0.0214)</td>
</tr>
<tr>
<td><strong>Subnational foreign capital share</strong></td>
<td>−0.0064</td>
</tr>
<tr>
<td></td>
<td>(0.0073)</td>
</tr>
<tr>
<td><strong>SOE output share</strong></td>
<td>0.0658*</td>
</tr>
<tr>
<td></td>
<td>(0.0372)</td>
</tr>
<tr>
<td><strong>Foreign firm output share</strong></td>
<td>−0.0049</td>
</tr>
<tr>
<td></td>
<td>(0.0245)</td>
</tr>
<tr>
<td><strong>Central FDI encouragement</strong></td>
<td>−0.0001</td>
</tr>
<tr>
<td></td>
<td>(0.0002)</td>
</tr>
<tr>
<td><strong>Central Controlling Equity Rule</strong></td>
<td>0.0013</td>
</tr>
<tr>
<td></td>
<td>(0.0018)</td>
</tr>
<tr>
<td><strong>Central Cohesion</strong></td>
<td>0.0018</td>
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<tr>
<td></td>
<td>(0.0013)</td>
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</table>

<table>
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<tr>
<th></th>
<th>Industry Concentration</th>
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<tbody>
<tr>
<td><strong>Year fixed effects</strong></td>
<td>yes</td>
</tr>
<tr>
<td><strong>Industry fixed effects</strong></td>
<td>yes</td>
</tr>
<tr>
<td><strong>Observations</strong></td>
<td>912</td>
</tr>
<tr>
<td><strong>R^2</strong></td>
<td>0.1984</td>
</tr>
<tr>
<td><strong>Adjusted R^2</strong></td>
<td>0.1721</td>
</tr>
</tbody>
</table>

*Note:*

*p<0.1; **p<0.05; ***p<0.01

Standard errors clustered by industry

All explanatory variables lagged by one year
concentration. This result is consistent with the argument that the central state is more activist in industries where SOE output shares are high, so as to protect state assets from being eroded by international competition. Another interpretation might be that the central state’s monitoring and enforcement problems are less serious in sectors dominated by SOEs, thus allowing it to better achieve its national champions policies.

Together, the evidence from this estimation suggest that the central state is more successful in its national champions strategy in industries where it already has stronger control via state ownership; and that it faces more challenges in building large conglomerates in industries where subnational governments have strong direct access to export markets, or in industries that take up a large share of employment. Both of these factors (export markets and threats to employment) are heightened in the WTO era, underlining the challenge for the central government to achieve its industrial policy goals under conditions of globalization.

6.6 Testing the Competitiveness of National Champions

Having established the center-local tensions that bedevil the central government’s national champions policy, I now turn to the question of how effective this policy is in creating competitive champions. To investigate this issue, I run two difference-in-difference estimations regressions of average industry levels of productivity on industry characteristics and policies.
6.6.1 Estimation strategy

I follow standard practice in economics in using the log of Total Factor Productivity (ln(TFP)) to capture the outcome of interest, calculated in two ways – the Olley-Pakes method and Ordinary Least Squares with fixed effects. More details are in Aghion et al. (2015), and the TFP data is obtained from the same authors. I include the following explanatory variables that might have an impact on TFP:

- To test if import competition via tariff liberalization has a direct impact on productivity, I include industry tariff levels (again inverted, as was done in previous estimations).

- To test the relationship between the presence of national champions in an industry and productivity, I include the measure for industry concentration.

- To test if industry size, employment or export strength have an impact on productivity, I include measures for industry output, employment and export shares.

- To test if the presence of SOEs or foreign firms affects productivity, I include measures of SOE output shares and foreign firm output shares.

- To test if the central government’s investment rules have any impact on productivity, I include the measures for FDI encouragement and the controlling equity rule.

- Finally, to test if there is any relationship between the relative policy activism of the central government and productivity, I include the two policy activism measures for developmental and directive strategies (the base measure excluded here is therefore the regulatory strategy).
### Results

Table 6.5: Testing competitiveness of national champions: Estimation results

<table>
<thead>
<tr>
<th></th>
<th>Productivity (OP) (1)</th>
<th>Productivity (FE) (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tariff (inverse)</td>
<td>0.0035*</td>
<td>0.0028</td>
</tr>
<tr>
<td></td>
<td>(0.0020)</td>
<td>(0.0021)</td>
</tr>
<tr>
<td>Industry Concentration</td>
<td>-1.6563*</td>
<td>-1.7858**</td>
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<tr>
<td></td>
<td>(0.8653)</td>
<td>(0.8802)</td>
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<tr>
<td>Industry output share</td>
<td>-10.3457*</td>
<td>-10.4795*</td>
</tr>
<tr>
<td></td>
<td>(5.6759)</td>
<td>(6.1546)</td>
</tr>
<tr>
<td>Industry employment share</td>
<td>5.1975</td>
<td>4.2929</td>
</tr>
<tr>
<td></td>
<td>(4.6548)</td>
<td>(4.6112)</td>
</tr>
<tr>
<td>Industry exports share</td>
<td>22.2387***</td>
<td>23.0452***</td>
</tr>
<tr>
<td></td>
<td>(7.5133)</td>
<td>(8.0230)</td>
</tr>
<tr>
<td>SOE output share</td>
<td>0.1380</td>
<td>0.0896</td>
</tr>
<tr>
<td></td>
<td>(0.1825)</td>
<td>(0.2087)</td>
</tr>
<tr>
<td>Foreign firm output share</td>
<td>-0.1091</td>
<td>-0.1185</td>
</tr>
<tr>
<td></td>
<td>(0.2633)</td>
<td>(0.2794)</td>
</tr>
<tr>
<td>Central FDI encouragement</td>
<td>-0.0002</td>
<td>0.0015</td>
</tr>
<tr>
<td></td>
<td>(0.0028)</td>
<td>(0.0032)</td>
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<td>Central Controlling Equity Rule</td>
<td>0.0056</td>
<td>-0.0037</td>
</tr>
<tr>
<td></td>
<td>(0.0384)</td>
<td>(0.0370)</td>
</tr>
<tr>
<td>Developmental strategies</td>
<td>-0.0030</td>
<td>-0.0101</td>
</tr>
<tr>
<td></td>
<td>(0.0190)</td>
<td>(0.0168)</td>
</tr>
<tr>
<td>Directive strategies</td>
<td>0.0129</td>
<td>0.0068</td>
</tr>
<tr>
<td></td>
<td>(0.0323)</td>
<td>(0.0267)</td>
</tr>
</tbody>
</table>

|                              | yes                   | yes                   |
| Year fixed effects           |                       |                       |
| Industry fixed effects       | yes                   | yes                   |
| Observations                 | 391                   | 391                   |
| R²                           | 0.8013                | 0.8059                |
| Adjusted R²                  | 0.6107                | 0.6143                |

Note: *p<0.1; **p<0.05; ***p<0.01
Standard errors clustered by industry
Table 6.5 shows the results of the estimation exercise, with Column (1) showing the results using the Olley-Pakes (OP) measure of productivity, and Column (2) using the OLS with fixed effects (FE) measure. One set of evidence from the regressions speaks to the relationship between competition and productivity. First, there is a strong relationship between an industry’s strength in exporting and its productivity, reflecting a fairly intuitive connection between the ability to compete on international markets and efficiency. Second, there is also some evidence of a positive relationship between import competition and productivity, with a positive and significant coefficient on the tariff variable in column (1) but not (2). This suggests that trade liberalization might have a positive effect on productivity by weeding out uncompetitive firms.

The results further offer evidence identifying factors that undermine industry productivity. Table 6.5 shows that there is a negative relationship (consistent across columns (1) and (2)) between industry concentration and productivity, and industry size and productivity. This suggests that the central government’s interventionist efforts to build large, globally competitive conglomerates is actually reducing efficiency in Chinese industries.

Together, these findings suggest that the central state’s national champions policy, intensified in the post-WTO era, might be generating inefficiencies in resources allocation, while liberalization itself contributes more to the productivity of the economy than does industrial policy.

6.7 Conclusion

This chapter has examined the sources of variation in state strategies across China’s manufacturing industries. While WTO entry has heightened the central state’s emphasis on building globally competitive national champions, weak account-
ability allows subnational states to adopt divergent strategies without being punished. At the same time, WTO entry has altered the incentives shaping the bureaucratic advancement of subnational states by providing direct access to external resources in the form of export markets and FDI.

By highlighting the channels through which WTO entry can affect the divergent deployment of state strategies across industries, I offer a new perspective on the challenges of industrial policymaking under conditions of globalization. I show that the area where central and subnational strategies exhibit the largest contradiction is in industries where FDI is officially encouraged. Using two case studies of the automobile and semiconductor industries, I demonstrate that policy tension arises because central and subnational states seek to deploy FDI to serve different political purposes. I further present findings explaining why the central state’s national champions policy is more successful in some sectors compared to others. Finally, I show that central industrial policies are not necessarily more effective, as more productive sectors tend to have weaker national champions.
The rules governing globalization have emerged largely from the principles embedded in democratic market economies and, to an increasing extent over time, they have come to require profound adjustments in national institutions. Yet a much more diverse range of nation-states are now participating in such deep-integration agreements, as evidenced by the inclusion of Vietnam and Brunei in the mega-regional trade agreement of the Trans-Pacific Partnership. Therefore, questions about when authoritarian states adopt some strategies rather than others in response to global economic rules, and why they do so, have become issues of vital theoretical and practical importance. This dissertation has examined the critical case of China’s entry into the WTO and provided a framework explaining why policy responses to WTO rules were neither top-down nor monolithic, despite single-party rule.

7.1 Key Findings

In this study, I have demonstrated that although China is governed by a single authoritarian party, there is no consensus within the vast party-state over how best to govern the economy. Rather, there exist three broad competing strategies of economic governance that state actors choose from in formulating their responses to trade liberalization: a directive strategy that is market-replacing in nature; a developmental...
strategy that is market-shaping, and a regulatory strategy that comprises market-enhancing measures. I identify and analyze these distinct strategies empirically by applying machine-learning methods in text analysis to an original dataset of Chinese industry regulations covering all manufacturing sectors from 1978 to 2014. In so doing, I provide new measures allowing for closer analysis and understanding of the contestation within the multi-layered Chinese state regarding how the state should govern the economy. I show that despite the WTO’s binding rules and demanding terms of accession, China’s entry into the organization did not result in a uniform convergence towards liberalization. Instead actors within the Chinese state adopted economic strategies in response to WTO entry that diverged across administrative levels, over time and across sectors. I provide evidence showing that these strategy choices are driven by two main forces: First is an actor’s likelihood of sanction – by the WTO, by the party leadership or by the central state – which varies unevenly within China’s governing structure. Second is an actor’s prospects for bureaucratic advancement, which are altered by WTO entry through economic and bureaucratic channels. The economic channels involve the new threat of import competition and new opportunities of access to foreign capital and export markets, while the bureaucratic channels involve new trade rules that enhance the policy influence of some actors while curbing that for others.

In my examination of variation in state responses across administrative levels, I demonstrate that policy divergence originates from a combination of international and domestic forces, which emphasize the likelihood of WTO sanction that each political unit faces and the diversity of that unit’s industrial base. Greater likelihood of sanction provokes regulatory responses corresponding to governance norms promoted by the WTO while greater industry diversity reduces the threat of import competition, thereby privileging developmental policies over directive ones. Therefore, WTO rules
that were fashioned to encourage the establishment of regulatory institutions actually provoke quite different economic strategies comprising directive and developmental policy measures at the subnational level.

Looking within the central state, I show how the weakening of WTO leverage over time interacts with the changing relationship between the Party leadership and its bureaucracy to generate an institutional dualism – a rise of regulatory and developmental policies, at different points in time. I demonstrate that the degree to which the Party leadership could push for regulatory reform depended on how embedded its ties were within the bureaucracy. During the Jiang Zemin - Zhu Rongji era, the leadership was able to effectively discipline central agencies and credibly commit the bureaucracy towards more regulatory reform because the ties in their network lay largely outside the central state. In contrast, in the Hu Jintao and Wen Jiabao era, the leadership could not punish central agencies without also inflicting penalties on members of their own network within the bureaucracy. This change in party-state relations led the direction of economic policy to be driven by central state agencies rather than the party leadership. At the same time, the balance of power between different central agencies changed over time as the leverage to be extracted from WTO rules gradually weakened, allowing developmental agencies to gain strength over regulatory ones and engage in rival institution-building.

Finally, I show that WTO entry has intensified the conflict between central and subnational states over the governance of key industries. While WTO entry heighten the central state’s desire to build globally-competitive national champions, paradoxically, it has also enhanced the ability of subnational states to bypass the center, by increasing their access to global markets and foreign capital. I show that the central state’s national champions policy is more likely to be undermined by divergent policies from subnational governments in industries that are more exposed to export

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markets and FDI. I also provide evidence showing that the center’s industrial policies are not necessarily more effective in fostering competitive conglomerates: sectors that are more dominated by national champions or driven by a greater preponderance of central policies are on average less productive.

In sum, this dissertation offers a new explanation for why, rather than constraining authoritarian states or credibly committing them to global economic rules, WTO rules provoke divergent responses within a state, in ways that do not necessarily strengthen the transition towards a market economy.

7.2 Implications

7.2.1 WTO Rules: Moving from Policy Space to Policy Responses

The first contribution that this research makes is to move beyond the treatment of trade rules in terms of whether or not they constrain the policy space of member states. While a robust debate has emerged over this topic, this dissertation has shown that such a binary framing obscures the full range of strategies that states can adopt in response to international agreements. Instead, I have provided an explanation for why specific actors within the state adopted regulatory responses in accordance with WTO rules, while others intensified their deployment of developmental and directive strategies.

