

ABSTRACT

Title of dissertation: REGULATING CHINA'S INDUSTRIAL
ECONOMY: A COMPARATIVE CASE
STUDY OF AUTO AND TELECOM SERVICE
SECTORS

Yukyung Yeo, Doctor of Philosophy, 2007

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This dissertation investigates how the Chinese state governs the business of strategic industries and explains the sources and patterns of the variation in economic regulation. Drawing on the conventional analytic frameworks of regulatory state but, at the same time, challenging their passive treatment of the Communist Party in the study of Chinese political economy, I propose a model of soft and hard regulation to better understand complex patterns of centralized regulatory regime. Taking two strategic industries, the automobile manufacturing and telecom service, as crucial comparative cases, I present three-fold arguments:

First, as the model of soft and hard regulation suggests, we need to consider a range of industrial sectors and relax the existing analytic framework that heavily focuses on the independence of the regulator in order to enhance our understanding of the regulatory regime in China's industrial economy. It would be flawed to conclude

that the nature of the Chinese state is transformed into a minimalist regulatory state, by overlooking the political control of the party as well as only relying on the conventional analytic frame and empirical sectors for the study of regulatory reform. The party organ is deeply enmeshed in both government and enterprises, and exercises considerable influence on the regulatory control over the leading state firms and sectors.

Second, my findings of the centralized regulatory oversight in the auto industry explicitly demonstrate the ways in which the Chinese central government regulates strategic but decentralized industry. It is often invisible and loose compared with centralized strategic sectors. Therefore, this would contribute to further specifying the forms of central control over cases that have a long history of decentralization policies.

Third, while existing literature has emphasized highly fragmented authority and bureaucratic struggles as the main political logic, this dissertation study argues that there is a strong central state effort to create a cohesive political power in order to secure crucial state assets, which directly relate to vested interests of the party-state.

REGULATING CHINA'S INDUSTRIAL ECONOMY:
A COMPARATIVE CASE STUDY OF
AUTO AND TELECOM SERVICE SECTORS

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Dedication

To my parents, Jung-Soon Shin and Jung-Woong Yeo

신정순, 여정웅, 사랑하는 나의 부모님께

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Thanks to my family in Korea. This long journey would not have been possible without their support, patience, and encouragement. And I am deeply grateful to my friend Kyusup Lee, who has given me an international call to the U.S., China, and Hong Kong every single day over the last six years. His unending sincere care has made it possible for me to steadily concentrate on the study.

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TABLE OF CONTENTS

Dedication	ii
Acknowledgements	iii
Table of Contents	v
List of Abbreviations and Note	iii
List of Tables	viii
List of Figures	ix
 Chapter One: Introduction	 1
I. The Puzzle on China's Industrial Regulation	1
II. Potential Contribution of This Study	5
III. Research Design.....	8
IV. Methodology	18
V. Main Findings	28
VI. Outline of the Dissertation.....	30
 Chapter Two: Theorizing Regulatory Governance in China	 35
I. Introduction	35
II. Globalization and Governance	37
III. Regulatory State in Diversity	42
IV. Regulation in Chinese Political Economy	48
The View from Mainland China	55
The Recentralized Regulatory State.....	58
The Decentralized Predatory State.....	61
The Regulatory State, Chinese Style	65
A Soft/Hard Regulation Model	68
V. Conclusion	71
 Chapter Three: Centralized Mixed Regulation: The Automobile Industry	 74
I. Introduction	74
II. The Nature of China's Auto Market.	77
III. The Structure of Government Authority for Regulation.....	85
IV. The Forms of Regulation: Three Cases	91
A. First Automotive Works (FAW) Group.....	92
B. Shanghai Auto Industry Corporations (SAIC) Group.....	104
C. Beijing Auto Industry Corporations (BAIC) Group	115
V. Conclusion	126

Chapter Four: Centralized Hard Regulation: The Telecom Service Industry	127
I. Introduction	127
II. State-run Monopoly: The Old Regime	132
III. Reform and New Challenges	136
IV. New Regulatory Mechanism	142
A. Empowering SASAC	152
B. Continued Strong Hand of the Party	161
C. Leading Small Group on Informatization	167
D. Constrained Regulator, the Ministry of Information Industry	169
E. Bounded Competition: Policies of Price and Market Entry	173
V. Conclusion	183
Chapter Five: Varied Central State Regulation	187
I. Introduction	187
II. Why Is Regulatory Controls Commonly Centralized	189
A. Strategic Significance	190
B. Political Needs for Central Regulation	197
III. Explaining Variations in China's Industrial Regulation	204
A. Sectoral Differences	205
B. Importance of Institutional Contexts	207
C. The Role of Foreign Investors in State Regulation	224
IV. Conclusion	228
Chapter Six: Conclusion	229
Appendices	247
Bibliography	253

LIST OF ABBREVIATIONS

BAIC	Beijing Automotive Industry Corporations
CCP	Chinese Communist Party
DO	Department of Organization of CCP
FAW	First Automotive Works
FDI	Foreign Direct Investment
MEI	Ministry of Electronics Industry
MEP	Ministry of Electronic Power
MII	Ministry of Information Industry
MPT	Ministry of Post and Telecommunications
MR	Ministry of Railways
NDRC	National Development and Reform Commission
NPC	National People's Congress
OECD	Organization for Economic Co-operation Development
PTAs	Provincial/municipal Telecommunications Administrations
SAIC	Shanghai Auto Industry Corporations
SASAC	State-owned Assets Supervision and Administration Commission
SDPC	State Development and Planning Commission
SETC	State Economic and Trade Commission
SOEs	State Owned Enterprises
SPC	State Planning Commission
WTO	World Trade Organizations

A NOTE ON NAME

With the exception of Chinese scholars or writers who published in English, Chinese name appear in surname preceding given name.

LIST OF TABLES

Table 1-1 : Measuring the Patterns of the Regulatory System	11
Table 2-1: Comparing Soft versus Hard Regulation.....	69
Table 3-1: Market Concentration in Automobile Manufacturing, 2002 and 2005	82
Table 3-2: Main Economic Data of FAW.....	95
Table 3-3: Main Economic Data of SAIC	106
Table 4-1: Comparison of the Telecom Regime.....	142
Table 4-2: Telecom Regulation	144
Table 4-3: Three Hats of Telecom Firm Leaders.....	164
Table 5-1: The Changing Position of the Auto Industry in China, 2000-2003.....	191

LIST OF FIGURES

Figure 2-1: Territorial and Organizational Structure of State Administration	51
Figure 3-1: FAW Structure	94
Figure 3-2: The Personnel Process in FAW	97
Figure 3-3: The Centralized Regulatory Structure for FAW	101
Figure 3-4: The Structure of SAIC Group	105
Figure 3-5: The Regulatory Structure of SAIC.....	114
Figure 3-6: The Structure of BAIC	116
Figure 3-7: Comparison with Traditional JV Auto Firms with New Ones in China	120
Figure 4-1: Bureaucratic Structure in the Telecom Service Industry after 2003	130
Figure 4-2: Restructuring China's Telecom Market.....	140
Figure 4-3: Governing Structure of Telecom Industry	149
Figure 5-1: Comparing Regulatory Structure in the Auto and Telecom Industries..	215

CHAPTER 1 INTRODUCTION

I. The Puzzle on China's Industrial Regulation

It was the summer of 2005 when I slowly started to interview Chinese officials and scholars working in the major state research institutions (i.e., the Development Research Center and the Chinese Academy of Social Science) in Beijing. After several interviews, however, I decided not to tell the potential interviewees that I was comparing China's state policies and regulations in the automobile and telecom service industries unless they insistently asked me. Even though I had explained why I was comparing these two sectors, for the Chinese industrial "economists," it did not make sense at all to compare two very different sectors. They thought that inherent sectoral distinctions necessarily required disparate governmental policies and governing mechanisms to manage and regulate the industries. They held that "needless to say, government policies are different because the auto is manufacturing and competition sector (*jingzheng hangye*) while telecom service is a natural monopoly (*longduan*)."

Yet the automotive and telecom service sectors in China share two key common points: both are strategically significant "commanding heights" and "pillar" industries in the national economy; and the creation of large state firms has been particularly emphasized and encouraged by the central leadership. In other words, the Chinese government seeks to make these strategic industries profitable and

competitive in both domestic and global markets under central control. Hence, sectoral differences are insufficient to account for the forms of regulation in China.

While some view the recent market liberalization and denationalization of ownership as a remarkable change in the Chinese political economy, both the automobile manufacturing and telecom service industries are still dominated by state ownership. To begin with, in the case of the auto industry, path-dependent policies of decentralization in the sector have allowed local authorities to enjoy discretionary power by retaining enterprise ownership. Since the auto industry is a major resource for local revenue and employment, most local governments have established their own medium or small scale auto firms and factories. According to one researcher in the National Development and Reform Commission (NDRC), as of 2005, 2,443 auto enterprises, which include all type of vehicles, such as passenger and commercial cars and trucks, are registered, and 21 provinces and cities produce cars.¹ As such, China's auto market is exceedingly fragmented. Despite these historically strong local components, the fragmented market structure, and much recent foreign investment, however, there is central regulatory control from the party-state directly monitoring major local auto businesses.

At the same time, if we look at another strategic industry, the telecom service sector is similarly dominated by public ownership. But, whereas automobile manufacturing consists of central/local state firms and private producers, all telecom service carriers are centrally-owned. As a consequence of strong central ownership, tight central regulation holds in the telecom service sector: it is supervised by a

¹ "Four Problems Challenge China's Auto Industry," *Renmin Ribao* (November 29, 2005) FBIS Transcribed Text, (Access: July 24, 2007)

central public agency, and the business management of telecom service is substantially controlled by comprehensive central power at the core. In contrast with the auto industry, there are no foreign-invested telecom service firms yet, even after new regulation that allows foreign telecom carriers to invest in China's telecom sector.