I explain this outcome by recasting the relationship between external rules and the state in terms of an active engagement. That is, I examine how WTO rules alter state strategies for economic governance. By moving past the treatment of China as a unitary actor in international affairs, I re-frame the question in terms of how trade
rules reconfigure politics within the state, and explain why different state actors adopt distinct strategies to adjust to the new economic and regulatory demands of a post-WTO environment.

As a result, I show that there are varying logics of adjustment within different parts of the state to the common “shock” of WTO entry. First, WTO entry affects the political interests of different state actors – subnational governments or central agencies – differentially. For some actors, WTO entry brings the opportunity of more resources (export markets, foreign capital or policy influence), while for others it presents a threat (via import competition or curbs on bureaucratic discretion). Second, the probability of being sanctioned by the WTO or party leadership varies unevenly for different actors within the vast and fragmented Chinese state. As a result, WTO entry does not lead to a uniform convergence towards liberalization, but rather triggers divergent reactions across different parts of the state. In short, I offer a new explanation for why international rules in fact provoked *multi-faceted* responses from an internally fragmented Chinese state, in ways neither expected nor desired by the architects of those rules.

### 7.2.2 External Rules as Credible Commitment

This research additionally demonstrates the unexpected pathways through which domestic politics can frustrate efforts by national leaders to use international commitments as leverage in their pursuit of domestic reform. In doing so, this dissertation provides a new political framework for understanding the limitations and unintended consequences of deploying external rules as credible commitments. The strategy of using external rules to drive domestic reform is a familiar one that many countries have deployed, from Mexico’s membership in the GATT and subsequent signing of
the North-American Free Trade Agreement (NAFTA) to Japan’s commitments to a range of domestic reforms under gaiatsu (or foreign pressure) during negotiations with the US\textsuperscript{1} (Tomz 1997; Tornell and Esquivel 1995; Schoppa 1993).

What we have seen from the case of China’s accession to the WTO, however, is that the efficacy of relying on external rules to drive domestic reform can change over time. Two factors affect the temporal effects of such external rules. The first relates to the depth and permanence of the commitment itself. Monetary union – for example, joining the Eurozone – is a deeply binding measure that involves the permanent and absolute loss of government control over policy domains such as interest rate-setting. When it comes to WTO rules, the scope and depth of commitments that China signed on to were undoubtedly substantial, as Chapters One and Two have indicated. However, entry into the WTO arguably does not lead to a permanent loss of control over policy in the same way that monetary union eliminates control over interest rates. Instead, most policy actions become more deeply contested in domestic politics and subject to challenge and sanction at the WTO’s dispute settlement board.

WTO rules were strongest in the years immediately following China’s entry, due to the highly specific timetable of commitments laid out in China’s Protocol of Accession. For example, Annex 3 of the Protocol lists the liberalization schedule for products subject to non-tariff measures such as import licenses, import quotas and import tenders. These non-tariff measures were to be eliminated at specific intervals: immediately upon accession for granulated sugar; e.g. by 2002 for sodium cyanide; and by 2004 for aviation kerosene. The implementation of these commitments were further closely monitored by China’s trading partners via the Transition Review Mechanism. However, most of these commitments were scheduled to be completed by 2005-2006, 

\textsuperscript{1}For example, the Structural Impediments Initiative talks in the late 1980s and early 1990s aimed at re-balancing the US-Japan economic relationship.
leading to a weakening of the WTO’s leverage over time.

A second reason that the strategy of relying on external leverage may not be durable is that long term support for a change in policy depends on the strength of domestic coalitions for or against that change. In cases where external leverage is used in the initial stage to overcome domestic opposition, but that leverage is impermanent, much depends on the degree to which there are “positive feedback effects” such that new coalitions of domestic support emerge to entrench the policy change (Pierson 2000). Why might it be that regulatory reform in China was not supported more strongly by domestic interests? One might imagine that exporters would benefit from a freer trading regime, and that consumers would benefit from cheaper imports. In the case of consumers, it could be that the challenge of collective action renders this group ineffective as an interest group (Olson 1971). As for exporters, they stand to benefit from trade liberalization relative to protectionism. However, it is not clear that they would prefer regulatory policies aimed at leveling the playing field to developmental ones, since the latter is likely to contain benefits, such as subsidies and credit incentives, that discriminate in favor of their industries. Therefore where external leverage serves as a substitute for – rather than stimulant to – domestic support, the effectiveness of a new policy is likely to fade over time, opening up space for opposition or “losers” from reform to advance their own agenda.

Compliance and costs

One common theme in the literature on international rules and compliance is that the probability of compliance is affected by the costs of reneging (e.g. reputational costs, audience costs, etc). By unpacking the diversity of interests within the nation-state, this dissertation has demonstrated the importance of considering variation in responses to these rules when the threat of sanction (or costs of non-compliance) falls
unevenly across actors within the state. In other words, there may be scope for extending the two-level game, which has been focused on negotiations \cite{Putnam1988}, to the politics of implementing international agreements. This dissertation has shown the value of examining the dynamics of a multi-level game in implementation, unpacking the ways in which variation in the costs of reneging borne by actors at different administrative levels can generate divergent responses to international commitments.

In joining the WTO, China subjected itself to the possibility of sanction and retaliation via the dispute settlement mechanism, thereby raising the costs of deviating from WTO rules. However, in the event of a dispute, it is the central state that has to bear the costs of collecting the relevant information and accounting for the alleged infringement at the WTO dispute settlement board, and – in the event of an unfavorable ruling – implementing or appealing the panel decision. Even more specifically, within the central state, it is the Ministry of Commerce who is in charge of WTO affairs. If other actors, such as subnational states or central agencies in charge of industrial policy enact measures that lead to a complaint being filed, they do not have to internalize the first-order negative effects of the dispute. Hence, an uneven distribution of the threat of sanction generates scope for divergent responses to WTO rules, even under conditions of single-party rule.

7.2.3 The Politics of Networks and Accountability in China

By examining the relationship between political networks and central state responses to the WTO, this study has uncovered a new dimension to the operation of networks in China. Existing studies tend to treat members within a particular network (or faction) as sharing a common interest, and focus on questions of how the presence of networks structures political competition and policymaking \cite{Dittmer2003}.
and Wu 1995; Shih 2008) or how membership in networks affects the probability of political advancement (Shih et al. 2012). In contrast, I focus on situations where interests can diverge within a network, in particular between the party leadership and the central bureaucracy. Under such circumstances, the location of where the leader’s networks are embedded comes to play a significant role. And while studies have emphasized the role of informal networks in facilitating policymaking (Lieberthal and Oksenberg 1988), I focus on the role that network embeddedness plays in shifting the locus of elite policymaking (party leadership versus central state). In so doing, I bring attention to an important channel through which networks can hinder, rather than facilitate, the party leadership’s ability to get its policies implemented.

Additionally, this study brings a new dimension to our understanding of how accountability operates in China, by highlighting the counter-intuitive role that network embeddedness plays in determining policy outcomes. Tsai (2007) suggests that one factor affecting public goods provision in Chinese villages is whether or not local officials are embedded into local solidary groups. Specifically, she argues that embeddedness improves public goods provision by raising the social obligations of local officials to contribute to village welfare, generating an informal channel of accountability in the absence of the electoral mechanism that provides accountability in democracies. In this study, I have shown that at the top echelons of governance, embeddedness can in fact undermine accountability. When the networks of party leaders are deeply embedded within the central bureaucracy, channels of accountability are broken because the leadership cannot effectively punish the state for deviating from its goals without also inflicting that punishment on members of its own network. As such, the periods associated with lagging or even reversals in economic reform in China have occurred during the tenure of leaders whose networks were deeply embedded in the central state.
7.2.4 Globalization and Institutional Change in China

While much literature on the political economy of China has focused on institutional change, there has been little work that explicitly brings in the repercussions of China’s growing participation in international institutions. Instead, accounts of institutional change in China have been by and large focused on domestic factors, and can be broadly divided between gradualism and experimentation on the one hand, and cyclical patterns and great reversals on the other. This dichotomy mirrors to some extent the tension in the literature on institutions between endogenous change and punctuated equilibrium.

Scholars writing from the gradualism perspective see China’s economic reform process as slowly evolving from one of piecemeal and ad-hoc initiatives (e.g. the household responsibility system, dual pricing reforms in the late 1970s and 1980s, and what calls “adaptive informal strategies”) to more coherent macroeconomic reforms (e.g. fiscal, banking and exchange rate reforms in the early 1990s), as market rationality slowly expands across different spheres of the economy. They would see China’s movement from Special Economic Zones to full WTO membership as part of an incremental and linear process of liberalization. This dissertation has shown, however, that the domestic response to WTO entry has been far from linear, and that liberalization has in fact been accompanied by strengthened measures representative of developmental and directive modes of governance.

offers an alternative framing, arguing that China’s unique approach of “experimentation under hierarchy” allows the center to chart the direction of policy reform through local innovation. and Perry (2011) argue that this experimental spirit distinguishes the CCP from other communist regimes, and
stems from both the CCP’s revolutionary roots as well as Mao’s guerilla military tactics of ceaseless change, pushing against any stable form of institutionalization or, indeed, any stable pattern of change. As Heilmann himself has documented, however, China’s share of experimental economic regulations fell dramatically after 2001, due to “WTO-driven harmonization with international regulatory standards”, suggesting a move towards greater institutionalization and stability in the post-WTO era (Heilmann 2007). The findings from this dissertation show that the post-WTO decline in experimentation that Heilmann documents has not been accompanied by a uniform movement towards stronger regulatory institutions. Instead, policy responses from different parts of the state have diverged, leading to a heterogenous process of policy-making.

Another body of literature adopts a cyclical view of change in China, with the Party vacillating between periods of relative control and relaxation. Skinner and Winckler (1969), writing about policy cycles in the Maoist era, see the Party shifting periodically from mobilization (following a period of normalcy) to demobilization and retrenchment (following a period of deterioration). Huang (2008) sees 1980s China as a period of market liberalism favoring rural growth and private entrepreneurship, while the 1990s involved a great reversal back to statism and policies favoring urban growth. Shih (2008), in explaining inflation control, argues that the Party delegates power to the provinces during periods of prosperity, then transfers that authority to central technocrats during periods of inflation. Scholars writing in this tradition might see WTO entry as a ‘centralizing’ moment, and expect future periods to bring about more decentralization (e.g. with localities engaging directly in global trade). However, the pattern of change documented in this dissertation is not one of cyclicalality. Rather, this study has provided evidence showing that WTO entry has resulted in intensified conflict between the central and subnational governments over industrial policy.
The strikingly different pattern of change uncovered in this dissertation stems, perhaps, from the fact that none of these existing theories brings in external rules systematically as a driver of institutional change, despite the WTO’s highly intrusive demands on the reforms that China needed to undertake as a price of entry. While Yang (2004); Mertha and Zeng (2005); Pearson (2007) and Hsueh (2011) all point to WTO accession as having some effect in driving the emergence of a regulatory state, questions about how the patterns and sources of institutional change in China might have shifted as a result remain relatively unexplored. Steinfeld (2012) sees globalization as providing a “bottom-up” process of change that will bring Chinese institutions into convergence with those in developed democracies, through what he calls “institutional outsourcing” – where the state cedes control over institutional reform to the demands of the global market and transnational production networks. Johnston (2008), on the other hand, proposes a process of socialization towards global norms that is more “top-down” in nature, driven by interactions at the international level. In contrast, my research provides a theory that explains why China’s fragmented domestic governance structure generates varying politics of adjustment to the common “shock” of WTO entry, leading to policy responses that are neither “top-down” nor “bottom-up”, but rather divergent and conflictual.

As a result, WTO entry reconfigures political competition within China’s authoritarian state, resulting in an intensified contestation between state actors. Rather than a convergence towards the strengthening of liberalizing institutions, we observe a surprising pattern of policy change: Actors within the state intensified their deployment of alternative strategies (developmental and directive), leading to an overall divergence and even rival institution-building within the central state.
7.3 The Future of China and the Global Order

What, then, do these findings imply for the future of China and the global order? A number of studies examining China’s behavior within the WTO observe that the Chinese government has not only largely fulfilled its WTO commitments, it has also become highly adept at deploying WTO rules towards its own advantage - in other words, that China has become a ‘status quo’ rather than revisionist player in the multilateral trading system (Lawrence 2006, Mercurio and Tyagi 2012, Gao 2011, Kennedy and Cheng 2012, Li 2012, Shaffer and Gao 2017). The findings of this dissertation suggest, however, that such ‘status quo’ behavior might actually derive from the actions of a narrow set of players within the vast Chinese state apparatus – in particular the Ministry of Commerce, an agency tasked with managing China’s WTO affairs and known to be more internationalist and reform-oriented compared to other ministries within the central government. Therefore it cannot be assumed that China’s behavior in broader global economic arenas, which might be driven by different ministries or even subnational governments, will similarly be in accord with the existing rules of the international economic order.

As indicated in Chapter One, signs of a more globally assertive China have been emerging for some time. One important event signalling the shift in China’s outward posture came when Xi Jinping made a number of remarks at a Politburo study session in December 2014. At this session, Xi noted that China was now embarking on a “new round of opening to the world”[^1] one that not only continued the long-established strategy of export promotion, opening China’s markets to the rest of the world and drawing in foreign capital, but that newly emphasized outbound foreign investment,

[^1]: xin yi lun duiwai kaifang” “新一轮对外开放”

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the “going out” of Chinese enterprises and the forging of new free trade agreements with other nations. In particular, Xi emphasized that China would no longer take a passive role in global economic governance. Instead, he pointed out that:

Accelerating the implementation of the free trade zone strategy is an important platform for our nation’s active participation in the making of international trade and economic rules, and for our efforts to gain institutional power in the global economic governance system. We cannot be a bystander, nor a follower, but must be a participant, a leader. By building free trade zones, we can strengthen our international competitiveness, project more Chinese voices and inject more Chinese elements in international rule-making, and defend and expand our country’s developmental interests (Xinhua News 2014).