In fact, existing literature that has emphasized the influence of sectoral differences argues that each industry tends to be regulated according to sector-specific characteristics, because different sectors have different forms of embedded industrial organization and development needs and policies.² For instance, in the automotive industry, under the policy of decentralization, the market was opened quite early to foreign investment in order to attract more capital, and competition among manufacturers is more market-oriented than in a natural monopoly sector. On the other hand, the telecom service sector, as one of the crucial infrastructure industries, has been monopolized and nationalized in the name of national security and public interest in both advanced and developing countries. For China's telecom service sector, even after regulatory reform, the market is still dominated by a small number of central state-owned carriers, and the entry of private and foreign capital is strictly controlled by the central government based on numerous regulations.

Indeed, the mode of economic governance is heavily influenced by sectoral characteristics. Yet what is more interesting is that, despite significant sector differences, *centralized* regulatory governance is commonly identified in both the

² Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995), p. 81; D. Michael Shafer, *Winners and Losers: How Sectors Shape the Developmental Prospects of States* (Ithaca; London: Cornell University Press, 1994), p. 23; Adam Segal and Eric Thun, "Thinking Globally, Acting Locally: Local Governments, Industrial Sectors, and Development in China," *Politics & Society*, Vol. 29 No. 4, (December 2001), p. 564.

automotive and the telecom service industries in China. Here puzzles surface: first, *why* is central state regulation commonly employed in China's auto and telecom industries, in spite of significant differences in sectoral and institutional characteristics? At the same time, the patterns of central regulation are *varied* in practice. As another puzzle, *how* are the patterns of central control over the auto and telecom service sectors varied? What makes diversity in regulatory practice if different? What are the forms of regulation? Does the level of ownership, such as central or local state ownership, generate different forms of regulation within one sector? If so, what gives rise to such variations under the seemingly constant context of central regulation? What can we learn about the manners and sources of regulation in the Chinese industrial economy through the practices in the auto and telecom sectors?

This research ultimately attempts to unveil the underlying political logic of central regulation in strategic industries in China.³ In doing so, automobile manufacturing, one of the most decentralized state sectors, offers an excellent comparative case with the highly centralized telecom sector, in showing how the central party-state maintains regulatory power over large local state firms. Interestingly, my major finding shows that strong local components do not necessarily lead to a deficiency of central control as is often readily assumed. The method of central oversight over local state firms is soft and invisible compared with the manner of regulation in central state firms. Moreover, the forms of central oversight *within* the sector are also varied between central and local state auto firms.

³ Here "strategic industries" means sectors that are dominated by state assets and have crucial fiscal or developmental contributions to the national economy.

Central state auto enterprise, similar to telecom service carriers, is tightly controlled by central regulatory power, while central control over local state auto firm is relatively soft through indirect and informal channels. Hence, mixed forms of regulation hold in China's automobile business.

This introduction chapter proceeds as follows: I first briefly address the potential contribution of this study. I then introduce the research design for this dissertation and explain dependent variables, key explanatory variables, and working hypotheses. I also discuss my case selection: why I chose the automobile and telecom service sectors. The chapter proceeds to explain my research methodology and processes in the field, and presents the major findings and key arguments in this dissertation. It then briefly offers an outline of the dissertation.

II. Potential Contribution of this Study

This dissertation study attempts to explain how the Chinese state governs the business of strategic industries and to explain the sources and patterns of the variation in economic regulation. Previous studies on the regulatory state in China have been largely confined to "traditional" industries using a "conventional" framework that has evolved from the experiences of Western countries.⁴ I hope that this study may have

⁴ Here, traditional industries include infrastructure or financial service industries, and conventional framework means the independent regulatory agency-focused approach. OECD, *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance* (Paris: OECD, 2002), p. 91; Fabrizio Gilardi, "Institutional Change in regulatory Policies: Regulation through Independent Agencies and the Three New Institutionalism," edited by Jacint Jordana and David Levi-Faur, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham; Northampton: Edward Elgar, 2004)

the following four potential contributions to the Chinese political economy. First, on the theoretical level, if diverse patterns of regulatory governance are here to stay, the literature that assumes that the regulatory state will supersede a strong interventionist state fails to explain the complexities in economic governance in China. This also means that the globalization literature, which hypothesizes the idea of regulatory convergence encouraged by international regimes and institutions, does not relevantly reflect variations across issue areas. In the context of China, since the industrial sectors studied here are heavily influenced by the institutional context from which they develop, they share some similarities. Hence, a firm division between an interventionist and a regulatory state tends to be simplistic. Rather, as they actually exist, there are more complexities than are captured by the established two contending views. I hope this comparative case study may shed light on some useful implications for both comparative and Chinese political studies.

Second, when regulation is defined as “standard-setting, supervision, and monitoring by means of the public authority”⁵ rather than external market control in the name of the public interest through formal procedures and agencies, we can find more divergent practices of regulation in the Chinese industrial economy. Central regulation in the decentralized auto industry shows how the patterns of regulation can be varied depending on the level of state ownership. This also means that while a conventional approach to regulation tends to focus on public versus private ownership, the practice of regulation in China demonstrates that much diversity is identified within public ownership depending on central or local state firms. In order

⁵ Shaoguang Wang, “Regulating Death at Coalmines: Changing Mode of Governance in China,” *Journal of Contemporary China*, Vol. 15 No. 46 (February 2006), pp. 1-2.

to explain how decentralization (decentralized issue area) is actually regulated by the central authority, I propose a model of soft/hard regulation. Given that the existing rich literature on decentralization has not predicted or explained the fact of soft/invisible central regulation in the decentralized issue area, I hope to reflect the complex and dynamic mechanism of regulation in China.

Third, a comparative case study of the auto and telecom industries in China's economic regulation not only fills the empirical gap by expanding the case into the decentralized strategic sector, but also contributes to building on the theory of the regulatory state by addressing diversity in the patterns of regulation. In the Chinese industrial economy, we know well that the ultimate regulatory power, in areas such as market entry, is still retained by the center, and that there are deeply penetrated central party-state hands in the business of the local economy, though the degree of influence varies depending on regions and sectors. Yet the forms of central control over decentralized state firms and industries have been less systematically specified and compared with centralized state firms and industries. Hence, the auto industry provides a useful opportunity to compare the mechanism of central regulatory structure in a decentralized industry with that in the centralized telecom service sector, and helps in better understanding the complexities in China's regulatory state.

Finally, central oversight over the automotive and telecom sectors fleshes out the increasing power of comprehensive state commissions at the core. As the existing literature of fragmented policy decision-making and implementation has emphasized, there are still bureaucratic struggles between central and local governments in the auto industry, and overlapped authority seen in the telecom sector. Yet the central

leadership has been making an effort to revamp and create comprehensive national power by integrating previously diffused and overlapped authority into the center. Their relative importance varies across the issue areas: while the National Development and Reform Commission (NDRC) is a sort of macroeconomic regulator in automobile manufacturing, the State-owned Assets Supervision and Administration Commission (SASAC), as the actual supervisor of telecom carriers, is rapidly expanding the scope of its authority. As such, this study may contribute to explaining how the recent centralized regulatory power may exercise control in the context of the politics of fragmentation in China.

III. Research Design

In this dissertation, there are two main research questions that I attempt to explore: first, *why*, despite significant differences in inherent sectoral characteristics, governing structure, ownership forms, and the roles of foreign investors, does “centralized regulatory control” emerge in key strategic industries in China? Second, under the centralized regulatory mechanism, *how* are the patterns of the regulatory state varied across as well as within the sector, and what are the sources of the variation? This study is concerned with not only identifying the manner and causes of central state regulation over strategic industries, but also capturing the complexities in China’s regulatory governance designed by the party-state. In order to answer these questions, the following steps are taken. First, I choose two of the most strategically significant but sectorally and institutionally disparate industries: the automobile

manufacturing and telecom service sectors. I then juxtapose the two cases in order to identify the specific pattern of regulation in each of the sectors, and try to sort out the key variables that spell out the creation of the varied forms of regulatory control from the center.

The Dependent Variable

The dependent variable that I attempt to examine is the pattern of the regulatory system in China's strategic industries. By defining regulation as "the mechanism of control which is rule-based behavior,"⁶ regulatory institutions are not necessarily limited to state-designated public agencies and procedures, as the conventional studies show.⁷ In China, regulatory authority is designed to monitor the business of state firms as well as to enhance competition and efficiency in markets. Focusing on two strategic industries, I explore whether/how the Chinese central leadership exercises control over the decentralized auto industry. If so, how are the patterns of central oversight distinct from the centralized telecom service sector?

While I will discuss this in more detail in the following section, divergent central-local state relations across sectors and localities have contributed to creating the varied patterns of central oversight for the local economy. The forms of centralized regulation can be loose/invisible, tight/formal, or a mixture of both, which I characterize as a soft/hard regulation model in this dissertation. I try to capture the

⁶ Philip Selznick, "Focusing Organizational Research on Regulation," in, edited by Roger G. Noll, *Regulatory Policy and the Social Sciences* (Berkeley: University of California Press, 1985); John Francis, *The Politics of Regulation: A Comparative Perspective* (Cambridge: Blackwell, 1993)

⁷ Giandomenico Majone, "The Rise of the Regulatory State in Europe," *West European Politics*, Vol.17 (1994): 77-101; *Regulating Europe* (London: Routledge, 1996); Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reforms in Advanced Industrial Countries* (Ithaca; London: Cornell University Press, 1996); Marc Allen Eisner, *Regulatory Politics in Transition* (Baltimore: Johns Hopkins University, 2000)

ways in which the central party-state supervises the decentralized state firms in key industries. As I referred to earlier, although we know that the central party-state still maintains decisive regulatory power (i.e., market entry) in managing the local industrial economy, most decentralization literature has focused on characterizing various types of local state in the local economy and has rarely explained whether/how central regulation is actually implemented or with what purpose. Hence, the soft and hard regulation model that I propose in this dissertation offers a useful explanation for the sources and patterns of the variation in central regulatory control over China's strategic industries. In measuring each pattern, based on both the large body of literature on regulation in general and my observations in field research,⁸ I identify three indicators to distinguish loose and invisible central oversight (soft regulation) from tight and formal central control (hard regulation). They include: 1) monitoring and enforcement powers; 2) rule-making authority; 3) policy implementation. In developing these indicators, first I juxtapose each soft versus hard pattern, then, I sort out the key indicators that give rise to divergent forms of regulation.

⁸ Robert Baldwin, Colin Scott, and Christopher Hood, *A Reader on Regulation* (Oxford: Oxford University Press, 1998); Christopher Hood, Colin Scott, Oliver James, George Jones, and Tony Travers, *Regulation inside Government: Waste-Watchers, Quality Police, and Sleaze-Busters* (Oxford: Oxford University Press, 1999); Philip Selznick, "Focusing Organizational Research on Regulation," in, edited by Roger G. Noll, *Regulatory Policy and the Social Sciences* (Berkeley: University of California Press, 1985); William W. Bratton et al., *International Regulatory Competition and Coordination* (Oxford: Oxford University Press, 1996), pp. 59-60.

Table 1-1. Measuring the Patterns of the Regulatory System

Forms of Central Regulatory System	Indicators
Loose/Invisible Central Oversight (“Soft” Regulation)	<i>Monitoring and enforcement:</i> by informal channels of central party-state
	<i>Rule-making power:</i> shared between central and local authorities
	<i>Policy implementation:</i> much leeway (i.e., price, market entry, industrial policies)
Tight/Formal Central Oversight (“Hard” Regulation)	<i>Monitoring and enforcement:</i> by specialized public agencies and procedures
	<i>Rule-making power:</i> concentrated in the central regulatory powers
	<i>Policy implementation:</i> very strict (i.e., price, market entry, and industrial policies)

1) *Monitoring and enforcement:* In terms of conventional ideas, regulation means that a “public agency monitors and promotes compliance with an authoritative set of rules.” However, in China’s key industries, there are also *informal* channels from the center to supervise the business of local major state firms. Since this mechanism is informal, its regulatory oversight is invisible and looser than regulation from the public agency. In other words, loose central regulation here is deduced from the lack

of formal authority to monitor local state firms. I measure invisible central oversight and its influence through interviews in local state firms in the field.

2) *Rule-making power*: One of the major tasks of regulation is setting rules and standards.⁹ While rule-making authority in the form of soft regulation is inclined to be shared between central and local authorities, regulatory power in hard regulation is highly concentrated in central public authorities. Thereby, even though the ultimate decision in most cases is made by the central government, the degree of regulation in the shared rule-making system is inevitably less tight than in the monopolized regulatory power system.

3) *Policy implementation*: In China's regulatory system, although the central government dominates the key decision-making authority, policy implementation shows some variance. For instance, in the regime of hard regulation, price, market entry, industrial policies, and their compliance are tightly supervised by the central regulatory power, while there is much more leeway in a soft regulation regime in implementing various central policies and regulations, due to strong local components.

Explaining Centralized but Varied Forms of Regulation

Drawing on the literature of China and Comparative Politics, I identify two main factors that potentially facilitate the convergence of central oversight in the Chinese industrial economy: political and economic concerns. Economic concern here means multiplier effects on the national economy, the creation of large state-owned

⁹ Baldwin et al (1998); Hood et al (1999)

enterprise groups, and the control over market entry marked by each issue area. In other words, the Chinese central leadership keeps regulatory control over industries whose development has spillover effects on the growth of other related sectors. Not only to enhance competitive edge and market efficiency, but also to achieve economies of scale, Beijing has encouraged incorporation of existing scattered inefficient firms into large-scale corporate groups. Political influence is related to the protection of the vested interests of the ruling party-state and the creation of powerful comprehensive state authorities at the core. Determining political influence is not straightforward. I try to measure it by tracing the views and policies from the central leadership, and by interviews with officials, scholars, and entrepreneurs in business.

The patterns of central regulation are varied not only across industries, but also within sectors. I do not entirely refute the influence of sectoral characteristics on diversity in regulation. But rather than entirely attributing influence to the factor of inherent sectoral differences, I identify three major explanatory variables that give rise to *diversity* in the forms of central regulation in the context of central regulatory powers. They include the differences in 1) historical trajectory, 2) governing structure, and 3) the role of foreign investors. The variable of governing structure consists of local state autonomy (central-local relations), bureaucratic relations within the center, and forms of ownership. As such, while central regulatory power commonly holds in China's strategic industries due to similar economic and political concerns as pointed out, the differences in developmental history, governing structure, and the role of foreign investors in each sector have contributed considerably to creating the varied forms of regulatory oversight from the center.

Historical trajectory: I employ this variable to estimate whether/how a different history of industrial evolution has an effect on the varied forms of regulation. The importance of the historical factor was indicated in Alexander Gerschenkron's classic work on the industrialization process.¹⁰ Following his thesis but further examining the influence of industrial history on the styles of regulation cross-nationally, Steven Vogel argues that "a nation's regulatory regime reflects its history of industrialization."¹¹ Given that industries within one country also have undergone different pathways, this study attempts to show how different development histories influence the creation of varied forms of central regulation in China.

Hypothesis 1: The varied forms of regulation are facilitated by different historical evolution across issue areas

Governing structure: This variable is intended to delineate various governing structures defined by industrial sectors in China, and to assess how they relate to forms of regulation. They can be divided into centralized and decentralized systems, depending on the degree to which decision-making power has been transferred to local governments and local state firms.¹² In the sense that "decentralization has profound influence on the ways government functions,"¹³ the type of governing

¹⁰ Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge: Harvard University Press, 1962)

¹¹ Vogel (1996: 23)

¹² Decentralization is defined here as "decentralization means that decision-making powers are transferred downward from some central point." Franz Schurmann, *Ideology and Organization in Communist China* (Berkeley: University of California Press, 1968), p. 175.

¹³ Schurmann (1968: 196)

structure can be a relevant factor in distinguishing the mechanism of regulation in China. I hypothesize that there are three key political and economic institutions that organize governing structure and affect the creation of regulatory patterns: local state autonomy, inter-governmental relations, and ownership forms.

Central-local state relations (Local state autonomy): As “every province has distinctive relationships with the center,” central-local state relations vary across issue areas. While much of the previous literature has been occupied with either debating the influence of fiscal decentralization on central-local relations¹⁴ or characterizing the role of the local state in a market-transition economy,¹⁵ less effort has been made to *specify* the forms of central regulation in the decentralized issue areas. While fiscal decentralization has contributed to increasing the autonomy and incentives of local states in managing and planning the local economy, some scholars argue that “higher levels strengthened their control over appointment and evaluation.”¹⁶ Furthermore, since central-local interactions are varied depending on regions as well as issue areas, the patterns of central oversight are assumed to be inevitably divergent. Hence, I

¹⁴ There is a large body of literature. As the most representative works, see, Christine P. W. Wong, “Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China,” *The China Quarterly*, No. 128 (December, 1991): 691-715; “Fiscal Reform and Local Industrialization: The Problematic Sequencing of Reform in Post-Mao China,” *Modern China*, Vol. 18, No. 2. (April, 1992): 197-227; Dali L. Yang, “Reform and the Restructuring of Central-Local Relations,” in Edited by David S. G. Goodman and Gerald Segal, *China Deconstructs: Politics, Trade, and Regionalism* (London; New York: Routledge, 1994); Shaoguang Wang, “The Rise of the Regions: Fiscal Reform and the Decline of Central State Capacity in China,” in Edited by Andrew G. Walder, *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary* (Berkeley: University of California Press, 1995); Jae Ho Chung, “Beijing Confronting the Provinces: the 1994 Tax-sharing Reform and Its Implications for Central-Provincial Relations in China,” *China Information*, Vol. 9, No. 2/3 (Winter 1994-95)

¹⁵ Jean C. Oi, “The Role of the Local State in China’s Transitional Economy,” *China Quarterly* No 144 (December 1995): 1132-1149.

¹⁶ Maria Edin, “Local State Corporatism and Private Business,” *Journal of Peasant Study*, 30, No. 3-4 (April/July 2003), p. 289.

include this variable to capture specific patterns and sources of central regulation in China's strategic industries.

Hypothesis 2-1: Divergent central-local relations across issue areas facilitate the creation of varied patterns of central regulation

Inter-governmental authority relations: In China, authority relationships among bureaucratic agencies are dynamic across issue areas as well as localities. They can be characterized as horizontal versus hierarchical depending on the manner and procedures of policy decision-making and implementation. In a hierarchical structure, since political power is concentrated on a small number of state bodies, bureaucratic infighting resulting from conflicting interests can be more effectively controlled than in a horizontal system, where the authority of state agencies is likely to be equivalent and shared. For instance, the regulatory powers in China's telecom business are concentrated on the hierarchically structured three central bodies: SASAC, the NDRC, and the Ministry of Information Industry (MII). Even though the MII is the specialized regulator responsible for encouraging market-oriented competition for the sector, SASAC and the NDRC may exercise direct control over telecom firms. Regardless of oppositions from the MII or the NDRC, SASAC as substantial regulator in the telecom service business is capable of structuring the market by merging the service carriers into gigantic corporations. This variable is used to assess whether/how inter-governmental relations influence the creation of patterns of central control.

Hypothesis 2-2: Authority relationships among bureaucratic agencies influence the shaping of patterns of central regulatory oversight

Forms of ownership: I hypothesize that the form of ownership is the most influential factor, in that it critically affects the degree of central regulation and determines the type of state regulation. Ownership forms here are specified as central state-owned, local state-owned, private, and foreign-invested. Thereby it gives rise to varied patterns of regulation in China's strategic industries. Enterprise ownership may grant or constrain the political and economic authority of a state institution. According to Steven Solnick, "Property rights determine more than just the distribution of the assets or resources in question. In a fundamental sense, they frame the issues of power and control central to any hierarchical relationship."¹⁷ Its significance is particularly outstanding in the Chinese industrial economy, where the structure of property rights is complex across sectors and regions.

Hypothesis 2-3: The variation in central regulation is facilitated by ownership form across as well as within the issue area

Role of the foreign investor Control over foreign investment has been the Chinese central government's key source of regulation.¹⁸ Particularly, the entry of foreign

¹⁷ Steven L. Solnick, "The Breakdown of Hierarchies in the Soviet Union and China: A Neoinstitutional Perspective," *World Politics* 48, No. 2 (1996), p. 214.