And indeed, China has been vigorously stepping up its outward economic engagements over the past decade and a half. Since joining the WTO in 2001, China has concluded eleven bilateral and regional free traded agreements (FTAs). It is in the process of negotiating agreements with Israel, Norway, Japan and Korea, Georgia, Sri Lanka, the Maldives and the Gulf Cooperation Council, while feasibility studies are being conducted with India, Columbia, Nepal and more. Its latest regional initiatives include the Asia-Pacific Free Trade Area (FTAAP), the Regional Comprehensive Economic Partnership (RCEP), and in the area of investment and loans the “One Belt, One Road” (OBOR) initiative and the Asian Infrastructure Investment Bank (AIIB).

These outward engagements have not gone un-noticed by the international press, who have speculated about the consequences of a more assertive China for the rules of the global order. In March 2015, for example, the United Kingdom’s decision to join China’s AIIB, over the warnings and disapproval of the US government, was

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3 Author’s translation. In Chinese, the exact remarks were: “加快实施自由贸易区战略,是我国积极参与国际经贸规则制定、争取全球经济治理制度性权力的重要平台,我们不能当旁观者、跟随者,而是要做参与者、引领者,善于通过自由贸易区建设增强我国国际竞争力,在国际规则制定中发出更多中国声音、注入更多中国元素,维护和拓展我国发展利益。”
interpreted as a major failure for US economic diplomacy [Reuters2015]. The UK’s decision opened the gates for other Western nations such as Australia, New Zealand, Germany and France to also apply for membership, leaving the US in an unusual position of isolation. One headline at that time foreshadowed: “Now China starts to write the rules” [Stephens2015].

Similarly, when Donald Trump withdrew the US from the TPP in January 2017, international reporting turned almost immediately to the prospects of an ascendant China. One headline read “As Trump retreats on trade, China moves in” [Von der Burchard and Marks2017], while another read: “Trump leaves Asia door open for China to dominate trade” [Alaco2017]. These predictions of a China-dominated world raise the key question: In a world where China writes the rules of the global economic order, how might Chinese rules differ from American ones?

If we were to try to compare between the two countries, one might argue that in highly generalized terms, one characteristic of American economic liberalization is that of predictability. Often the most uncertain aspect of an American trade agreement lies in Congress – either over whether Congress will grant Trade Promotion Authority (TPA) to the President, or whether or not a trade deal will get ratified. Because all trade agreements require Congressional approval, US trade negotiators have to craft a package containing the right combination of market access concessions and protections that will be approved by the legislature, and which the US’ trading partners have little scope to influence. As such, American FTAs largely follow a set template, regardless of who the other party is.[4] A typical US FTA will emphasize, apart from tariff reduction, services liberalization, rules on investment and government procurement, intellectual property rights protection, and protections for labor

[4]I am grateful to Robert Lawrence for this observation.
Another feature of American-style liberalization is its emphasis on rules and transparency, with the terms of engagement set out in advance and clarified over many rounds of domestic and international negotiations. While TPP negotiations were criticized for their secrecy, once the full text of the agreement was released it provided enough detail for economists to be able to assess the economic impacts of the agreement on both signatories and non-signatories.

In contrast, the Chinese approach to economic liberalization looks very different. Two things are striking when one examines China’s external economic initiatives. First, the terms of liberalization across China’s many trade agreements vary widely. China’s FTA with Singapore, for example, committed to a total elimination of tariffs for 85% of Singapore’s manufacturing exports, while the FTA with Chile liberalized trade in services across a wide range of sectors. The FTA with Peru, in contrast, involved a gradual reduction of tariffs over a period of 16 years, and a general (non-specific) commitment to services liberalization.

Second, as pointed out in Chapter One, many of these initiatives are lacking in detail. China tends to launch initiatives with objectives sketched out in broad strokes. The OBOR initiative, for example, has generated great excitement both within and outside of China. Broadly, it is an outward economic strategy that aims to bring bilateral Chinese investment and trade deals to a loose collection of countries along the old Silk Road stretching westwards from China into Central Asia and Europe (the “Belt”), and southwards into maritime routes from Southeast Asia to South Asia and Africa (confusingly termed the “Road”). The exact details of what the initiative entails and what role institutions such as the Silk Road Fund and the AIIB will play, however, remain vague and are only becoming clarified slowly over time. Such an approach not only mirrors China’s early incremental process of domestic reform, it
also maximizes the space for China to adjust and adapt as the economic environment evolves.

Drawing from the findings of this dissertation, I argue that treating the Chinese state as a unitary actor in global affairs would lead to misleading predictions about the nature of a China-led globalization. Rather, the insights provided by this study suggest that the outward strategies embodied in China’s economic initiatives will be driven by multiple and conflicting – rather than convergent – approaches to economic governance. Just as different actors within the Chinese state responded to the WTO with multi-faceted strategies, so the lack of consensus within the state over state-economy relations could translate into multiple “varieties of Chinese capitalism” in its outward engagements (Hall and Soskice 2001).

Indeed, domestic opinion within China is divided over what the “One Belt, One Road” initiative is and the role that the state should play in ‘Belt and Road’ projects. As Jia Qingguo, Dean of Peking University’s School of International Studies has pointed out, conflicting understandings of what OBOR entails exist not only in scholarly circles, but also within the government (Jia 2015). Disagreements vary widely among Chinese thinkers over the geo-strategic elements of the initiative, as well as whether the government should guide investments or let the market decide on which projects to finance (Godement and Kratz 2015).

And just as the interests of subnational governments drove the divergence of policy responses to China’s WTO entry, so do subnational interests appear to be shaping the contours of the OBOR initiative. According to a report by Anbound, a think-tank with links to the central government, the plan for OBOR was originally restricted to the “New Silk Road” initiative, focused on infrastructure investments in Central Asia. However, coastal provinces in the southeast persistently lobbied the center to expand the scope of the initiative, leading the “maritime silk road” component stretching
through Southeast Asia to be added (Anbound 2015). Indeed, the various components of the OBOR initiative appear to be a “consolidation and political elevation of pre-existing policy ideas and practice at the sub-national level in China”, with provinces such as Xinjiang, Yunnan and Chongqing all having developed plans for outward economic trade and investment connections before Xi proposed the initial idea in 2013 (Summers 2016).

Since the Belt and Road initiative has been elevated to a national priority closely tied to Xi Jinping, financial and political support for projects associated with OBOR have grown exponentially. It is not clear, however, if over time the goals and features of the initiative will gain greater clarity and coherence, or if it will remain a loose agglomeration of the interests of various actors within the state. At the central level, the ‘Belt and Road’ initiative is being driven by the National Development and Reform Commission (NDRC), the Ministry of Finance and the Ministry of Commerce (MOFCOM). As this dissertation has shown, the NDRC and MOFCOM tend to deploy very different strategies in their governance of economic issues. And as Chapters Four and Six have pointed out, fierce competition for bureaucratic advancement often leads subnational governments to deploy national priorities towards their own narrow political objectives. Currently, with many provinces struggling with a slowing economy and excess capacity, subnational interest in the OBOR initiative has intensified. By July 2015, 21 out of 31 provinces had developed their own provincial “One Belt, One Road” plans, in a bid to draw central funds to their region (EIU Views Wire 2015). According to one report, this competition is leading subnational governments to subsidize projects that may not be profitable (Tang 2015).

Hence, as we look at China’s behavior across a range of global economic arenas, what emerges is not one China bringing a more aggressive state capitalism to challenge the international economic order – but multiple Chinas. When it comes to
the WTO, parts of the Chinese state have undergone substantial transformation to come into conformity with the regulatory mode of governance promoted by WTO rules. Yet other parts of the state have responded with greater developmentalism, and even stronger directive modes of governance. Rather than adopting a common set of terms and conditions, China’s FTAs with different countries vary widely in their scope and depth of liberalization. And its overseas projects under the “Belt and Road” initiative appear to be driven by subnational actors with their own distinct local political economies, ranging from market-friendly Zhejiang province to FDI-dominated Guangdong and state-dominated Jilin province. None of these developments add up to coherent Chinese model of state capitalism aimed at upending existing international rules. Rather than a clash of civilizations, a rising and more assertive China might be bringing greater heterogeneity and variability to the rules of globalization, reflective of the divergent modes of governance embedded in its internal structure.

7.4 China and the WTO: a sui generis case?

How far do these findings and the overall theoretical framework apply beyond China? Chapter Two has explained both the unique trajectory of China’s domestic economic reform and the political dynamics on the US and Chinese sides that led to the creation of the ambitious Protocol of Accession to the WTO. This protocol was far more detailed than what other newly-acceding members have had to sign on to, reflective of the US’ concerns over China’s economic size and authoritarian governing structure. To some extent, then, the findings of this dissertation may reflect dynamics unique to China.

However, the scope of this research can and should travel beyond the Chinese case. First, the depth of adjustment that China had to undertake in its Protocol of
Accession can be considered an early case of the trend towards ever-deeper terms of integration in trade agreements. The rules governing SOEs in the draft Trans-Pacific Partnership, for example, go even beyond what China committed to in the WTO (Cimino-Isaacs 2016). Second, trade initiatives such as the TPP are increasingly drawing in countries from a diverse range of political systems (e.g. Vietnam), making the question of how non-democratic regimes respond to such intrusive economic rules a topic of substantive importance. Finally, the strategy of using external rules to overcome domestic opposition is one that many countries, especially developing ones, have deployed over the years. I propose two broad areas where the conclusions from this study might generalize to other cases.

First, this dissertation’s arguments that relate to why China’s decentralized structure generated divergent responses to liberalization have important implications for other large, decentralized or federalized countries. For example, literature on US trade policy has examined why the trade preferences of officials at different levels of the American federal system diverge. In broad terms, the benefits from protection are highly concentrated in smaller constituencies, as these constituencies tend to be dominated by a few or a single industry. Therefore, politicians from smaller constituencies will be subject to stronger demands for protection relative to those who oversee larger constituencies (Mansfield and Busch 1995; Rogowski 1987b). This logic has been used to explain why the US President (who has the largest constituency size) is less protectionist relative to Congress (Bailey et al. 1997; Milner and Rosendorff 1996; Lohmann and O’Halloran 1994), while the Senate is less protectionist relative to the House (Schiller 1999) (See Karol (2007) for a test of this argument). One might expect that such dynamics might not travel to a single party regime such as China. However, this dissertation has shown that de-facto or quasi-federal structures in China generate similar divergence in responses to trade liberalization across administrative
levels.

Within comparative politics, scholars have written extensively about the politics of decentralization in countries in Latin America (in particular Brazil and Mexico) and India, and examined the sources of subnational variation in developmental and industrial policy within those countries (Montero 2010; Eaton 2004; Falleti 2010; Sinha 2005). For example, Snyder (1999) examines why the deregulation of the coffee sector in Mexico led to the emergence of re-regulation at subnational levels, resulting in distinct governance institutions across different Mexican states. Most of these studies acknowledge the broader context of globalization and global markets, but do not bring in the influence of global rules in a systematic way. This dissertation has shown that the “winners and losers” from globalization can vary within a decentralized state, as the economic benefits and threats from trade liberalization to governments at higher levels of administration differ from those at lower levels. Therefore, an area for future research might lie in connecting the subnational politics of other large, decentralized countries to the politics of responding to global rules.

Second, this study has provided a generalizable explanation for why, even under conditions of single-party rule, responses to globalization might diverge within a regime. While the opacity commonly associated with single-party regimes might render political conflict less visible, this analysis has underscored the point that authoritarian governance does not translate into a convergence of interests within the state apparatus. Indeed while authoritarian regimes are often associated with repression – of civil society, opposition parties and media – another feature of authoritarian rule might be that the most significant political competition ends up being almost entirely internalized within the state. While disagreements over economic policy in developed democracies frequently manifest themselves in competition between political parties, this study suggests that similar conflict in single-party regimes might
show up across competing parts of the state. Potential lines of contestation might lie
between the party leadership and the state, or across competing factions, depending
on which parts of the state stand to gain or lose from new global economic rules.

Another reason to expect similar dynamics at play in other single-party regimes
is that authoritarian states arguably have more to lose from WTO entry compared to
developed democracies, due to the potential for these external rules to affect two di-
mensions of autocratic interests. First, the economic effects of WTO entry alters the
ability of state actors to generate the economic growth needed to meet the demands
of performance legitimacy often associated with non-democratic systems (Huntington
1993). Second, WTO rules governing state behavior threatens to reshape the distribu-
tion of bureaucratic discretion and control over resources. In developed democracies
there is a relatively clear distinction between party and state, and politicians compete
for resources and influence through legislative and electoral contests. In authoritar-
ian regimes, by contrast, bureaucratic control over resources feeds directly into the
ability of state actors (who are also politicians) to engage in political competition.
Therefore to the extent that new trade agreements are increasingly focused on the
harmonization of domestic regulations, we might expect external rules to intensify
conflict within authoritarian regimes over who retains influence over economic policy.