¹⁸ Barry Naughton, "Hierarchy and the Bargaining Economy: Government and Enterprise in the Reform Process," In edited by Kenneth G. Lieberthal and David M. Lampton, *Bureaucracy, Politics, and Decision Making in Post-Mao China* (Berkeley: University of California Press, 1992), p 249; Yasheng Huang, *Selling China: Foreign Direct Investment during the Reform Era* (Cambridge: Cambridge University Press, 2003)

investment is one of “the primary means of central government controls.”¹⁹ While there is an argument that regulation from the center neither captures nor accounts for the variation in the effective use of FDI across localities,²⁰ my focus is not the regional variation in development outcome using foreign investment, but the variation in the forms of central regulatory control that foreign investment can bring about. I hypothesize that more foreign investors (i.e., shareholders in foreign-invested state firm) are likely to make central control loose due to shared authority. Moreover, the involvement of the foreign investor in Chinese industries varies exceedingly across the sectors. Hence I use this variable to assess whether/how the involvement of a foreign investor makes a difference in the shaping of varied forms of regulation marked by issue areas.

Hypothesis 3: The variation in the forms of central regulation is facilitated by the roles of foreign investors across issue areas

IV. Methodology

Case Selection

This dissertation explores the patterns of regulation in China’s strategic industries, and analyzes causal conditions that generate diversity in economic regulation. In doing so, this study compares two economic sectors in one country. The study of a

¹⁹ Eric Thun, *Changing Lanes in China: Foreign Direct Investment, Local Governments, and Auto Sector Development*, (Cambridge: Cambridge University Press, 2006), pp. 52; 63

²⁰ Thun (2006)

single country is beneficial in that it makes it possible “to hold constant the macroeconomic environment and the policy framework set by the central government while having variation at the sub-national level.”²¹ Cross-sectoral comparison is useful in illuminating varied forms of state regulation in the market, because “state involvement and desired role varies systematically across sectors due to the differences in the technological and organizational characteristics.”²² In the field of Chinese political economy, a large body of literature has taken either an industry-specific or an industry-comparison approach to identify a complex institutional landscape across various issue areas.²³

With a view to exploring the complex patterns of regulation in China’s strategic industries, I choose two strategically significant but widely disparate industries: automobile manufacturing (specifically, the passenger car) and telecommunication service. According to Arend Lijphart, “cases may be selected for analysis because of an interest in the case *per se* or because of an interest in theory-building.”²⁴ Drawing on this, I believe that case selection of the automobile manufacturing and telecom service industries can contribute to advancing existing

²¹ Thun (2006: 42)

²² Evans (1995: 93). In addition, Jones and Mason also have suggested that “sectoral characteristics like economies of scale and the relative importance of technology help create “institutional advantage” for different kinds of state involvement.” Cited from Evans (1995: 93)

²³ Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structures, and Processes* (Princeton: Princeton University Press, 1988); Thun (2006); Scott Kennedy, *The Business of Lobbying in China* (Cambridge; London: Harvard University Press, 2005); Thomas Moore, *China in the World Market: Chinese Industry and International Sources of Reform in the Post-Mao Era* (Cambridge: Cambridge University Press, 2002); Segal and Thun (2001); Edward S. Steinfeld, *Forging Reform in China: The Fate of State-Owned Enterprises* (Cambridge: Cambridge University Press, 1998); Jae Ho Chung, “The Political Economy of Industrial Restructuring in China: The Case of Civil Aviation,” *The China Journal* 50 (July 2003); Margaret M. Pearson, “The Business of Governing Business in China: Institutions and Norms of the Emerging Regulatory State,” *World Politics* 57 (January 2005): 296-322.

²⁴ Arend Lijphart, “Comparative Politics and the Comparative Method,” *The American Political Science Review*, Vol. 65, No. 3 (September 1971), p. 691.

theory of China's regulatory state by comparing and contrasting these two key sectors. The central government has put a great emphasis on the importance of these two sectors, arguing that auto manufacturing as a "pillar industry" (*zhizhu chanye*) plays a significant role in facilitating overall economic development due to its multiplier effects on other sectors, whereas the telecom service sector is regarded as the "commanding heights" (*jingji mingmai*), which exerts a critical influence on people's lives and on national security. Hence, the cases of the automobile and telecommunication service sectors serve to offer an excellent comparison in showing how the Chinese state regulates two strategically significant but economically very distinct sectors.

Secondly, I also consider the variation that exists in key explanatory variables across as well as within the sector to identify whether/how these variations have an impact on the creation of divergent patterns within the central regulatory system. Specifically, the auto and telecom service sectors show differences in both foreign investments and ownership forms (central/local state-owned or private). While auto manufacturing has great activity by foreign investors in the form of joint ventures with Chinese state firms (both central and local), there are no foreign invested firms or investors yet in the telecom service sector where central state ownership dominates.

Finally, although literature on China's regulatory state is evolving, most studies have been confined to the areas of conventional infrastructure and financial service, or the rationalization of administrative organization.²⁵ Given that the forms

²⁵ Dali L. Yang, *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China* (Stanford: Stanford University Press, 2004); Pearson (2005); Sebastian Heilmann,

of regulation reflect the relationship between government and industry, we can better understand complex patterns of regulation and China's regulatory mechanism in the industrial economy not only by expanding an empirical case into other types of strategic industry, but also by relaxing the existing independent regulator model. The comparative case studies of the automobile manufacturing and telecom service sectors, therefore, can provide a strong example of how China's two strategic sectors generate the varied patterns of regulatory governance.

Comparative Case Studies

In order to meet these research goals, I use comparative case studies, and specifically, in-depth interviews, archival research, and participant observation are employed in the research process. The comparative method is appropriate in unraveling "the different causal conditions and configurations connected to different outcomes."²⁶ It is also indicated that this explicit emphasis on diversity differentiates the comparative method from the broad range of qualitative approaches.²⁷ According to Charles Ragin, "Comparative researchers who study *diversity* tend to look for differences among their cases, and examine patterns of similarities and differences across cases

"Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry," *The China Quarterly* 181 (2005): 1-25; Wang (2006); Andrews-Speed et al., "The Ongoing Reforms to China's Government and State Sector: The Case of the Energy Industry," *Journal of Contemporary China* Vol. 9 No. 23 (2000): 5-20.

²⁶ Charles C. Ragin, *Constructing Social Research: The Unity and Diversity of Method* (Thousand Oaks; London; New Delhi: Pine Forge Press, 1994), p. 108.

²⁷ *Ibid*

and try to come to terms with their diversity.”²⁸ Hence, not only by exploring diversity and the causes creating it, but also by “specifying how diversity is patterned,”²⁹ I believe that we can refine and advance the existing theoretical framework in studying China’s complex systems of regulation.

In addition, I also use case studies in conducting the comparative method. In effect, as Lijphart has commented, “the discussion of the comparative method is not complete without a consideration of the case study method.”³⁰ While a variety of views, methodological critiques, and definitions on the case study exist, there is an important agreement that the virtue of case studies is to contribute to “theory-building” by generating propositions.³¹ Although case studies are inappropriate for theory-testing or theory-controlling, they lead comparative researchers to intensively examine and deepen the understanding of the cases. Thereby, comparative case studies of the automobile and telecom service sectors in China make it possible for us to elaborate and refine the existing analytic framework that has heavily relied on the independent regulatory model in the study of regulation.

Overview of the Research Process: Data Collection

For my dissertation research, I carried out the field work in mainland China for nine consecutive months, from July 2005 to March 2006, and in Hong Kong from April -

²⁸ Ragin (1994: 107)

²⁹ Ragin (1994: 111)

³⁰ Lijphart (1971)

³¹ Giovanni Sartori, “Compare Why and How: Comparing, Miscomparing and the Comparative Method,” In Edited by Mattei Dogan and Ali Kazancigil, *Comparing Nations: Concepts, Strategies, Substance* (Oxford: Blackwell, 1994), p. 23; Lijphart (1971), p. 683; Ragin (1994); John Gerring, “What Is a Case Study and What Is It Good for?” *American Political Science Review* Vol. 98, No. 2 (May 2004): 341-354.

June 2006. Before the field research, I conducted pilot research in the University Service Center (USC) for China Study at the Chinese University of Hong Kong in January 2005. During that time, I mainly collected statistical data and internal government reports (*neibu zhiliao*), such as *Gaige Neichan* or *Jingji Yanjiu Cankao*, to trace and understand important points and issues that the Chinese government discussed in policy-making and implementation. Access to internal government reports is one of the best parts of the USC, because these reports are not accessible in China, including in the National Library in Beijing, Beijing University Library, and Qinghua University Library.

In the field, I planned to focus on the auto industry for the first four months, and then move to the telecom service sector. Since most major research institutions and telecom firms are located in Beijing, I based myself in Beijing in July 2005. In the meantime, I have traveled to several other cities to visit the major auto enterprises. As referred to earlier, I used in-depth interviews³² and participatory observation in exploring my research questions. Although finding interviewees in China was truly a “dark, slow, and painful” process,³³ in-depth interviews were crucial for my

³² Questionnaire is attached in the Appendix.

³³ In order to meet more interviewees in the field within the limited time period, I could not rely only on someone’s introduction. So, I searched for relevant scholars or officials from Chinese journals and newspapers and emailed them. But response was very rare. For the telecom industry, I found many relevant scholars to interview in the Beijing University of Post and Telecommunications. First, I checked the main research interests of each in the department webpage, then emailed the target interviewees, around 10. However, I did not receive a single reply. I was totally frustrated and told a German friend working in the Chinese Academy of Social Science. She advised me to write an email in “Chinese,” not English. Even though Chinese scholars understand it, they are not willing to reply in English! After I emailed in Chinese, most of them replied to me. I fortunately had opportunities to talk with them. In addition, whenever I tried to make an appointment, Chinese officials or scholars always said “*henmang*” (very busy), but I could not just wait and wait. As another strategy to meet more people, without appointments I went to the Institute of Industrial Economy every Tuesday and Thursday when all scholars would be in. While they easily refused to meet when I contacted by telephone or email, it was not easy to reject me when I stopped by their offices, asking for “a few

dissertation in order to understand the aims of government policies, the processes of policy-making and implementation, and the dynamic power relations among governmental departments as well as between central and local governments, and government-state firm relations. I believe that only through a range of in-depth interviews, I was able to uncover the centralized regulatory mechanism for the major local auto state firms. For the telecom sector, I came to understand which state institution holds substantial control over the telecom business.