Finally, should we expect the same kinds of responses to emerge from other coun-
tries? Disagreements over the role of the state in economic governance exist in all
countries, and policies geared towards developmentalism can be found even in devel-
oped market economies, as evinced in the European Union’s official “EU Industrial
Policy” and the US’s “Buy America” initiative. The three types of state strategies that
this study has focused on (market-replacing, market-shaping and market-enhancing)
are in some ways reflective of China’s incremental process of transitioning away from
the planned economy, but nevertheless capture the major competing approaches to
economic governance across a diversity of economies. Therefore at a minimum, we might expect a similar typology of responses from developing countries such as Vietnam and other post-Communist regimes seeking to join international economic agreements. For other types of economic systems, the choices of state strategies might differ and may be focused more on developmental versus regulatory strategies, with a smaller role for directive strategies which are partially rooted in a central planning mode of governance. Nevertheless, as the rules of globalization have come to demand increasingly substantial adjustments in domestic policies, there are fewer reasons to expect that these rules would result in a uniform convergence towards liberalization. This dissertation has shown that – particularly in the case of decentralized or authoritarian regimes – the introduction of global rules alters incentives within the state such that these rules can become subject to internal conflict, leading actors to respond with divergent, rather than convergent, strategies for growth.
A  |  Appendix to Chapter 4

A.1 Main Regression Results
Table A.1: Responses from the central government

<table>
<thead>
<tr>
<th>Central Strategies</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crackdown</th>
<th>Rectification</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Tariff (inverse)</td>
<td>0.0010*</td>
<td>0.0014*</td>
<td>0.0002</td>
<td>0.0001</td>
<td>-0.0003</td>
<td>0.0004</td>
</tr>
<tr>
<td>(2) (0.0005)</td>
<td>(0.0007)</td>
<td>(0.0006)</td>
<td>(0.0006)</td>
<td>(0.0002)</td>
<td>(0.0003)</td>
<td></td>
</tr>
<tr>
<td>(3) Tariff standard deviation</td>
<td>0.0009</td>
<td>0.0007</td>
<td>0.0016</td>
<td>0.0009</td>
<td>-0.0005</td>
<td>0.0007</td>
</tr>
<tr>
<td>(4) (0.0009)</td>
<td>(0.0010)</td>
<td>(0.0011)</td>
<td>(0.0011)</td>
<td>(0.0009)</td>
<td>(0.0005)</td>
<td></td>
</tr>
<tr>
<td>(5) Industry output (RMB bn)</td>
<td>-0.00004**</td>
<td>-0.00004</td>
<td>-0.00004</td>
<td>0.00002</td>
<td>-0.00001</td>
<td>-0.000004</td>
</tr>
<tr>
<td>(6) (0.00002)</td>
<td>(0.00002)</td>
<td>(0.00002)</td>
<td>(0.00002)</td>
<td>(0.00001)</td>
<td>(0.00001)</td>
<td></td>
</tr>
<tr>
<td>(7) Industry exports (RMB bn)</td>
<td>-0.00003</td>
<td>0.00001</td>
<td>-0.00001</td>
<td>-0.00003</td>
<td>0.00003</td>
<td>0.00001</td>
</tr>
<tr>
<td>(8) (0.00004)</td>
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<td>(0.00004)</td>
<td>(0.00002)</td>
<td>(0.00003)</td>
<td>(0.00001)</td>
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</tr>
<tr>
<td>(9) Industry employment (millions)</td>
<td>0.0158</td>
<td>-0.0112</td>
<td>-0.0270</td>
<td>-0.0126</td>
<td>-0.0070</td>
<td>0.0042</td>
</tr>
<tr>
<td>(10) (0.0325)</td>
<td>(0.0269)</td>
<td>(0.0496)</td>
<td>(0.0163)</td>
<td>(0.0113)</td>
<td>(0.0150)</td>
<td></td>
</tr>
<tr>
<td>(11) SOE output share</td>
<td>0.0113</td>
<td>0.0204</td>
<td>0.0714*</td>
<td>0.0028</td>
<td>0.0095</td>
<td>0.0009</td>
</tr>
<tr>
<td>(12) (0.0411)</td>
<td>(0.0427)</td>
<td>(0.0424)</td>
<td>(0.0354)</td>
<td>(0.0266)</td>
<td>(0.0253)</td>
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</tr>
<tr>
<td>(13) Foreign output share</td>
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<td>0.0432</td>
<td>0.1037</td>
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<td>0.0251</td>
<td>-0.0032</td>
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<tr>
<td>(14) (0.0653)</td>
<td>(0.0611)</td>
<td>(0.0684)</td>
<td>(0.0669)</td>
<td>(0.0502)</td>
<td>(0.0299)</td>
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<tr>
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<td>yes</td>
<td>yes</td>
<td>yes</td>
<td>yes</td>
<td>yes</td>
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<td>R^2</td>
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<td>0.0497</td>
<td>0.0613</td>
<td>0.0611</td>
<td>0.0824</td>
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<tr>
<td>Adjusted R^2</td>
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<td>0.0407</td>
<td>0.0502</td>
<td>0.0500</td>
<td>0.0675</td>
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</table>

Note: *p<0.1; **p<0.05; ***p<0.01. Standard errors clustered by industry
Table A.2: Responses from the provincial government

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<th></th>
<th>Provincial Strategies</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crankdown</th>
<th>Rectification</th>
</tr>
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<tr>
<td></td>
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<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
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<tr>
<td>Tariff (inverse)</td>
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<td>0.0005</td>
<td>0.0012***</td>
<td>0.0014*</td>
<td>0.0014**</td>
<td>-0.0009</td>
<td>0.0004</td>
</tr>
<tr>
<td></td>
<td></td>
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<td>(0.0004)</td>
<td>(0.0008)</td>
<td>(0.0006)</td>
<td>(0.0007)</td>
<td>(0.0003)</td>
</tr>
<tr>
<td>Tariff standard deviation</td>
<td></td>
<td>-0.0005</td>
<td>0.0020***</td>
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<td>-0.0003</td>
<td>-0.0007</td>
<td>0.0004</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.0013)</td>
<td>(0.0007)</td>
<td>(0.0009)</td>
<td>(0.0006)</td>
<td>(0.0012)</td>
<td>(0.0006)</td>
</tr>
<tr>
<td>Industry output (RMB bn)</td>
<td></td>
<td>0.00001</td>
<td>0.00001</td>
<td>-0.00002</td>
<td>-0.00004</td>
<td>-0.00004*</td>
<td>-0.000004</td>
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<tr>
<td></td>
<td></td>
<td>(0.00002)</td>
<td>(0.00001)</td>
<td>(0.00002)</td>
<td>(0.00001)</td>
<td>(0.00002)</td>
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</tr>
<tr>
<td>Industry exports (RMB bn)</td>
<td></td>
<td>0.00005</td>
<td>-0.00001</td>
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<td>0.00001</td>
<td>-0.00004</td>
<td>-0.00002</td>
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<td>(0.00002)</td>
<td>(0.00002)</td>
<td>(0.00001)</td>
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</tr>
<tr>
<td>Industry employment (millions)</td>
<td></td>
<td>-0.0469</td>
<td>-0.0195*</td>
<td>0.0024</td>
<td>-0.0280**</td>
<td>0.0209</td>
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<td>(0.0378)</td>
<td>(0.0113)</td>
<td>(0.0272)</td>
<td>(0.0132)</td>
<td>(0.0218)</td>
<td>(0.0165)</td>
</tr>
<tr>
<td>SOE output share</td>
<td></td>
<td>-0.0441</td>
<td>0.0486*</td>
<td>-0.0213</td>
<td>-0.0155</td>
<td>-0.1001*</td>
<td>0.0570</td>
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<tr>
<td></td>
<td></td>
<td>(0.0527)</td>
<td>(0.0259)</td>
<td>(0.0531)</td>
<td>(0.0320)</td>
<td>(0.0514)</td>
<td>(0.0414)</td>
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<tr>
<td>Foreign output share</td>
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<td>-0.0602</td>
<td>0.0013</td>
<td>0.0048</td>
<td>0.0372</td>
<td>0.0247</td>
<td>0.0714*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.0658)</td>
<td>(0.0425)</td>
<td>(0.0578)</td>
<td>(0.0322)</td>
<td>(0.0879)</td>
<td>(0.0423)</td>
</tr>
<tr>
<td>Year and Industry fixed effects</td>
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<td>yes</td>
<td>yes</td>
<td>yes</td>
<td>yes</td>
<td>yes</td>
</tr>
<tr>
<td>Observations</td>
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<td>543</td>
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<td>543</td>
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<td>543</td>
</tr>
<tr>
<td>R^2</td>
<td></td>
<td>0.0437</td>
<td>0.0554</td>
<td>0.0550</td>
<td>0.0725</td>
<td>0.0709</td>
<td>0.0373</td>
</tr>
<tr>
<td>Adjusted R^2</td>
<td></td>
<td>0.0349</td>
<td>0.0442</td>
<td>0.0438</td>
<td>0.0578</td>
<td>0.0566</td>
<td>0.0297</td>
</tr>
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</table>

*Note:* *p*<0.1; **p*<0.05; ***p*<0.01. Standard errors clustered by industry.
Table A.3: Responses from the local government

<table>
<thead>
<tr>
<th>Local Strategies</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crackdown</th>
<th>Rectification</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td></td>
</tr>
<tr>
<td>Tariff (inverse)</td>
<td>-0.0006** (0.0003)</td>
<td>-0.0007** (0.0003)</td>
<td>-0.0002 (0.0009)</td>
<td>0.0009 (0.0010)</td>
<td>0.0030** (0.0013)</td>
<td>0.0001 (0.0007)</td>
</tr>
<tr>
<td>Tariff standard deviation</td>
<td>-0.0019*** (0.0006)</td>
<td>-0.0007 (0.0007)</td>
<td>0.0030** (0.0014)</td>
<td>-0.0005 (0.0010)</td>
<td>0.0002 (0.0021)</td>
<td>0.0008 (0.0013)</td>
</tr>
<tr>
<td>Industry output (RMB bn)</td>
<td>-0.00001 (0.00001)</td>
<td>0.00001 (0.00002)</td>
<td>-0.00002 (0.00001)</td>
<td>-0.00002 (0.00002)</td>
<td>-0.00004 (0.00002)</td>
<td>0.00001 (0.00002)</td>
</tr>
<tr>
<td>Industry exports (RMB bn)</td>
<td>0.000004 (0.000002)</td>
<td>-0.00004 (0.00003)</td>
<td>-0.0001 (0.00003)</td>
<td>0.00003 (0.00002)</td>
<td>0.00002 (0.00003)</td>
<td>-0.00003 (0.00001)</td>
</tr>
<tr>
<td>Industry employment (millions)</td>
<td>0.0044 (0.0161)</td>
<td>-0.0089 (0.0155)</td>
<td>0.1197 (0.0762)</td>
<td>-0.0087 (0.0178)</td>
<td>-0.0765 (0.0911)</td>
<td>-0.0188 (0.0615)</td>
</tr>
<tr>
<td>SOE output share</td>
<td>-0.0086 (0.0293)</td>
<td>0.0364* (0.0215)</td>
<td>0.0100 (0.0770)</td>
<td>-0.0105 (0.0324)</td>
<td>-0.0382 (0.1176)</td>
<td>0.0079 (0.0514)</td>
</tr>
<tr>
<td>Foreign output share</td>
<td>-0.0071 (0.0399)</td>
<td>0.0864** (0.0361)</td>
<td>0.1826* (0.1053)</td>
<td>-0.0007 (0.0373)</td>
<td>0.0179 (0.1440)</td>
<td>0.0673 (0.0476)</td>
</tr>
</tbody>
</table>

| Year and Industry fixed effects | yes | yes | yes | yes | yes | yes |
| Observations | 423 | 423 | 423 | 423 | 423 | 423 |
| $R^2$ | 0.0309 | 0.0562 | 0.1355 | 0.1086 | 0.1378 | 0.0626 |
| Adjusted $R^2$ | 0.0234 | 0.0426 | 0.1028 | 0.0824 | 0.1045 | 0.0475 |

Note: *p<0.1; **p<0.05; ***p<0.01. Standard errors clustered by industry.
A.2 Regulations by Sector

Figure A.1: Number of regulations by sector and level (post-1978)
A.3 Accountability & Industry Diversity Estimation

Results
Table A.4: Responses of provincial government to change in accountability

<table>
<thead>
<tr>
<th>Province-level Strategies</th>
<th>Standards (1)</th>
<th>Certification (2)</th>
<th>HT-Dev (3)</th>
<th>Agro-Dev (4)</th>
<th>Crackdown (5)</th>
<th>Rectification (6)</th>
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<td></td>
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<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
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<tr>
<td>Trade openness</td>
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<td></td>
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<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
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<tr>
<td>FDI share of GDP</td>
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<td>-0.0006</td>
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<td>0.0002</td>
<td>-0.0001</td>
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<td></td>
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<td>(0.0003)</td>
<td>(0.0005)</td>
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<td>(0.0003)</td>
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<tr>
<td>SCE share of GDP</td>
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<td>0.0004</td>
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<td>Industry Diversity</td>
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<td>GDP</td>
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<td>0.0000</td>
<td>0.0000000</td>
<td>-0.000000**</td>
<td>-0.000000*</td>
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<td>(0.000000)</td>
<td>(0.000000)</td>
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</tr>
<tr>
<td>Ln GDP per capita</td>
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<td>0.0001</td>
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<td>-0.00005</td>
<td>-0.000003</td>
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</tr>
<tr>
<td>Fiscal balance</td>
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<td>-0.000002</td>
<td>0.000003</td>
<td>0.000001</td>
<td>0.000001</td>
<td>0.00001</td>
</tr>
<tr>
<td></td>
<td>(0.000001)</td>
<td>(0.000001)</td>
<td>(0.000003)</td>
<td>(0.000001)</td>
<td>(0.000001)</td>
<td>(0.000001)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>0.00002</td>
<td>-0.000003**</td>
<td>-0.00001</td>
<td>-0.000004</td>
<td>-0.0001***</td>
<td>-0.00001</td>
</tr>
<tr>
<td></td>
<td>(0.00003)</td>
<td>(0.00001)</td>
<td>(0.00002)</td>
<td>(0.00002)</td>
<td>(0.00002)</td>
<td>(0.00001)</td>
</tr>
<tr>
<td>Province accountability*Trade openness</td>
<td>-0.0002</td>
<td>-0.0001</td>
<td>-0.0002**</td>
<td>-0.0004***</td>
<td>-0.0001</td>
<td>-0.0002***</td>
</tr>
<tr>
<td></td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
</tr>
</tbody>
</table>

|                          | yes          | yes             | yes       | yes         | yes         | yes             |
|                          | 284          | 284             | 284       | 284         | 284         | 284             |
| R²                       | 0.1660       | 0.1154          | 0.1167    | 0.0714      | 0.1404      | 0.1081           |
| Adjusted R²              | 0.1368       | 0.0951          | 0.0962    | 0.0588      | 0.1157      | 0.0891           |