In both the auto and telecom service sectors, I conducted in-depth interviews with Chinese economic officials and scholars, state firm managers (both Chinese and foreigners in foreign-invested firms), economic consultants, and journalists who work in the field of the auto and telecom industries. For the auto industry, the most important and interesting interviews came from conversations with local entrepreneurs. Their responses sharply contrasted with officials and scholars in Beijing. Particularly, regarding the role and influence of the central party-state on local auto business, while scholars and officials in Beijing emphasized “the theory” that the center provides the only macro policy direction, information from managers in local state firms who are actually in the business enabled me to better understand the mechanism of central regulation in China’s auto industry.

In the initial stage, I started with one Chinese scholar affiliated with the CASS. However, since his institution is not related to my research topic, I had to wait until he introduced me to his colleague, who worked in the Institute of Industrial Economy. One by one, in a sort of “snow ball effect,” I had more opportunities for

minutes” although it usually turned out longer than planned. Getting an interviewee in China without someone’s introduction was truly a tough process demanding lots of effort.

interviews. Moreover, since a personal network (*guanxi*) is particularly significant in Chinese society, having someone's introduction enabled me to meet additional people. In order to obtain more interviews, I have always asked interviewees to introduce the next person, which was a fairly effective strategy for talking with more people.

While the form of in-depth interviews is open-ended, I tried to keep the conversation within the boundaries of my key concern by raising some relevant questions. However, some interviewees requested a list of questions ahead of time and preferred following the questionnaire exactly. While in-depth interviews are my major resource for data collection, I also attended the annual conference and forum in the auto sector in Shenyang (November 2005) and Beijing (April 2006). These participatory observations were good opportunities to observe how government officials and firm managers communicate with each other and whether ideas from business are considered in government policy. Even though most firms in the auto sector are state-owned, I observed that through these conferences, both government and business have the opportunity to explain how certain policies are adopted and to hear responses from auto firms. Most importantly, these events provided me with an excellent "network" for future interviews, which is the most difficult but critical part of field research in China.

In the auto sector, I focused on three large enterprises: China First Automotive Work (FAW) Group Corporation, Shanghai Automobile Industry Corporations (SAIC), and Beijing Automobile Industry Corporations (BAIC). Although they are all state-owned, FAW is owned by the central government (specifically, central

SASAC); SAIC and BAIC are owned by each municipal government. The different level of ownership is important in this study, in showing that the forms of central oversight *within* the sector are also varied between central and local state auto manufacturers. Thereby, the varied patterns of the regulatory system are found not only across industries but also within one sector that has both central and local state ownership.

I was fortunate to be able to obtain interviews with both Chinese and foreign managers. Interviews include: China FAW Group Corporation, FAW-VW, and China Auto Industry Research in Changchun; Shanghai Automobile Industry Corporation (SAIC) Group, SAIC-GM, SAIC-VW, Chery Enterprise Shanghai Office, Geely Auto International Corporation, Shanghai Automotive News, and Shanghai Academy of Social Science (SASS), A.T. Kearney (auto consulting firm) in Shanghai; Geely Automobile Enterprise Group in Hangzhou and Taizhou; Guangzhou-Honda in Guangzhou. In Beijing, Beijing-Hyundai Automobile Enterprise, Daimler-Chrysler Auto Enterprise, and China Automobile News are included. Valuable information and insights concerning China's automotive industry policies and regulation were also collected from interviews with government officials working in the Department of Industry and Economy of the DRC.

In the telecom sector, because all enterprises and major research institutions are located in Beijing, I obtained the most valuable materials during intensive interviews from December 2005 to February 2006 in Beijing. Unlike the auto industry, since access to Chinese telecom enterprises is extremely strict for a foreign doctoral student, I focused on interviewing Chinese officials and scholars who work

in the government research institutions or universities. This includes: the Development Research Center of the State Council (specifically, Department of Enterprise Research); the Research Center for Regulation and Competition of Chinese Academy of Social Science (CASS); Center for Informatization Study of CASS; Institute of Industry and Economy of CASS; Institute of Law of CASS; China Academy of Telecom Research of MII, and Beijing University of Post and Telecommunications (BUPT). In total, I have conducted seventy-two interviews, each one and a half to two hours long, with sixty-two individuals across seven cities.

Prior to interviews with government officials and some renowned scholars, I read their articles or other interviews from Chinese economic newspapers and journals. At the beginning of the interview, I usually started to ask questions by showing my knowledge of the individual's background. Drawing on these sources, I persuaded them to tell me their frank opinions and detailed explanations of some ambiguous and complex decision-making process and implementation. In addition, concerning how auto industrial policies and regulations are actually practiced at the enterprise level, I learned from interviews with entrepreneurs from different firms. In doing so, as the interview process continued, accumulated different viewpoints across institutions (both academic and business) and localities supplied me with valuable comparative points as well as more resources for future interviews. I was able to obtain more detail and specific responses. I always compared the accounts of Chinese officials, entrepreneurs, and scholars from different institutions and localities on the same issues.

V. Main Findings

Based on a comparative case study of China's automobile and telecom service industries, the major findings in this study are:

First, China's key strategic industries are controlled by a centralized regulatory mechanism. It has been often assumed that central regulatory oversight for the auto industry is rarely addressed and analyzed due to its strongly decentralized public ownership and powerful local authority. Yet there is an *invisible* system of central regulation for the business of major local state firms in order to secure the vested interests of the party-state. This invisible regulatory body, organized by the central party-state, directly monitors not only the management of crucial assets and budgets in local auto state firms, but also the implementation of national industrial policies and rules at the local level. For clarification, my concern in this study is not to evaluate the effect of central oversight, rather to identify the mechanism of regulatory control in China's industrial economy.

Second, under central oversight, there are varied forms of regulatory control over China's strategic industries. In order to better understand these varied patterns of regulation, I propose a model of soft and hard regulation in the context of central state oversight. "Soft regulation" is characterized as relatively loose regulatory power from the center by an invisible controlling mechanism, while "centralized hard regulation" refers to the tight and direct central supervision of assets and personnel management by means of formal public authorities and procedures. Not only by expanding the

cases into strategic but decentralized sectors, but also by relaxing existing analytic frames that have centered on the independent regulatory agency, I find a form of soft regulation in the auto industry. On the other hand, hard regulation emerges in the telecom service sector. Hence, diversity in patterns of regulation reflects the complex relationship between government and industry in China.

Third, the auto and telecom service industries exhibit different patterns of central regulation not simply because of inherent sectoral differences, rather because of the considerable differences in historical evolution, governing structure, the roles of foreign investors, and the level of ownership across as well as within one sector. Therefore, emphasis on sectoral differences from the conventional view is insufficient to capture and explain the diversity and complexity in China's emerging regulatory regime. Particularly, the level of public ownership, central or local, is crucial in determining the pattern of regulation from the center. Local state ownership provides local governments with the formal authority to carry out substantial discretion in supervising the business of local state firms, which inevitably constrains the authority of central oversight. Central state ownership allows the center to exercise tight and direct regulatory power. Hence, mixed central and local forms of public ownership in the auto industry significantly contribute to formulating diverse patterns of central regulation even within the sector.

Fourth, comprehensive state institutions at the core, such as the NDRC and SASAC, are empowering, holding substantial power in regulating the auto and telecom service industries. While the 1998 and 2003 government restructuring programs were designed to streamline and rationalize the function of government,

central control from these two comprehensive national commissions is increasingly strengthened. The auto and telecom service industries particularly show the case. In the telecom service sector, I find that SASAC, not the MII, exercises substantial control over the telecom service business by holding the right of personnel and supervising the management of assets and budgets. Moreover, although the reform in the telecom sector encourages market competition, price and market entry are very strictly supervised by SASAC under the direct control of the State Council. On the other hand, the NDRC plays a major role in regulating automobile manufacturing, and SASAC is less powerful in the auto than in the telecom service industry because of strong local components. Despite decentralization policies, the central NDRC retains the authority to structure the market by controlling market entry, both domestic and foreign firms, and the approval of key projects, such as the establishment of new assembly firms or joint ventures with foreign firms.

Finally, one of the key factors that make the practices of China's regulatory governance distinct is the continued significant role of the Party in both government and business. This shows that even though the Chinese state has been actively pushing forward market-oriented reforms, it does not necessarily lead to the diluted influence of the Party in economic governance. In both the auto and telecom state firms, the party committee (*dangwei*) is deeply penetrated into the boards of directors and exerts a critical influence on making key managerial decisions. These include the personnel of top executives and monitoring the business management of the firms. Top executives and senior managers are dominated by members of the party committee, and the personnel of the government is under the direct control of the

Department of Organization of the Central Party Committee. Both senior officials of regulatory bodies and executives of major state-owned firms are first recommended by the Organization Department of the Party, for they know exactly who is the most appropriate to protect crucial state assets.

Drawing on these findings, I propose the following three arguments: *First*, as the model of soft and hard regulation suggests, we need to consider a range of industrial sectors and relax the existing analytic framework that heavily focuses on the independence of the regulator in order to enhance our understanding of the regulatory regime in China's industrial economy. It would be flawed to conclude that the nature of the Chinese state is transformed into a minimalist regulatory state, by overlooking the political control of the party as well as only relying on the conventional analytic frame and empirical sectors for the study of regulatory reform.

Second, my findings of the centralized regulatory oversight in the auto industry explicitly demonstrate the ways in which the Chinese central government regulates strategic but decentralized industry. It is often invisible and loose compared with centralized strategic sectors. Therefore, this would contribute to further specifying the forms of central control over cases that have a long history of decentralization policies.

Last but not least, while existing literature has tended to emphasize highly fragmented authority and bureaucratic struggles as the main political logic, this dissertation study argues that there is a strong central state effort to create a cohesive

political power in order to secure crucial state assets, which directly relate to vested interests of the Party-state.