Note: *p<0.1; **p<0.05; ***p<0.01. Standard errors clustered by province. Weight on Party Secretary = 0.2
Figure A.2: Comparing provincial and prefecture industry diversity
<table>
<thead>
<tr>
<th>Province Strategies</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Rectification</th>
<th>Crackdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry Diversity</td>
<td>$-0.0001$</td>
<td>$0.001^{***}$</td>
<td>$0.001^{**}$</td>
<td>$0.003^*$</td>
<td>$0.0002$</td>
<td>$-0.0001$</td>
</tr>
<tr>
<td></td>
<td>$(0.001)$</td>
<td>$(0.001)$</td>
<td>$(0.0004)$</td>
<td>$(0.002)$</td>
<td>$(0.0004)$</td>
<td>$(0.001)$</td>
</tr>
<tr>
<td>WTO Exposure</td>
<td>$0.005$</td>
<td>$-0.004$</td>
<td>$-0.009^{***}$</td>
<td>$-0.016^*$</td>
<td>$-0.001$</td>
<td>$-0.002$</td>
</tr>
<tr>
<td></td>
<td>$(0.004)$</td>
<td>$(0.004)$</td>
<td>$(0.002)$</td>
<td>$(0.008)$</td>
<td>$(0.002)$</td>
<td>$(0.004)$</td>
</tr>
<tr>
<td>Province Accountability</td>
<td>$-0.0001^*$</td>
<td>$-0.00001$</td>
<td>$-0.00001$</td>
<td>$0.00003$</td>
<td>$-0.00001$</td>
<td>$-0.00001$</td>
</tr>
<tr>
<td></td>
<td>$(0.0001)$</td>
<td>$(0.00002)$</td>
<td>$(0.00002)$</td>
<td>$(0.00003)$</td>
<td>$(0.00002)$</td>
<td>$(0.00002)$</td>
</tr>
<tr>
<td>FDI share of GDP</td>
<td>$-0.0003$</td>
<td>$-0.001$</td>
<td>$-0.001^*$</td>
<td>$0.001$</td>
<td>$-0.0001$</td>
<td>$-0.0002$</td>
</tr>
<tr>
<td></td>
<td>$(0.001)$</td>
<td>$(0.001)$</td>
<td>$(0.0003)$</td>
<td>$(0.001)$</td>
<td>$(0.0003)$</td>
<td>$(0.001)$</td>
</tr>
<tr>
<td>SCE share of GDP</td>
<td>$-0.001$</td>
<td>$-0.0004$</td>
<td>$0.001^{**}$</td>
<td>$0.001$</td>
<td>$-0.0001$</td>
<td>$-0.001^{***}$</td>
</tr>
<tr>
<td></td>
<td>$(0.001)$</td>
<td>$(0.0002)$</td>
<td>$(0.0003)$</td>
<td>$(0.0003)$</td>
<td>$(0.0002)$</td>
<td>$(0.0003)$</td>
</tr>
<tr>
<td>GDP</td>
<td>$-0.000000$</td>
<td>$-0.00000$</td>
<td>$-0.00000$</td>
<td>$0.00000$</td>
<td>$-0.000000^{***}$</td>
<td>$-0.000000^{***}$</td>
</tr>
<tr>
<td></td>
<td>$(0.000000)$</td>
<td>$(0.000000)$</td>
<td>$(0.000000)$</td>
<td>$(0.000000)$</td>
<td>$(0.000000)$</td>
<td>$(0.000000)$</td>
</tr>
<tr>
<td>Log GDP per capita</td>
<td>$0.001$</td>
<td>$-0.0001$</td>
<td>$0.00005$</td>
<td>$0.0002$</td>
<td>$-0.00001$</td>
<td>$-0.0002$</td>
</tr>
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<td>$(0.0002)$</td>
<td>$(0.0001)$</td>
<td>$(0.0002)$</td>
<td>$(0.0001)$</td>
<td>$(0.0002)$</td>
</tr>
<tr>
<td>Fiscal balance</td>
<td>$-0.000000$</td>
<td>$-0.00000$</td>
<td>$0.000000$</td>
<td>$0.000000$</td>
<td>$0.000001$</td>
<td>$0.000002^*$</td>
</tr>
<tr>
<td></td>
<td>$(0.000001)$</td>
<td>$(0.000001)$</td>
<td>$(0.000000)$</td>
<td>$(0.000001)$</td>
<td>$(0.000001)$</td>
<td>$(0.000001)$</td>
</tr>
<tr>
<td>Unemployment</td>
<td>$0.00002$</td>
<td>$-0.00003^{**}$</td>
<td>$-0.00000$</td>
<td>$0.00002$</td>
<td>$-0.00001$</td>
<td>$-0.0001^{***}$</td>
</tr>
<tr>
<td></td>
<td>$(0.00003)$</td>
<td>$(0.00001)$</td>
<td>$(0.00002)$</td>
<td>$(0.00002)$</td>
<td>$(0.00002)$</td>
<td>$(0.00002)$</td>
</tr>
<tr>
<td>Industry Diversity*WTO Exposure</td>
<td>$-0.006$</td>
<td>$0.003$</td>
<td>$0.009^{***}$</td>
<td>$0.021^*$</td>
<td>$-0.0005$</td>
<td>$-0.001$</td>
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<tr>
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<td>$(0.005)$</td>
<td>$(0.004)$</td>
<td>$(0.003)$</td>
<td>$(0.011)$</td>
<td>$(0.002)$</td>
<td>$(0.004)$</td>
</tr>
</tbody>
</table>

Year and province fixed effects: yes; yes; yes; yes; yes; yes
Observations: 284; 284; 284; 284; 284; 284
R^2: 0.181; 0.117; 0.146; 0.104; 0.111; 0.183
Adjusted R^2: 0.149; 0.096; 0.121; 0.085; 0.092; 0.151

Note: *p<0.1; **p<0.05; ***p<0.01. Standard errors clustered by province
A.4 Endogeneity Checks

A.4.1 Pre-WTO Trends Analysis

I regress the topic proportion of the selected topics in industry policies in the pre-WTO years (1998 to 2001) on their total tariff reduction in the post-WTO years (2001 to 2005), using an interaction term between the size of the tariff reduction and a linear time trend as the key independent variable. If an industry that would experience a high tariff reduction at WTO entry already had a trajectory of, for example, increasing developmental policies, then this would show up as a positive coefficient on the interaction term. Tables A.6 to A.8 below show the results of the pre-WTO trends analysis for all six topic proportion outcomes, at the central, provincial and local levels. The results offer assurance that the significant estimations presented in Chapter Four are not driven by trends already existing in the pre-WTO period.

In Tables A.6 and A.7 showing central and province-level results respectively, none of the interaction term coefficients is significant for any of the outcomes. In Table A.8 showing local-level results, only the interaction term coefficients for the agro-processing development and rectification topic proportion outcomes are positive and statistically significant. The positive coefficients suggest that in the years running up to China’s WTO accession, local governmental policies related to agro-processing development and rectification were increasing for sectors that would later experience larger tariff reductions. However, the analysis in Chapter Four does not show evidence that these tariff reductions then led to a continued increase in either of these two topics in the post-WTO years.
Table A.6: Pre-WTO industry policy trends and WTO tariff reductions (Central)

<table>
<thead>
<tr>
<th>Central level pre-WTO trends</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crackdown</th>
<th>Rectification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-WTO years</td>
<td>0.014***</td>
<td>0.013**</td>
<td>0.008</td>
<td>0.008</td>
<td>−0.004*</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(0.005)</td>
<td>(0.006)</td>
<td>(0.005)</td>
<td>(0.007)</td>
<td>(0.002)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>WTO Tariff Change</td>
<td>0.185</td>
<td>0.088</td>
<td>−0.949</td>
<td>−1.493</td>
<td>−0.179</td>
<td>0.041</td>
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<tr>
<td></td>
<td>(0.527)</td>
<td>(1.190)</td>
<td>(1.228)</td>
<td>(1.465)</td>
<td>(0.197)</td>
<td>(0.265)</td>
</tr>
<tr>
<td>Pre-WTO years*WTO Tariff Change</td>
<td>−0.0001</td>
<td>−0.00004</td>
<td>0.0005</td>
<td>0.001</td>
<td>0.0001</td>
<td>−0.00002</td>
</tr>
<tr>
<td></td>
<td>(0.0003)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
</tr>
<tr>
<td>Constant</td>
<td>−28.605***</td>
<td>−25.957***</td>
<td>−15.720</td>
<td>−16.914</td>
<td>7.046*</td>
<td>−1.471</td>
</tr>
</tbody>
</table>

|                 | 238       | 238          | 238    | 238      | 238       | 238          |
|                 | 0.061     | 0.065        | 0.064  | 0.061    | 0.012     | 0.021        |
| Adjusted R²     | 0.049     | 0.053        | 0.052  | 0.049    | −0.001    | 0.008        |
| Residual Std. Error (df = 234) | 0.061 | 0.055 | 0.057 | 0.072 | 0.041 | 0.029 |

Note: *p<0.1; **p<0.05; ***p<0.01
Table A.7: Pre-WTO industry policy trends and WTO tariff reductions (Provincial)

<table>
<thead>
<tr>
<th>Province level pre-WTO trends</th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crackdown</th>
<th>Rectification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-WTO years</td>
<td>0.004</td>
<td>0.004</td>
<td>0.006</td>
<td>0.001</td>
<td>0.001</td>
<td>0.004</td>
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<tr>
<td></td>
<td>(0.003)</td>
<td>(0.004)</td>
<td>(0.005)</td>
<td>(0.002)</td>
<td>(0.004)</td>
<td>(0.003)</td>
</tr>
<tr>
<td>WTO Tariff Change</td>
<td>-0.391</td>
<td>0.336</td>
<td>1.347</td>
<td>0.788</td>
<td>-0.547</td>
<td>-0.010</td>
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<td></td>
<td>(0.381)</td>
<td>(0.554)</td>
<td>(1.063)</td>
<td>(0.891)</td>
<td>(0.453)</td>
<td>(0.613)</td>
</tr>
<tr>
<td>Pre-WTO years*WTO Tariff Change</td>
<td>0.0002</td>
<td>-0.0002</td>
<td>-0.001</td>
<td>-0.0004</td>
<td>0.0003</td>
<td>0.0001</td>
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<td></td>
<td>(0.0002)</td>
<td>(0.0003)</td>
<td>(0.001)</td>
<td>(0.0004)</td>
<td>(0.0002)</td>
<td>(0.0003)</td>
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<tr>
<td></td>
<td>(6.769)</td>
<td>(7.950)</td>
<td>(9.096)</td>
<td>(4.484)</td>
<td>(7.393)</td>
<td>(5.163)</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Observations</th>
<th>167</th>
<th>167</th>
<th>167</th>
<th>167</th>
<th>167</th>
<th>167</th>
</tr>
</thead>
<tbody>
<tr>
<td>R²</td>
<td>0.027</td>
<td>0.039</td>
<td>0.029</td>
<td>0.062</td>
<td>0.011</td>
<td>0.049</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.009</td>
<td>0.022</td>
<td>0.011</td>
<td>0.045</td>
<td>-0.007</td>
<td>0.031</td>
</tr>
<tr>
<td>Residual Std. Error (df = 163)</td>
<td>0.048</td>
<td>0.042</td>
<td>0.043</td>
<td>0.024</td>
<td>0.064</td>
<td>0.040</td>
</tr>
</tbody>
</table>

*Note:* *p<0.1; **p<0.05; ***p<0.01
Table A.8: Pre-WTO industry policy trends and WTO tariff reductions (Local)

<table>
<thead>
<tr>
<th></th>
<th>Standards</th>
<th>Certification</th>
<th>HT-Dev</th>
<th>Agro-Dev</th>
<th>Crackdown</th>
<th>Rectification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-WTO years</td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
</tr>
<tr>
<td>Pre-WTO years</td>
<td>$-0.001$</td>
<td>$-0.002$</td>
<td>$0.008^*$</td>
<td>$-0.001$</td>
<td>$0.0001$</td>
<td>$-0.003$</td>
</tr>
<tr>
<td></td>
<td>(0.003)</td>
<td>(0.004)</td>
<td>(0.004)</td>
<td>(0.002)</td>
<td>(0.004)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>WTO Tariff Change</td>
<td>$-0.635$</td>
<td>$-0.854$</td>
<td>$0.327$</td>
<td>$-1.100^{**}$</td>
<td>$-0.943$</td>
<td>$-3.408^{**}$</td>
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<td>(0.664)</td>
<td>(0.678)</td>
<td>(0.427)</td>
<td>(0.508)</td>
<td>(0.990)</td>
<td>(1.666)</td>
</tr>
<tr>
<td>Pre-WTO years*WTO Tariff Change</td>
<td>$0.0003$</td>
<td>$0.0004$</td>
<td>$-0.0002$</td>
<td>$0.001^{**}$</td>
<td>$0.0005$</td>
<td>$0.002^{**}$</td>
</tr>
<tr>
<td></td>
<td>(0.0003)</td>
<td>(0.0003)</td>
<td>(0.0002)</td>
<td>(0.0003)</td>
<td>(0.0005)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>Constant</td>
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<td>$4.628$</td>
<td>$-15.639^*$</td>
<td>$1.390$</td>
<td>$-0.177$</td>
<td>$6.196$</td>
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<tr>
<td></td>
<td>(6.228)</td>
<td>(7.694)</td>
<td>(8.507)</td>
<td>(3.632)</td>
<td>(7.001)</td>
<td>(9.853)</td>
</tr>
<tr>
<td>Observations</td>
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<td>129</td>
<td>129</td>
<td>129</td>
<td>129</td>
<td>129</td>
</tr>
<tr>
<td>R$^2$</td>
<td>0.014</td>
<td>0.011</td>
<td>0.042</td>
<td>0.077</td>
<td>0.013</td>
<td>0.115</td>
</tr>
<tr>
<td>Adjusted R$^2$</td>
<td>$-0.010$</td>
<td>$-0.012$</td>
<td>0.019</td>
<td>0.055</td>
<td>$-0.011$</td>
<td>0.094</td>
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<td>Residual Std. Error (df = 125)</td>
<td>0.027</td>
<td>0.034</td>
<td>0.043</td>
<td>0.028</td>
<td>0.044</td>
<td>0.060</td>
</tr>
</tbody>
</table>

*Note:* $^p<0.1; ^{**}p<0.05; ^{***}p<0.01$
A.4.2 Do Industry Characteristics Predict Tariff Reductions?