VI. Outline of the Dissertation

This dissertation is composed of six chapters. Chapter 2 attempts to view China's practice of industrial regulation in a theoretical framework. I introduce three major approaches and carefully review their relevance. I, then propose a model of soft/hard regulation to help better understand the mechanism of regulation in the Chinese industrial economy. Before discussing the issue of regulation in the context of the Chinese political economy, I first introduce the concepts of globalization, governance, regulation, and the regulatory state in order to locate this study in a broad context. The chapter also presents the definition of regulation and the regulatory state for this study.

Chapters 3 and 4 analyze the forms of regulation in the automobile manufacturing and telecommunications service sectors. The first part of chapter 3 provides a brief historical overview of the developmental process of the automotive industry, and introduces administration and ownership structure. It then goes on to discuss my findings in three major auto state firms designed to show how level of ownership and the continued influence of the party influences the creation of varied patterns of regulation within the sector. Once again, I selected one centrally-owned, the First Automotive Works (FAW) Group and two locally-owned auto enterprises,

the Shanghai Automobile Industry Corporations (SAIC) Group, and the Beijing Automobile Industry Corporations (BAIC) Group.³⁴

In Chapter 4, I first introduce the old regulatory regime in the telecom service sector prior to reform, and then explain internal and external challenges that led the Chinese state to push forward the successive reforms in the telecom markets. The chapter proceeds to discuss the new regulatory architecture of the sector and proposes centralized hard regulation as the specific form of the regulatory state. I demonstrate how the central regulatory powers in practice tightly control the sector through two policies: price and market entry. Unlike the auto industry with a large number of firms, there are only four major telecom service carriers, all centrally-owned. Hence, I take all four major firms into account in general rather than focusing on specific enterprises.

In Chapter 5, I attempt to systematically compare the regulatory governance of the two cases. After introducing some factors of strategic importance that bring about the central regulation in China's automobile and telecom service industries, I explain the underlying political logic that has led the Chinese top leadership to centralize regulatory power. The chapter proceeds to analyze what gives rise to the varied patterns of regulation, and how these forms are different across as well as within the sectors.

³⁴ Over the last decade, the market share of the FAW and SAIC Group together has been over 50 percent. Also, while the FAW is owned by the central government, the SAIC and BAIC are each owned by Shanghai and Beijing municipal governments. This would offer a good comparison for inter-governments and government and business nexus within the sector. Although the system of holding corporations (*konggu gongsi*) has been rapidly restructuring ownership in the auto enterprise group, most major auto firms are owned and controlled by the state, for either the central or local government still holds possession of the largest stocks in the auto holding corporation groups.

In the Conclusion chapter, I summarize the characteristics of the regulatory system in China's industrial economy and highlight the importance of variations in the forms of central regulation, resulting from the differences in the level of ownership (central vs. local), the structure of government authority, and the role of foreign investments. I also suggest that we need to disaggregate the concept of the regulatory state, which has been treated as unitary in order to better capture the complexities appearing in the varied patterns and sources of regulation in the Chinese industrial economy.

CHAPTER 2

THEORIZING REGULATORY GOVERNANCE IN CHINA

I. Introduction

The regulatory state is rising as a new benchmark of governance in an era of globalization. Some even argue that “we are said to live in the age of the regulatory state.”¹ While the meaning of the regulatory state varies depending on the focus of the subject, regions, and discipline,² it is generally agreed that the regulatory state seeks to underpin the market by means of the authority of rules. The state does not try to replace the market. However, as Jude Howell has commented with regard to governance in China, “At the heart of governance processes is the fundamental question of ‘who has the right to govern?’; ‘who has power and who has authority,’ and how are the two related.”³ This is particularly important in the context of China where the relations between the right to govern and the ownership of power are often inconsistent and highly complex.

In order to situate the case of China in a broader context, in this chapter, I offer a brief introduction to the study of globalization and its effect on creating the regulatory state. Much of the literature states that the rise of the regulatory state is a

¹ Christopher Hood et al., *Regulation inside Government: Waste-Watchers, Quality Police, and Sleaze-Busters* (Oxford: Oxford University Press, 1999), p. 3; Majone (1994; 1996); Francis McGowan and Helen Wallace, “Toward a European Regulatory State,” *Journal of European Public Policy* Vol. 3, No. 4 (1996): 560-576.

² Jordana and Levi-Faur (2004)

³ Jude Howell eds., *Governance in China* (Lanham: Rowman & Littlefield Publishers, INC, 2004), p. 8

global phenomenon. Scholars highlight the role of international institutions and policy diffusion, because “globalization impacts on institutional landscape of the state towards a regulatory reform as well as on policy choices.”⁴ There are also debates: while some argue for convergence of the regulatory state, assuming that variations across sectors and nations are temporary;⁵ others put more emphasis on divergent practices of regulation across sectors as well as countries. In the second part of the chapter, I closely review a variety of notions of regulation and the regulatory state in a global context. In order to distinguish China’s regulatory governance from the conventional model of independent regulator,⁶ I then introduce the work of scholars of regulatory state in the field of Comparative Politics. These studies emphasize national variations in regulatory practices as a result of different state institutions, ideas, and historical pathways of industrialization.

In the third part, I discuss state regulation in the Chinese political economy. After briefly introducing the government reforms in 1998 and 2003, I present three concurrent and contending views on the nature of the Chinese state-business relations.⁷ They include: Dali Yang’s minimalist regulatory state, Minxin Pei’s decentralized predatory state, and Margaret Pearson’s constrained regulatory state. I challenge the first two models’ assumptions on the effects of institutional reforms and their “passive” treatment of the Party. Drawing on both Pearson’s work on centralized

⁴ Kanishka Jayasuriya, “Globalization and the Changing Architecture of the State: the Regulatory State and the Politics of Negative Co-ordination,” *Journal of European Politics*, 8 (1), (February 2001), p. 103.

⁵ Jayasuriya (2001); Jordana and Levi-Faur (2004: 9)

⁶ This model is highly based on the experiences and domestic conditions of advanced industrialized countries. It is a kind of global standards recommended by the major international institutions and regime such as OECD, the World Bank, and the WTO.

⁷ While there are other leading literature regarding China’s regulatory state (i.e., Shaoguang Wang), I confine to the study of “economic” regulation, which is the focus of my dissertation.

strategic industries and findings from my field work, I propose a soft/hard regulation model to capture and better understand the varied patterns of the regulatory state in the Chinese industrial economy. The soft/hard regulation model emphasizes that, in China, the forms of regulation under the central oversight are divergent not only across industries but also within the sector. For the strategically important but locally-owned state firms, central regulation is invisible and loose, which I call soft regulation. This soft/invisible regulation reflects that decentralized state sectors and firms are not necessarily parallel to the lack of central control. The central party-state extends an invisible but strong hand to monitor the business of core local firms. Hard regulation suggests that regulatory control over central state firms is very tight through formally designated regulator and central state institutions. Moreover, when the sector is dominated by both central and local state firms, mixed forms of regulation, soft and hard, arise.

II. Globalization and Governance

While there is no one agreed-upon definition, globalization is in general conceived as the increasing trans-border flows of goods, service, information, culture, and people. It denotes the expanding scale, growing intensity, speeding up and deepening impact of such trans-border flows on inter-societal interaction from the global level.⁸ In particular, economic globalization highlights “enhanced trade and financial

⁸ David Held et al., *Global Transformation: Politics, Economics, and Culture* (Stanford: Stanford University Press, 1999)

integration”⁹ facilitated by reduced transaction costs and policy barriers as well as technological progress and innovation.¹⁰ While globalization has its roots in economic exchange,¹¹ it implies much more than a trade-GDP ratio. It also represents the increasing exposure of local identities and interests to international and transnational forces. Globalization, therefore, is a process rather than an end-goal.

To date, much scholarly debate has been centered on the effects of globalization on the state capacity and sovereignty.¹² Some argue that the role of the state has been significantly challenged and leaked away by the increasing power of private authority and a range of non-state actors across borders.¹³ Others note the continuing salience of states in both political and economic life in globalization.¹⁴ Making an example of Singapore, Peter Evans argues that “successful participation in global markets may be best achieved through more intense state involvement.”¹⁵

Contrary to the globalist premise, Evans finds the positive correlation between trade

⁹ Dani Rodrik, “Governance of Economic Globalization,” In edited by Joseph S. Nye and John D. Donahue. *Governance in a Globalizing World* (Washington: Brookings Institution Press, 2000), p. 348.

¹⁰ Jeffrey Frankel, “Globalization of the Economy,” In edited by Joseph S. Nye and John D. Donahue. *Governance in a Globalizing World* (Washington: Brookings Institution Press, 2000), p. 45.

¹¹ Kevin H. O’Rourke and Jeffrey G. Williamson, *Globalization and History: The Evolution of Nineteenth- Century Atlantic Economy* (Cambridge: The MIT Press, 1999)

¹² Sovereignty is broadly defined as “state judicial control over its territory and citizens.” Stephen Krasner provides four dimensions of sovereignty: international, domestic, the Westphalia, and interdependence. *Sovereignty: Organized Hypocrisy* (Princeton: Princeton University Press, 1999).

¹³ Susan Strange, “The Defective State,” *Daedalus* 124 (Spring 1995), p.56; Cable Vincent, “The Diminished Nation-State: A Study in the Loss of Economic Power,” *Daedalus* 124 (Spring 1995), p. 27; A Clare Culter, Virginia Haufler and Tony Porter, *Private Authority and International Affairs* (Albany: State University of New York, 1999); Margaret E. Keck and Kathryn Sikkink, *Activist Beyond Borders: Advocacy Networks in International Politics* (Ithaca, N.Y.: Cornell University Press, 1998)

¹⁴ Kenneth N. Waltz, “Globalization and Governance,” *PS: Political Science and Politics* Vol. 32, No. 4 (December 1999); Robert Wade, “Globalization and Its Limits: Reports of the Death of the National Economy are Greatly Exaggerated,” In edited by Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp.60-88; David M. Cameron, “The Expansion of the Public Economy: A Comparative Analysis,” *American Political Science Review* 72, no. 4 (1978); Dani Rodrik, “Why Do More Open Economies Have Bigger Governments” (NBER Working Paper no. 5537, April 1996)

¹⁵ Peter Evans, “Eclipse of the State?: Reflections on Stateness in an Era of Globalization” *World Politics*, 50, no. 1 (1997: 69-70)

openness and increasing role for the state.¹⁶ More integration into a global market does not necessarily lead to “diminished” or “eclipse” of the state. Rather, strong but more sophisticated and competent state authority is required. The real issue is not the decline of the role of state, but the institutional *shifting* of the state and forms of public authority corresponding to governing a global political economy. This relates to the following issue of governance.