To check if China’s WTO tariff reductions are endogenous to Chinese industrial or bureaucratic interests, I estimate the effects of industry characteristics in the pre-WTO period (1998-2001) on tariff changes in the post-WTO period (2001-2005). If sectors with particular characteristics (e.g. state ownership) were being systematically protected by the Chinese government, then we would observe a negative relationship between a sector’s SOE output share and its WTO tariff reduction. The industry characteristics include:

- Industry share of total exports. The government might allow larger tariff cuts for export-oriented industries, as these industries are less likely to be threatened by import competition.

- Industry share of total output. Industries with a large output share might represent products with a large domestic market, leading to a desire to protect such industries.

- Industry share of total employment. In order to maintain social stability, the government might wish to protect industries that employ a large share of workers.

- State-owned enterprise (SOE) share of industry output. The government might want to protect industries in which it has a stronger ownership stake.

- Foreign Invested Enterprise (FIE) share of industry output.

- Hong-Kong, Macau, Taiwan (HMT) share of industry output. Sectors dominated by foreign enterprises are likely to be more liberalized, leading to greater
willingness to allow import competition.

The results are shown in Table A.9 below. I run three estimations, first regressing the post-WTO change in tariffs on the average pre-WTO levels of industry characteristics (Column 1), then on the change in pre-WTO levels of industry characteristics (Column 2), and finally on both levels and changes in industry characteristics (Column 3). The results show no significant results at the 5% significance level, while Column 3 shows a positive correlation at the 10% level between the industry share of national output and industry tariff reductions.

If industry output share is indicative of market size, then the weak correlation between the size of the domestic market and the amount of trade liberalization in Column 3 might suggest that foreign economies successfully negotiated larger cuts for sectors that represented a larger domestic market.

A.5 Details on Text Analysis

A.5.1 Pre-processing of Text and Generating Topics

The regulations were converted from html to text format and then segmented (spaces inserted between words). The texts were then processed to remove punctuation, english letters and numbers. There are 63,626 unique words in the corpus, excluding words comprised of just one character. I removed stopwords (commonly occurring words, such as ‘the’ and ‘that’ in English) and all agency names, to avoid agency names (such as the National Development and Reform Commission) being

---

1With controls for SOE, FIE and HMT output, the base term omitted from the analysis is the private sector share of industry output.
Table A.9: Do Industry Characteristics Predict Tariff Reductions?

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<thead>
<tr>
<th></th>
<th>Post-WTO change in tariffs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
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<tr>
<td>Share of national exports</td>
<td>59.865</td>
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<td>(346.628)</td>
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<tr>
<td>Share of national output</td>
<td>165.596</td>
</tr>
<tr>
<td></td>
<td>(193.735)</td>
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<td>Share of national employment</td>
<td>−77.279</td>
</tr>
<tr>
<td></td>
<td>(163.370)</td>
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<td>Sectoral SOE output share</td>
<td>4.001</td>
</tr>
<tr>
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<td>(4.944)</td>
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<tr>
<td>Sectoral FIE output share</td>
<td>4.704</td>
</tr>
<tr>
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<td>(5.951)</td>
</tr>
<tr>
<td>Sectoral HMT share</td>
<td>1.750</td>
</tr>
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<td>(5.570)</td>
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<td>Change in share of national exports</td>
<td>1,949.722</td>
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<td>Change in share of national output</td>
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<tr>
<td>Change in share of national employment</td>
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<td>(669.534)</td>
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<tr>
<td>Change in sectoral SOE output share</td>
<td>−29.106</td>
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<td>Change in sectoral FIE output share</td>
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<td>Change in sectoral HMT share</td>
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<tr>
<td></td>
<td>(23.422)</td>
</tr>
<tr>
<td>Constant</td>
<td>3.634*</td>
</tr>
<tr>
<td></td>
<td>(1.963)</td>
</tr>
<tr>
<td></td>
<td>5.904***</td>
</tr>
<tr>
<td></td>
<td>(0.822)</td>
</tr>
<tr>
<td></td>
<td>2.592</td>
</tr>
<tr>
<td></td>
<td>(2.256)</td>
</tr>
<tr>
<td>Observations</td>
<td>119</td>
</tr>
<tr>
<td>R²</td>
<td>0.064</td>
</tr>
<tr>
<td></td>
<td>0.020</td>
</tr>
<tr>
<td></td>
<td>0.125</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.014</td>
</tr>
<tr>
<td></td>
<td>−0.032</td>
</tr>
<tr>
<td></td>
<td>0.025</td>
</tr>
</tbody>
</table>

*Note: p<0.1; **p<0.05; ***p<0.01
All covariates are pre-WTO averages (1998 to 2001)
counted as representing one particular strategic orientation or another. All industry names and technical terms associated with an industry were also filtered out (for example chemical names in the chemicals industry), so as to avoid generating clusters of words centered around these technical specifics.

Given the large size of the corpus, this dissertation employs an unsupervised machine-learning algorithm to generate ‘topics’ that are latent within the documents (see Blei and Lafferty (2007) on the Correlated Topic Model (CTM)). The CTM has been shown to provide a better fit to data compared to alternative methods such as Latent Dirichlet Allocation (LDA) (Blei et al. 2003). Each word in the vocabulary of the corpus is assumed to have some probability of belonging to a topic, and each topic is therefore a mixture over different words. Each document is a mixture over topics and a document is allowed to comprise more than one topic. Since topics are likely to be inter-related, the CTM also estimates the correlation between topics.

Scholars have noted that there is no fixed rule to identifying the “correct” number of topics to be set by the analyst, with the choice depending on the objective of the analysis and “granularity” with which one wishes to view the data (Roberts et al. 2014; Chang et al. 2009). There is a variety of data-driven approaches to assist in picking the appropriate number of topics, the most common being held-out likelihood which assesses how well the models generated using training data fits to an unseen “held-out” set of documents. For a very large corpus of documents such as in this analysis, however, the held-out likelihood is likely to be continuously increasing in the number of topics up to a high upper range, leading to a significant decline in substantive interpretability as the number of topics rises (in the Blei and Lafferty (2007) example the held-out likelihood for a corpus of 1,452 documents does not decline even up to 120 topics).

Instead, I employ an alternative method combining measures of semantic coher-
ence and exclusivity (Roberts et al. 2014). Semantic coherence measures how consistently words that are assigned with high probability to a topic tend to co-occur within documents (Mimno et al. 2011), while exclusivity measures how similar a topic is to another topic generated by the algorithm. The optimal number of topics is picked by plotting the results and restricting candidate models to those residing on what Roberts et al. (2014) call the “semantic coherence-exclusivity frontier” (where no model is strictly dominated by another in the two criteria). Figure A.3 shows the semantic coherence and exclusivity score of different numbers of topics applied to the corpus. Topic numbers at the “coherence-exclusivity frontier”, namely K=27, 28, 41, 49 and 51 were selected and the top 20 words for each topic carefully checked through for overall substantive meaning. K=41 was ultimately selected based on topic quality. Topics in K=27 and 28 tended to have a few chained topics (i.e. words from two different issue areas but which share a common word occurring within one topic), whilst topics in K=49 and 51 had a few topics that were not substantively meaningful.

### A.5.2 Topics Generated by the Correlated Topic Model

Table A.10 shows the top five words belonging to each topic generated by the CTM algorithm (topic labels assigned by the author after a close reading of the top 20 words and top 10 documents in each topic), while Figure A.4 shows the proportions of each topic in the entire corpus.
Figure A.3: Selecting the ‘right’ number of topics (1978-2014 corpus)
Figure A.4: Topic proportions
<table>
<thead>
<tr>
<th>Topic Label</th>
<th>word 1</th>
<th>word 2</th>
<th>word 3</th>
<th>word 4</th>
<th>word 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>accounts</td>
<td>assets</td>
<td>cost</td>
<td>cost</td>
<td>enterprise</td>
<td>income</td>
</tr>
<tr>
<td>arbitration</td>
<td>contract</td>
<td>purchase</td>
<td>protocol</td>
<td>signed</td>
<td>responsibility</td>
</tr>
<tr>
<td>punitive</td>
<td>in charge</td>
<td>illegal</td>
<td>punish</td>
<td>according to law</td>
<td>fine</td>
</tr>
<tr>
<td>trade</td>
<td>import export</td>
<td>export</td>
<td>import</td>
<td>international</td>
<td>trading</td>
</tr>
<tr>
<td>trade and sales</td>
<td>sales</td>
<td>service</td>
<td>trading</td>
<td>brands</td>
<td>responsibility</td>
</tr>
<tr>
<td>legality</td>
<td>management</td>
<td>run</td>
<td>service</td>
<td>service</td>
<td>public security</td>
</tr>
<tr>
<td>emergency</td>
<td>emergency</td>
<td>have to</td>
<td>get on</td>
<td>deal with</td>
<td>claim</td>
</tr>
<tr>
<td>information security</td>
<td>information</td>
<td>system</td>
<td>management</td>
<td>qualification</td>
<td>user</td>
</tr>
<tr>
<td>implementation</td>
<td>jobs</td>
<td>responsible for</td>
<td>good</td>
<td>strengthen</td>
<td>implement</td>
</tr>
<tr>
<td>safety</td>
<td>safety</td>
<td>management</td>
<td>produce</td>
<td>operation</td>
<td>get on</td>
</tr>
<tr>
<td>rectification</td>
<td>control</td>
<td>consolidation</td>
<td>jobs</td>
<td>shut down</td>
<td>safety</td>
</tr>
<tr>
<td>insurance</td>
<td>insurance</td>
<td>proxy</td>
<td>approval</td>
<td>qualifications</td>
<td>reply</td>
</tr>
<tr>
<td>development</td>
<td>produce</td>
<td>base</td>
<td>construction</td>
<td>development</td>
<td>improve</td>
</tr>
<tr>
<td>human capital</td>
<td>train</td>
<td>examination</td>
<td>occupation</td>
<td>assess</td>
<td>appraisal</td>
</tr>
<tr>
<td>demonstration</td>
<td>construction</td>
<td>spread</td>
<td>service</td>
<td>system</td>
<td>pilot</td>
</tr>
<tr>
<td>permits (registration)</td>
<td>enterprise</td>
<td>produce</td>
<td>license</td>
<td>management</td>
<td>registered</td>
</tr>
<tr>
<td>finance</td>
<td>transaction</td>
<td>audit</td>
<td>get listed</td>
<td>business</td>
<td>financial</td>
</tr>
<tr>
<td>certification</td>
<td>product</td>
<td>authenticate</td>
<td>label</td>
<td>mark</td>
<td>claim</td>
</tr>
<tr>
<td>crackdown</td>
<td>regulation</td>
<td>special</td>
<td>supervision</td>
<td>behavior</td>
<td>jobs</td>
</tr>
<tr>
<td>investment</td>
<td>project</td>
<td>construction</td>
<td>investment</td>
<td>reform</td>
<td>main</td>
</tr>
<tr>
<td>prices</td>
<td>price</td>
<td>market</td>
<td>retail</td>
<td>wholesale</td>
<td>carried out</td>
</tr>
<tr>
<td>construction</td>
<td>engineering</td>
<td>design</td>
<td>construction</td>
<td>construction</td>
<td>acceptance</td>
</tr>
</tbody>
</table>
Table A.10 continued.