The Effect of Globalization on Governance

How does globalization affect governance? In this study, governance is defined as “the processes and institutions, both formal and informal, which guide and restrain the collective activities of a group.”¹⁷ The form of governance varies depending on the ways in which the state transforms and adapts to the society. The concept of governance is becoming popular because it “covers the whole range of institutions and relationships involved in the process of governing.”¹⁸ Keohane and Nye state that “globalization is strongly affecting domestic governance, but it is far from making the nation-state obsolete as some predict.”¹⁹ The important issue here is the ways in which globalization has transformed the institutional landscape of the state. While the

¹⁶ Evans (1997: 67)

¹⁷ Robert O. Keohane and Joseph S. Nye, “Introduction,” In Edited by Joseph S. Nye Jr. and John D. Donahue, *Governance in a Globalizing World* (Washington, D.C.: Brookings Institution Press, 2000), p. 12. There are various ways to define governance depending on the subject of the study. Pierre and Peters comment that “it has become an umbrella concept for such a wide variety of phenomena as policy networks, public management, coordination of sectors of the economy, public-private partnerships, corporate governance, and ‘good governance’ as a reform objectives promoted by the World Bank and the IMF. Jon Pierre and B. Guy Peters, *Governance, Politics, and the State* (New York: St. Martin’s Press, 2000), p. 14.

¹⁸ Pierre and Peters (2000: 1)

¹⁹ Keohane and Nye (2000: 36)

state has adjusted to changes in and demands of the global structure, it maintains control by developing institutional mechanisms for regulation.

More importantly, globalization has been regarded as the major driving force of such policy diffusion as regulatory reform programs that emphasize the streamlining government structure and the promotion of transparency and competition in the market.²⁰ In effect, a global trend towards the regulatory state as the best practice of governance is not irrelevant to bring about institutional shift in the forms of public authority.²¹ Much of the globalization literature assumes a convergence of regulatory policy encouraged by the WTO regime and international institutions, such as the World Bank or the OECD. The role of these international institutions is significant in that they advise policy recommendations that emphasize competition, transparency, and accountability for “good governance.” Furthermore, the convergence school holds that the divergent patterns of regulation may continue due to varying historical legacies and state intervention in the market. Nonetheless, these will eventually fade away over time.

According to convergence thesis, domestic policies ultimately tend to become alike due to the growing similarity in structures, processes, and performances. It claims that the increasing economic interactions across countries have led to

²⁰ World Bank, *World Development Report 2002: Building Institutions for Markets* (Oxford: Oxford University Press, 2002)

²¹ Jacint Jordana and David Levi-Faur, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham: Edward Elgar, 2004); David Levi-Faur, “The Global Diffusion of Regulatory Capitalism,” *The Annals of the American Academy*, 598 (March 2005): 12-32; Fabrizio Gilardi, “Spurious and Symbolic Diffusion of Independent Regulatory Agencies in Western Europe,” Prepared for presentation at the workshop “The Internationalization of Regulatory Reforms,” Center for the Study of Law and Society, University of California at Berkeley, 25-26 April 2003.

competition among various models of economic governance.²² The most desirable set of institutions arising as a result of international competition diffuse and become implemented as a form of good governance.²³ As Elaine Kamarck points out international economic competition has been one of major driving forces in public administration reform movements over the last two decades.²⁴ It has aimed at not only enhancing efficiency in administration, but also organizing business-friendly market environment in order to attract more foreign investment.²⁵

On the other hand, while convergence helps explain the global diffusion of regulatory policy, some pay more attention to the diversity, noting that different institutional arrangements formulated by domestic political and economic structures have shaped divergent national trajectories.²⁶ Pierre and Peters have commented that “It is virtually impossible to make any clear generalization about governance to date. It must be contextualized.”²⁷ National diversities have been more accelerated because countries have different views on the desirable role of government in markets. These

²² Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp. 4-5. In the Introduction Chapter, although both Berger and Dore have a belief in the national diversity in an age of globalization, they point out three major factors to lead to convergence: the triumph of market forces, the result of diffusion of best practice and competition among institutional forms, and the internationally negotiated or coerced choice of set of rules and institutions.

²³ Depending on the domestic political, economic, and cultural contexts, although there is a great variance in policy implementation, Beth Simmons and Zachary Elkins evidence the empirically strong relationship between competition for capitals and the global diffusion of liberal economic policy. This finding is based on 182 IMF – member states from 1967 to 1996. Beth Simmons and Zachary Elkins, “The Globalization of Liberalization: Policy Diffusion in the International Political Economy,” *American Political Science Review*, Vol. 98, No. 1 (February 2004), pp. 171 – 189.

²⁴ Elaine Ciulla Kamarck, “*Globalization and Public Administration Reform*,” In Edited by Joseph S. Nye Jr. and John D. Donahue, *Governance in a Globalizing World* (Washington, D.C.: Brookings Institution Press, 2000), p. 232.

²⁵ Kamarck (2001: 232) indicated four major driving forces in these global waves of public administration reform: global economic competition, democratization, the information revolution, and the performance deficit

²⁶ Robert Boyer, “The Convergence Hypothesis Revisited: Globalization but Still the Century of Nations,” In Edited by Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp. 56-59.

²⁷ Pierre and Peters (2000: 69)

variations in state involvement have created different practices in regulation.²⁸ It also echoes Keohane and Milner's finding that "internationalization is having profound effects on domestic politics, but these effects vary cross-nationally due to different institutional as well as political-economic conditions."²⁹ As such, I suggest that this divergent convergence approach is particularly useful in illuminating how China's lingering legacies of Communist institutions, such as state ownership and the Party, has contributed to create distinct practices of regulatory state, making complex forms of regulation.³⁰ In order to help distinguish the pattern of regulation in China, I first present the conventional ideas on the regulatory state and various practices in the following.

III. Regulatory State in Diversity

Defining the Regulatory State

Regulation has a wide range of connotations: from the narrowest a set of authoritative rules accompanied by public agency for monitoring compliance³¹ to an all inclusive concept of governance.³² In the middle of them, regulation can be delineated as "the aggregate efforts by state agencies to steer the economy including rule-making or

²⁸ Vogel (1996); Mark Thatcher, "Regulation after delegation: independent regulatory agencies in Europe," *Journal of European Public Policy* Vol. 9, no. 6 (2002), pp. 954-972.

²⁹ Robert O. Keohane and Helen V. Milner, "Internationalization and Domestic Politics: An Introduction," In edited by Robert O. Keohane and Helen V. Milner, *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996), p. 7.

³⁰ Lance L. P. Gore, *Market Communism: The Institutional Foundation of China's Post-Mao Hyper-Growth* (Oxford: Oxford University Press, 1998)

³¹ Jordana and Levi-Faur (2004: 3-4)

³² McGowan and Wallace (1996: 562)

ownership,”³³ not just to correct market failure as the economic theory of regulation contends. While the economic theory of regulation argues that regulation occurs in order to correct the market failure by monopolized business, its ultimate purpose is *political* so as to promote “the interests of more influential pressure groups as a political instrument of redistribution and rent-seeking.”³⁴ In addition, an institutional approach to regulation pays particular attention to political control over regulators. Terry Moe has pointed out that “oversight power by appointment or strict procedural requirements” have been used as the means of political control over regulatory agency.³⁵ As such, the problem of political control has been already indicated in existing studies.

What, then, is the regulatory state? It is an entity which highlights the necessity of the state in making markets work better.³⁶ The state still plays a role in the market, but its aim of intervention, providing institutional foundations, and the power of rule-making is different from the positive state that relies more on the authority to tax and spending than market principles.³⁷ This makes it for the form of regulation to be associated with “particular patterns of government conduct that may be embedded in the nature of state-society relations.”³⁸ However, the terms of the regulatory state are defined in different ways across countries. For example, while the U.S. emphasizes the “reinvented” role of the state to encourage private economic

³³ Jordana and Levi-Faur (2004: 3)

³⁴ Gary S. Becker, “A Theory of Competition among Pressure Groups for Political Influence,” *Quarterly Journal of Economics* Vol. 98(1983): 371-400.

³⁵ Terry Moe, “Interests, Institutions, and Positive Theory: The Politics of the NLRB,” *Studies in American Political Development* 2 (1987)

³⁶ Francis McGowan and Helen Wallace, “Towards a European Regulatory State,” *Journal of European Public Policy*, 4 (1996): 560-576

³⁷ Giandomenico Majone, “From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance,” *Journal of Public Policy* 17, no. 2 (1996), p. 142.

³⁸ McGowan and Wallace (1996: 563)

activity that protects social and economic objectives, the regulatory state in Britain is the “withdrawal” of the state from the key public sectors and underscores the importance of privatization and competition in the market.³⁹

Likewise, although some argue that its characteristics vary at the national level,⁴⁰ the regulatory state tends to emphasize ‘process’ rather than outcome as the desirable economic governance. Therefore, competition, transparency, and legalization are encouraged to help underpin the market. The regulator is independent from the central government and intervenes in the market by the use of “authority, rules, and standard-setting.”⁴¹

National Diversity in Regulation

In advanced and developing countries, the state remains central to *re-regulate* business by making more rules and establishing institutional agency.⁴² As a result, the regulatory state is evolving as a new mode of governance, but its patterns of regulation widely vary across countries as well as industries. While early studies focused on interest groups,⁴³ much research of late takes state institutions and ideas as key variables, persuasively showing how domestic political-economic institutions

³⁹ Colin Scott, “Regulation in the Age of Governance: The Rise of Post-Regulatory State,” In Edited by Jacint Jordana and David Levi-Faur, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham: Edward Elgar, 2004), pp. 148-149; Vogel (1996: 129-134)

⁴⁰ M. Markus Muller, *The New Regulatory State in Germany* (Birmingham: Birmingham University Press, 2002); Michael Moran, *The British Regulatory State: High Modernism and Hyper Innovation* (Oxford: Oxford University Press, 2003)

⁴¹ Jordana and Levi-Faur (2004: 8)

⁴² Vogel (1996); Jordana and Levi-Faur (2004); Majone (1996); Pearson (2005)

⁴³ George J. Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics and Management Science* Vol. 6 No 2 (1971): 3-21; Barry R. Weingast and Mark J. Moran, “Bureaucratic Discretion or Congressional Control,” *Journal of Political Economy* Vol. 91, No 5 (1983): 765-800.

and policies under the similar global pressures create national diversity in regulatory innovations and practices.⁴⁴ Furthermore, this dissertation posits that more variations are likely to appear in China's industrial economy where the Communist Party and public ownership remain dominant political-economic institutions. In the following section, I introduce some major works on regulatory state in the field of Comparative Politics and present contending models of regulation.