<table>
<thead>
<tr>
<th>hightech devt</th>
<th>industry</th>
<th>development</th>
<th>enterprise</th>
<th>technology</th>
<th>product</th>
</tr>
</thead>
<tbody>
<tr>
<td>foreign enterprise</td>
<td>register</td>
<td>ratify</td>
<td>certificate</td>
<td>effective</td>
<td>coordinate</td>
</tr>
<tr>
<td>permits (requirements)</td>
<td>run</td>
<td>management</td>
<td>license</td>
<td>enterprise</td>
<td>quality</td>
</tr>
<tr>
<td>standards</td>
<td>test</td>
<td>quality</td>
<td>supervise</td>
<td>detect</td>
<td>qualified</td>
</tr>
<tr>
<td>funds</td>
<td>funds</td>
<td>special</td>
<td>management</td>
<td>financial</td>
<td>fund</td>
</tr>
<tr>
<td>production approval</td>
<td>stock</td>
<td>group</td>
<td>responsibility</td>
<td>manufacture</td>
<td>dedicated</td>
</tr>
<tr>
<td>license</td>
<td>process</td>
<td>science &amp; technology</td>
<td>technology</td>
<td>industry</td>
<td>zone</td>
</tr>
<tr>
<td>tech performance</td>
<td>standard</td>
<td>test</td>
<td>claim</td>
<td>technology</td>
<td>detect</td>
</tr>
<tr>
<td>fees</td>
<td>goods</td>
<td>toll</td>
<td>standard</td>
<td>carried out</td>
<td>fare</td>
</tr>
<tr>
<td>approval</td>
<td>application</td>
<td>put on record</td>
<td>declare</td>
<td>registered</td>
<td>examine</td>
</tr>
<tr>
<td>planning</td>
<td>management</td>
<td>plan</td>
<td>have to</td>
<td>jobs</td>
<td>carried out</td>
</tr>
<tr>
<td>inspection</td>
<td>examination</td>
<td>jobs</td>
<td>monitor</td>
<td>supervision</td>
<td>supervise</td>
</tr>
<tr>
<td>tax</td>
<td>appreciation</td>
<td>tax</td>
<td>invoice</td>
<td>tax</td>
<td>income tax</td>
</tr>
<tr>
<td>tenders</td>
<td>subsidy</td>
<td>funds</td>
<td>bidding</td>
<td>financial</td>
<td>subsidy</td>
</tr>
<tr>
<td>R and D</td>
<td>technology</td>
<td>profession</td>
<td>the study</td>
<td>expert</td>
<td>review</td>
</tr>
<tr>
<td>antidumping</td>
<td>survey</td>
<td>product</td>
<td>domestic</td>
<td>anti-dumping</td>
<td>price</td>
</tr>
<tr>
<td>renewal</td>
<td>purchase</td>
<td>recover</td>
<td>industry commerce</td>
<td>management</td>
<td>update</td>
</tr>
<tr>
<td>upgrade</td>
<td>industry</td>
<td>industry</td>
<td>resources</td>
<td>use</td>
<td>complex</td>
</tr>
<tr>
<td>land</td>
<td>construction</td>
<td>planning</td>
<td>facility</td>
<td>protection</td>
<td>land</td>
</tr>
</tbody>
</table>
A.5.3 Selection of Topics into Strategies

Figure A.5 shows the correlations between topics selected into the representative strategies and other topics.

The ‘ideal type’ topic representing the directive strategy is labeled “Rectification”. There are two topics directly correlated to this topic: “Crackdown” and “Upgrade”. The latter topic is excluded as it is correlated with topics in the Developmental strategy type, leaving the two topics “Rectification” and “Crackdown” in the directive category.

The ‘ideal type’ topic representing the developmental strategy is labeled “High-tech development”. The three topics directly correlated with this ideal typical topic are: “Agro-processing development”, “Demonstration” and “Upgrade”. The “Demonstration” topic is excluded as there was no strong agreement amongst the independent validators on the classification of this topic. The “Upgrade” topic is excluded as it is also correlated with a topic in the directive strategy type, leaving two topics “High-tech development” and “Agro-processing development” in the developmental category.

The ‘ideal type’ topic representing the regulatory strategy is labeled “Standards”. The two topics directly correlated with this topic are “Certification” and “Inspection”. The latter is excluded from the analysis because it is also correlated with topics in the directive state category, leaving two topics “Standards” and “Certification” in the regulatory category.
Figure A.5: Correlation between topics
A.5.4 Construct validity: Independent validation of topics

Seven undergraduates were recruited from Peking University and the China University of Politics and Law to act as independent validators. Each validator was given a set of definitions for the three strategies (an English translation of these definitions is in Section A.5.4). To ascertain that they understood these definitions, each validator was asked to give a written description of each strategy in their own words. They were then asked to classify the top three documents from each of the 41 topics as either “Directive”, “Developmental”, “Regulatory” or “Other” (a total of 123 documents). The documents were presented to the validators in a random order without additional information. In line with the mixed-membership nature of the algorithm used to generate topics, the validators were allowed to classify documents as belonging to more than one strategy along a sliding scale ranging from 0 to 100. For example, a document could be classified 80% “Developmental” and 20% “Other” and so on. The validators were not allowed to consult with each other during this exercise, so as to avoid their influencing each other’s choices.

The scores given by each validator were then averaged for each topic and re-scaled from 0 to 10, such that 10 represents a unanimous classification across all validators for all three documents in a topic. As the top three documents for each topic tend to be similar, a consistency score was calculated for each validator comprising the average standard deviation in their scoring across the top three documents in each topic. The validators’ classifications were weighted by these consistency scores. This weighting did not result in substantive changes in overall classification results (see Table A.11 for the full scores).

Figure A.6 shows the validation results for the topics selected into the three types of strategies. The documents in the Directive type (“Rectification” and “Crackdown”)
were given near unanimous scores in the Directive category (9.7 and 9.8 respectively), while the documents in the Developmental strategy type ("High-tech Development" and "Agro-processing Development") were given similarly high scores in the Developmental category (9.7 and 9.3 respectively). The documents in the Regulatory orientation ("Standards" and "Certification") also received high scores in the Regulatory category (8 and 7.9 respectively). Two other topics scored higher in Regulatory strategy type, but the documents in these topics are concerned with safety and building construction guidelines, and therefore might be too narrow to be good representations of a regulatory type. Moreover, the topics directly correlated to these two topics did not score highly as regulatory, rendering them unfeasible for the topic selection process described in Chapter Four.

Definitions for Independent Validation

The following are English translations for the definitions for each strategy type that the independent validators used in their classification exercise.

- **Directive type:** This type of policy relies on state control over resource allocation and relies on interventionist administrative measures rather than market mechanisms to meet policy objectives. Examples of such policies include: setting production targets, directing enterprise mergers, directing company closures and targeted campaigns against illegal activities. Such policies are therefore market-replacing in nature, in the sense that under free market conditions, changes in industry activities such as enterprise mergers and closures, as well as production volumes will be determined by firm or consumer behavior based on profit margins and price signals, not according to government directives. The language in such policies can emphasize a range of different activities, such as
Figure A.6: Topic classification by independent validators
<table>
<thead>
<tr>
<th>Topic Number</th>
<th>Topic Name</th>
<th>Directive</th>
<th>Developmental</th>
<th>Regulatory</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Accounts</td>
<td>2.3</td>
<td>0</td>
<td>5.8</td>
<td>1.9</td>
</tr>
<tr>
<td>2</td>
<td>Arbitration</td>
<td>1.6</td>
<td>0</td>
<td>1.6</td>
<td>6</td>
</tr>
<tr>
<td>3</td>
<td>Punitive</td>
<td>4.1</td>
<td>0</td>
<td>2.2</td>
<td>3.7</td>
</tr>
<tr>
<td>4</td>
<td>Trade</td>
<td>2</td>
<td>0</td>
<td>6.1</td>
<td>1.9</td>
</tr>
<tr>
<td>5</td>
<td>Trade and sales</td>
<td>3.1</td>
<td>1</td>
<td>4.4</td>
<td>1.6</td>
</tr>
<tr>
<td>6</td>
<td>Legality</td>
<td>3</td>
<td>0</td>
<td>4.9</td>
<td>2.1</td>
</tr>
<tr>
<td>7</td>
<td>Emergency</td>
<td>2.2</td>
<td>0</td>
<td>6.6</td>
<td>1.2</td>
</tr>
<tr>
<td>8</td>
<td>Information security</td>
<td>1.6</td>
<td>0</td>
<td>5.5</td>
<td>2.1</td>
</tr>
<tr>
<td>9</td>
<td>Implementation</td>
<td>3</td>
<td>1.7</td>
<td>0.5</td>
<td>4.8</td>
</tr>
<tr>
<td>10</td>
<td>Safety</td>
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<td>0</td>
<td>9.6</td>
<td>0.2</td>
</tr>
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<td>11</td>
<td>Rectification</td>
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<td>0</td>
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<td>0</td>
</tr>
<tr>
<td>12</td>
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<td>1</td>
<td>5.6</td>
<td>0.5</td>
</tr>
<tr>
<td>13</td>
<td>Agro-process Devt</td>
<td>0.6</td>
<td>9.3</td>
<td>0.1</td>
<td>0</td>
</tr>
<tr>
<td>14</td>
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<td>0</td>
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<td>5.2</td>
</tr>
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<td>15</td>
<td>Demonstration</td>
<td>2.6</td>
<td>4</td>
<td>2</td>
<td>1.4</td>
</tr>
<tr>
<td>16</td>
<td>Permits (registration)</td>
<td>4.2</td>
<td>0</td>
<td>5.1</td>
<td>0.6</td>
</tr>
<tr>
<td>17</td>
<td>Finance</td>
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<td>0.5</td>
<td>4.6</td>
<td>1.1</td>
</tr>
<tr>
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<td>0</td>
<td>7.9</td>
<td>1</td>
</tr>
<tr>
<td>19</td>
<td>Crackdown</td>
<td>9.8</td>
<td>0</td>
<td>0.2</td>
<td>0</td>
</tr>
<tr>
<td>20</td>
<td>Investment</td>
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<td>0.5</td>
<td>4.4</td>
<td>1.9</td>
</tr>
<tr>
<td>21</td>
<td>Prices</td>
<td>4.2</td>
<td>0</td>
<td>5.8</td>
<td>0</td>
</tr>
<tr>
<td>22</td>
<td>Construction</td>
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<td>0.5</td>
<td>9.2</td>
<td>0.2</td>
</tr>
<tr>
<td>23</td>
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<td>9.9</td>
<td>0</td>
<td>0</td>
</tr>
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<td>0.5</td>
<td>5.6</td>
<td>2.4</td>
</tr>
<tr>
<td>25</td>
<td>Permits (requirements)</td>
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<td>0.3</td>
<td>7.3</td>
<td>0.4</td>
</tr>
<tr>
<td>26</td>
<td>Standards</td>
<td>0.7</td>
<td>0</td>
<td>8</td>
<td>1.3</td>
</tr>
<tr>
<td>27</td>
<td>Funds</td>
<td>1.6</td>
<td>4.9</td>
<td>2.7</td>
<td>0.8</td>
</tr>
<tr>
<td>28</td>
<td>Production approval</td>
<td>2</td>
<td>4</td>
<td>3.3</td>
<td>0.7</td>
</tr>
<tr>
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<td>License</td>
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<td>0</td>
<td>7.8</td>
<td>0</td>
</tr>
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<td>30</td>
<td>Technical performance</td>
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<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>31</td>
<td>Fees</td>
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<td>0</td>
<td>7.8</td>
<td>0.2</td>
</tr>
<tr>
<td>32</td>
<td>Approval</td>
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<td>0</td>
<td>7.5</td>
<td>1</td>
</tr>
<tr>
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<td>Planning</td>
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<td>0.1</td>
<td>5.2</td>
<td>1.9</td>
</tr>
<tr>
<td>34</td>
<td>Inspection</td>
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<td>0</td>
<td>5.7</td>
<td>0.9</td>
</tr>
<tr>
<td>35</td>
<td>Tax</td>
<td>2.7</td>
<td>0.2</td>
<td>1.9</td>
<td>5.3</td>
</tr>
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<td>36</td>
<td>Tenders</td>
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<td>0.9</td>
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<td>1.2</td>
<td>0.4</td>
<td>6.2</td>
</tr>
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<td>Antidumping</td>
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<td>0</td>
<td>5.1</td>
<td>1.7</td>
</tr>
<tr>
<td>39</td>
<td>Renewal</td>
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<td>0.5</td>
<td>5.8</td>
<td>1</td>
</tr>
<tr>
<td>40</td>
<td>Upgrade</td>
<td>6.5</td>
<td>1.8</td>
<td>1.3</td>
<td>0.4</td>
</tr>
<tr>
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the use of administrative measures to restructure industries, specific types of mergers or closures or enforcements to be implemented, and language emphasizing punishments of illegal activities or violations. The overall tone of directive policies is more strict and interventionist.

- **Developmental type:** This type of policy combines administrative measures and incentives to attract investment and stimulate growth, especially foreign investment and foreign technology. Such policies are therefore market-shaping in nature, in the sense that measures are designed to stimulate and facilitate the development of industries, such as in high-tech sectors or to improve production in existing low value-added industries. Examples of such policies include measures providing R&D subsidies, tax rebates, and other incentives to attract technology, FDI, and the establishment of new industries or firms. The language in such policies can emphasize a range of different activities, such as approving investment, the establishment of new firms, new experimental or demonstration projects, the encouragement of high-tech industries and innovation, as well as the development of existing industries that may not have high technology content. The overall tone of developmental policies is more positive and encouraging.

- **Regulatory type:** This type of policy sets regulation to improve market functions and to address market failures. Such policies are therefore market-enhancing in nature, in the sense that measures are designed to set clear benchmarks for firm competition. Examples of such policies include standards setting and monitoring for products to either protect consumer welfare or to meet industrial and international standards. The language in such policies can emphasize a range of different issues and activities, from meeting quality and safety
standards, to certification requirements, to inspection and monitoring of standards. The overall tone of regulatory policies is more neutral and technocratic, emphasizing scientific and technical assessments.

A.6 Additional Robustness Checks

A.6.1 Corpus size, topic stability and topic quality

The approach adopted in this study is to generate topics from a corpus of documents that is as large as possible in order to maximize topic quality. The quality of the topics generated is of core importance to the study as these topics are the outcome of interest. In this case, the corpus collected spans China’s entire post-reform period (1978 to 2014). The proportions of the topics generated are then used as the dependent variable in separate difference-in-difference estimations using industry covariates from 1998 to 2007. The two reasons for implementing the analysis separately for this shorter time period are that: (a) this is the most pertinent period for analysis, comprising both pre- and post- WTO years; and (b) this is the period for which covariate data on industry characteristics is available. However, such an approach raises the concern of whether or not topics are changing significantly over time, such that topics generated from a corpus of documents spanning 1978-2014 do not capture the relevant policy concerns in 1998-2007, or are somehow biased towards a time period outside of 1998-2007.

To check if topics are biased by documents outside the 1998-2007 period, I first examine whether or not any of the words in the document-term matrix for the full corpus of documents do not occur in the 1998-2007 corpus. I find that this applies to only one word: “party branch”. I further check to see which words occur only in
documents in the post-WTO period and not the pre-WTO period (and vice versa). I find that only 9 words for documents in the post-WTO period do not occur in the pre-WTO era ("unexpected", "party branch", "race", "accident insurance", "build", "Peru", "answer", "interview" and "high-end"). As such, it is unlikely that the topics generated using the full set of available years are skewed by different words occurring in the post-WTO period.

To further check if topics are changing significantly over time, I re-run the topic generation exercise, using documents only from 1998-2007 (14,484 documents). Apart from checking to see if the topics generated are similar to those from the full corpus, this robustness exercise also reveals what impact using a smaller corpus has on topic quality. The main challenge here, however, would be determining the "correct" number of topics that would enable comparison with the topics generated using the full corpus.

Using the 1998-2007 corpus, I first generated 41 topics for comparison, as the main analysis used 41 topics. I find that the topics generated using the 1998-2007 corpus are broadly similar to those generated using the 1978-2014 corpus, thereby addressing concerns about topic stability over time. However, generating 41 topics using a smaller corpus leads to a decline in topic exclusivity and hence topic quality. In other words, the topics generated are less distinct from each other, suggesting that 41 topics is too large a number for this corpus. For example, three of the topics generated using the 1998-2007 corpus are all related to different degrees standards, compared one topic with the 1978-2014 corpus. In addition, the topics tend to share more words in common. For example, the word "qualifies" occurs in four topics using the 1998-2007 corpus versus one topic with the 1978-2014 corpus, while the word "industry" occurs in six topics using the 1998-2007 corpus versus three topics with the 1978-2014 corpus.
Next, I use the approach of jointly maximizing semantic coherence and exclusivity, as was done in the main analysis (see Section A.5.1), to determine what, if not 41, a more appropriate number of topics should be. Using this approach, the ‘optimal’ number of topics was found to be 25 (see Figure A.7). With this approach, I find that the topics generated are similar to those generated from the 1978-2014 corpus, but with a lower topic quality. This deterioration in topic quality can be directly observed in terms of top words in each topic. For example, both the main analysis and this analysis generated a topic related to standards. However, the top 10 words in the standards topic generated in the 1998-2007 corpus contains a higher number of general words not directly related to standards setting and supervision, such as “management” and “carry out”. In contrast, the top 10 words in the standards topic generated using the 1978-2014 corpus are all strongly specific to the topic. Similarly, a topic related to rectification was generated in both analyses. While the top 10 words in the rectification topic generated using the 1978-2014 corpus are all strongly specific to the topic, those in the topic generated using the 1998-2007 corpus again contain a higher number of more general words such as “market”, “strengthen” and “business” (see Figure A.8).

The checks in this section justify the analytic approach adopted in this dissertation, which is to use the full corpus of documents from 1978-2014 to generate the topics that are the outcome of interest in the study. The robustness checks have shown that topic stability between the two periods of 1978-2014 and 1998-2007 are not a concern, and that subsetting the topic generation exercise to just the 1998-2007 period would result in a significant decline in topic quality.
Figure A.7: Selecting the ‘right’ number of topics (1998-2007 corpus)

Figure A.8: Comparing topic quality across corpus sizes
A.6.2 Trade-off between topic quality and incorporating estimation uncertainty

Another concern with the estimation approach adopted in this dissertation is that by running the difference-in-difference estimations separately from the topic generating process, the analysis does not take into account estimation uncertainty of the generated topics. Ideally, the analysis in this study would be implemented entirely within the structural topic model (stm) package, which is able to incorporate topic estimation uncertainty into the regression analysis. However, a practical consideration prevents such an approach from being adopted.

Analysis within the stm package requires that document-level covariates are available for all years for which there are documents. As discussed earlier, the relevant industry covariates for the analysis are available only for 1998-2007. In order to incorporate estimation uncertainty of topics into the analysis, the corpus would need to be sub-set to just 1998-2007. And as the previous section has shown, this results in a substantial decline in topic quality. Therefore, the main trade-off in implementing this analysis is between maximizing topic quality (by using the full set of documents from 1978-2014) and incorporation of estimation uncertainty (by using only documents from 1998-2007).

This trade-off means that it becomes difficult to assess the results of the analysis run within STM. While it is useful to run this analysis to check if the results are similar to those in the main analysis, the decline in topic quality means that it is not clear if we should even expect the results to be replicated, nor how to interpret situations when results are inconsistent from those in the main analysis.

For example, Figure A.9 below shows the change in the prevalence of the standards topic as tariffs decline, for the center, province and local governments, for the
analysis run within STM using the 1998-2007 corpus. The figure shows that while the prevalence of language related to standards is consistently higher at the central level compared to province and local governments, that there is no significant relationship between the prevalence of standards language with changes in tariff levels. However, it is unclear if this result is due to poorer topic quality, or if it implies that the results in Chapter Four are not robust.
Figure B.1: Timeline of economic agency restructuring
C | Appendix to Chapter 6

This Appendix presents short examples of how the central government responded to WTO entry with similar consolidation drives to build national champions in three very different industries: tobacco, automobiles and textiles.

C.1 Tobacco

The tobacco industry is often referred to as the “last bastion of the planned economy” in China (Wang 2013; Li 2001a). It stands out as one of the few sectors whose monopoly status and command-and-control governance was retained even past China’s WTO accession. Monopoly control over all aspects of tobacco and cigarette production was established by the State Council in 1983 and formalized into law in 1991 (Wang (2009) for an overview). Despite this centralized governance, the industry nevertheless struggled with the problem of excess investment and capacity throughout the 1990s. With tobacco being a major contributor to local state tax revenue, there was no incentive for individual local states to curb production as long as it could be taxed. In order to protect their revenue streams, local governments erected inter-provincial trade barriers to prevent the inflow of tobacco products from

1 Regulations on Tobacco Monopoly 烟草专卖条例 yancao zhuanmai tiaoli issued September 23, 1983.

2 Tobacco Monopoly Law (approved by the National People’s Congress) 中华人民共和国烟草专卖法 zhonghua renmin gongheguo yancao zhuanmai fa promulgated on June 29 1991.
other localities (Zhou 2000). Therefore while the industry was in principle governed by the central State Tobacco Monopoly Agency (STMA), in practice the sector was decentralized and run by subnational state monopolies (Wang 2013).  

In the late 1990s, as the prospect of WTO entry grew close, pressure for reform mounted within the industry. WTO entry meant that tariffs on tobacco leaf would be reduced from 28% to 10%, on cigars from 65% to 25%, and on cigarettes from 65% to 25%. China also committed to eliminating non-tariff barriers ranging from license quotas to retail permits. Import and sales rights over foreign cigarettes, however, would be retained by the STMA’s state-owned trading company  

Foreign firms were also restricted from investing in cigarette production in China. This liberalization, while moderate, nevertheless meant that the tobacco industry would have to face greater import competition from global corporations such as British American Tobacco and Phillip Morris. An erosion of the CNTC’s domestic market share would threaten both government revenues and tobacco farmers who were already reliant on government subsidies to grow their crops. Therefore from the late 1990s onwards, there started to be calls within the industry (such as in the China Tobacco Journal) for structural reorganization.  

In 2001, STMA head Ni Yijin focused the industry’s response to WTO-entry on the formation of a batch of competitive large enterprises and enterprise groups which could produce internationally competitive brand name products (Zhongguo guojia yancao zhuanmai ju 2002). This would mean consolidating large enterprises while shutting down smaller operations. Specific targets were set for restructuring. Small

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3 The Tobacco Monopoly Law enacted in 1991 attempted to tighten enforcement by establishing permits across all aspects of the industry: production, wholesale, retail, sale of foreign cigarettes/cigars as well as transportation, but it was not until 1997 that the set of implementing rules for the law were issued by the State Council, suggesting that the Law was perhaps not strictly enforced for much of the 1990s (Wang 2013).

4 China National Tobacco Import and Export Corporation.
factories with an output of less than 100,000 cases were to be shut down by the end of 2004. Factories that had mid-scale output of between 100,000 and 300,000 cases were to be merged into larger ones (Zhongguo guojia yancao zhuanmai ju 2003). Factories operating at a larger scale did not escape this consolidation drive. A series of trans-provincial mergers would also be implemented in order to break down inter-provincial trade barriers (Li 2001a). The logic was that through consolidation, China’s tobacco industry would be able to remain competitive by strengthening a few large “champion” enterprises.

C.2 Automobiles

The development of China’s automobile industry in the Mao era had been heavily influenced by military considerations, and which has generated long term repercussions for automotive industrial policy. In the 1950s, factories producing buses, jeeps and trucks were deliberately spread out across China’s western and southwestern regions as part of Mao’s “Third Front” strategy to build up a strong industrial base (Thun 2006). Each province was to have at least one factory so as to ensure self-sufficiency (Oh 2013). Consolidation and the fostering of national champions has therefore been a constant theme in the automotive industry’s development. In the 1980s, industrial policy focused on targeting large scale production in six chosen SOEs (the “three large and three small” policy), coupled with restrictions on market entry. In 1994, the automotive industrial policy specifically pointed out problems of overly dispersed investment and the need to “rationalize the industrial structure” so as to achieve economies of scale and reach global competitiveness. The document specified that by 2000, six to seven enterprise groups would become domestic “backbone enter-

\(^5\)产业结合理化, chanye jiegou helihua.
prises”. Three to four large auto enterprise groups would be globally competitive by 2010. However, the decentralization of the Mao era has proven difficult to overcome in subsequent decades, with “as many as one half of the original Third Front factories” still located in various central and western provinces (Anderson 2012).

As with the tobacco industry, the prospect of WTO entry intensified concerns within the industry regarding competitiveness. China agreed to cut tariffs on whole cars from around 80-100% to 25%, and tariffs on car parts from around 15-50% to 10%. Import licenses and distribution, sales and service rights would be liberalized within the first three years of accession and local content requirements eliminated (WTO Protocol of Accession). With WTO entry, the central government’s core concern lay chiefly with the effects of import competition on the domestic industry and its ambitions for developing globally competitive auto firms. Not surprisingly, industry leaders responded with a renewed emphasis on the need for consolidation. Similar to the central government’s response for the tobacco industry, industry leaders in 2001 called for the breaking down of inter-regional domestic trade barriers and building up a few large conglomerates with global competitiveness (Zhongguo qi che gong ye gong si and Zhongguo qi che gong ye lian he hui 2002). In 2004, the NDRC released a new Automotive Development Policy. The focus on fostering a few “backbone enterprises” to become globally competitive national champions was again reiterated, highlighting the central government’s attachment to this policy goal.

C.3 Textiles

The textiles industry, in contrast to the tobacco and automobile industries, was one of the first in China to be liberalized. Central governance over the textiles industry was relaxed in 1993 when the Ministry of Textiles Industry (MTI) was abolished.
and authority over the sector reduced to a Bureau of Textiles (BOT) under the State Economic and Trade Commission, while governance over other aspects of the industry was separated out to the State Development and Planning Commission and the State General Bureau of Quality Supervision and Inspection Quarantine. As a result, many central-level controls over the industry were relinquished. At lower levels of administration, local textile bureaus were converted to textile corporations or associations. Policies on market entry were also terminated, and these changes combined to give local governments and the industry associations much more autonomy over the sector’s development (Hsueh 2011).

Amidst this liberalization, however, the central government still grappled with the familiar problem of overcapacity, dispersed production and inefficiency. In the early 1990s, the MTI’s plans for the industry included – like those for the automobile and tobacco sectors – the creation of large, globally competitive and export oriented multinational companies. The importance of this objective was renewed as the prospect of WTO entry drew close. In 1998, a State Council Notice on “Relevant Issues regarding Deepening Reform and Structural Adjustment, Overcoming Difficulties and Reversing Losses in the Textile Industry” noted that due to duplication of projects, excessive low-capacity production, poor technology and over-employment, the textile industry was at that point in time one of the most highly indebted and problematic sectors in China. The notice then outlined the major restructuring efforts that were to take place over the next three years. Loss-making SOEs were to be privatized or shut down and outdated spindles destroyed, alongside the importation of more advanced machinery (Moore 2002). The prospect of WTO entry was a clear driver of these developments. At the same time, the central government emphasized the need for the textile industry to grasp the opportunities provided by WTO entry by focusing on structural adjustment and for firms to embrace the “going out” strategy.

These three short examples serve to illustrate a common worry generated by WTO entry: that of ensuring that China’s enterprises would emerge as successful competitors in the global economy. Hence we can observe the central government responding with a consistent policy theme across a broad array of industries. In order to manage the “shock” of WTO entry, China needed to address the situation of decentralized production and excess capacity afflicting many industries. In order to better compete with foreign firms, industries across China needed to consolidate and restructure their enterprises into large conglomerates that would eventually become globally competitive ‘national champions'.
Bibliography


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Zhongguo qi che gong ye gong si and Zhongguo qi che gong ye lian he hui (2002). Zhongguo qi che gong ye nian jian = China automotive industry yearbook. Beijing: Ji xie gong ye chu ban she.


List of Interviews

The identities of interview subjects have been kept anonymous (except in cases where the interviewee explicitly agreed to be named), in accordance with the research protocol approved by Harvard University’s Committee on the Use of Human Subjects. The list below provides a Subject ID for each interviewee, as well as a general description and the location, month and year of each interview.

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