Contrasting the historical trajectories of industrialization in Britain and Japan, Steven Vogel claims that the policy-making elite's ideas on the role of government and state institutions generate considerable variations in reform across countries as well as industries.⁴⁵ Although Vogel does not refute the influence of global wave of deregulation and liberalization, he contends that the major driving force for regulatory reform lies in domestic politics, not international competition and pressures. Moreover, it is the government, not interest groups, which government initiates and controls the process even in the most industrialized countries. The state-led and designed reforms have given rise to diverse forms of regulatory state cross-nationally and sectorally. Most importantly, Vogel argues that regulatory reform towards freer markets and less government through deregulation paradoxically has contributed to strengthening the state's regulatory control over industrial activities. Hence *re-regulation* by governments in markets comes on the stage.

Another strand of extensive study on regulatory state is emerging in the Western Europe. Regulation in Europe has been traditionally through public ownership, assuming that public ownership would help government effectively

⁴⁴ David Levi-Faur, "The Global Diffusion of Regulatory Capitalism," *The Annals of the American Academy*, 598 (March 2005), p. 16.

⁴⁵ Vogel (1996)

regulate the economy for the public interests. Rather than making independent regulatory bodies, European countries preferred to assign “important regulatory responsibilities to central government department.”⁴⁶ Changes in the mode of governance from interventionist to regulatory state slowly began to appear since the late 1970s. Economic globalization and regulatory reforms greatly accelerated in the 1980s.⁴⁷ Giandomenico Majone indicates that “statutory regulation by independent agencies is rapidly becoming the most important mode of regulation, indeed the leading edge of public policy-making in Europe.”⁴⁸ However, there are some difficulties in generalizing a pattern of regulation in Europe, for there are extensive differences in historical legacy of industrialization, the goals and methods of government regulation in the market, and the relative importance of industrial policy among Britain, France, and Germany. Through regulatory reform, while Britain shows many similarities with “the American-style regulatory state,” such as substantial separation of government from business activities, France and Germany appear similar to Japan with respect to the state-led reform and industrial policies.

Pointing out that the regulatory state is heavily premised upon state capacity, Colin Scott argues that the idea of regulation by state institution is incomplete. Scott introduces the notion of the “post-regulatory state,” opens up the floor for a variety of governing mechanisms, norms, and control processes.⁴⁹ While the regulatory state emphasizes state law and hierarchical control by state institutions including

⁴⁶ Majone (1996: 22)

⁴⁷ Giandomenico Majone, “From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance,” *Journal of Public Policy* Vol. 17, No 2 (1997): 139-167.

⁴⁸ Giandomenico Majone, “The Rise of Statutory Regulation in Europe,” In edited by Majone, *Regulating Europe* (London: Routledge, 1996)

⁴⁹ Scott (2004: 147)

government departments, courts, and independent regulator, the post-regulatory state gives much credit to non-state regulation (i.e., business associations or NGO) by non-state law. While enterprises and NGOs have been treated as the key regulators in the regulatory state regime, the post-regulatory state argues that “business and NGOs have the capacity to monitor the activities of both government and businesses for compliance with norms of their or others’ making.”⁵⁰

In sum, the existing literature has contributed to demonstrate how state institutions and ideas under the similar external circumstances and pressures construct a variety of forms of regulatory states.. Yet these previous efforts have been confined to “traditional sectors” (i.e., public utilities or finance) using “conventional analytic framework” that centers on the function of independent regulatory agency and norms of liberalization and privatization. In this study, I suggest that when we relax both “a range of traditional industry” and “the analytic framework” in the existing regulatory state literature, we can find the varied patterns of economic regulation *within* one country or industry. The goals of economic regulation also vary, from correcting market failure and promoting efficiency to steering the national economy. In the context of China, given that the ownership of assets is retained by the party-state, the underlying political logic is to secure their vested interests rather than to protect the public interests. For the purpose of this, regulation is defined as “the mechanisms of control characterized as rule-based behavior using of institutions for scrutiny and enforcement in order to promote specific public objectives.”⁵¹ This would help

⁵⁰ Scott (2004: 165)

⁵¹ McGowan and Wallace (1996: 562)

demonstrate how states exercise regulatory control over strategic key industries as well as natural monopoly sectors.

IV. Regulation in Chinese Political Economy

Before examining the on-going scholarly debates as to the nature of Chinese state in governing industrial economy, I introduce the pre-reform regime and the 1998 and 2003 government reforms so as to present the backgrounds of institutional change. These two administration reforms are important, in that, first, they offered an opportunity to modify the function of Chinese government from direct intervention and planner to indirect regulator. The regulatory state, as we referred to earlier, is assumed to mainly charge of coordinating the macro-economic steering. Second, these path-breaking government reforms flesh out the central leadership's intention to create a cohesive regulatory power at the core.

The Government Reforms

Pre-1998 Regime

The State Council, serving the cabinet in the Chinese political system, was the core organizational body that managed the economy. As the top executive arm of the Chinese government, it was directed by the prime minister and vice premiers, and a number of commissions (*weiyuanhui*), ministries (*bu*), administrative agencies (*zhishu jigou*) and offices (*banshi jigou*) were directly subordinated to the State

Council.⁵² Most commission and ministries organized “own nationwide vertical bureaucratic hierarchies, with offices at each subordinate territorial level of administration.”⁵³ At the centre, two key state bodies, the State Planning Commission (SPC) and the State Economic Commission (SEC), demonstrated the bureaucratic characteristics of the legacies of the planned economy, even though the reform toward a market economy was in motion.

Before the 1998 administrative reform, the SPC, as a planner of the national economy, was primarily responsible for managing the macro-economy, setting the Five Year Plan, supplying materials, and determining the distribution of resources such as investment projects and funds.⁵⁴ The SPC held the authority to guide and coordinate the performance of ministries and other state bodies. At the same time, other agencies had to be consulted on a range of issues. The SPC was not, therefore, independent from other commissions and ministries. This made it difficult for the SPC to engage in decisive and coherent policy making and implementation.⁵⁵ While the SPC was in charge of making the plans, the SEC mainly played a role of “organizing the implementation of the production plans made by the SPC” and monitoring the proper implementation of the state plan in industrial production.⁵⁶ Above all, state industries were directly managed by a bulk of industrial ministries that supplied materials and made production plans.

⁵² Lieberthal and Oksenberg (1988); Kenneth Lieberthal, *Governing China: From Revolution Through Reform*, Second Edition (New York; London: W. W. Norton & Company, 2002); Yang (2004)

⁵³ Lieberthal (2002: 177)

⁵⁴ Lieberthal and Oksenberg (1988: 64-65)

⁵⁵ For example, as to the annual and long term financial balance, SPC had to consult with the Ministry of Finance; with the Ministry of Foreign Economic Relations and Trade about foreign trade balance; with the People’s Bank on the monetary dimensions. See, Lieberthal and Oksenberg (1988: 65-66)

⁵⁶ *Ibid* (1988: 72-73)

As the market economy matured, the Chinese top leadership recognized the need for the change in both the functioning of the government and government-enterprise relations. During the Deng era, a series of institutional reforms in administration that aimed to downsize administrative unit and personnel were carried out in 1982, 1988, and 1993.⁵⁷ Through these reforms, while the number of administrative agencies decreased from 86 to 59 to 31, the number of civil servants on “the government payroll as a whole increased from 34.65 million in 1992 to 36.73 million in 1996.”⁵⁸ Normatively, the notion of “separation of government and enterprise (*zhengqi fenkai*) was the guiding principle of the reforms since 1988 reform.”⁵⁹ These early efforts were not successful because state firms depended heavily on administrative support and protection.⁶⁰ Resisting change, bureaucrats were “too busy helping their enterprises” that provided the major source of revenues.⁶¹ As the problems of asset loss, debts, and management inefficiency of the major large state firms became serious in the mid 1990s, the former premier Zhu Rongji decided to substantially reform the administrative structure of state-owned enterprises.

⁵⁷ Ting Wai, “Reform of the *Nomenklatura* in 1998: A Preliminary Appraisal,” In Edited by Chong Chor Lau and Geng Xiao, *China Review 1999* (Hong Kong: The Chinese University Press, 1999), p. 51.

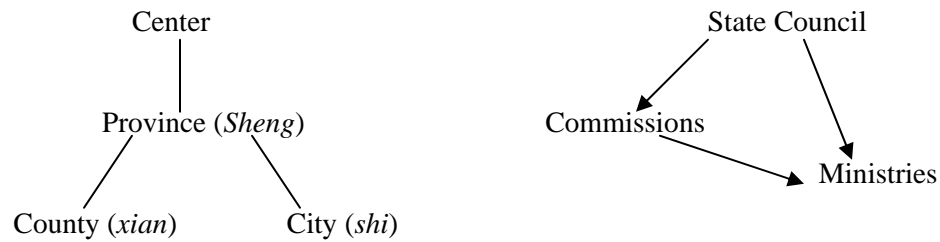
⁵⁸ Zhiyong Lan, “The 1998 Administrative Reform in China: Issues, Challenges and Prospects,” *Asian Journal of Public Administration* Vol. 21, No. 1 (June 1999), p. 35

⁵⁹ Che-Po Chan and Gavin Drewry, “The 1998 State Council Organizational Streamlining: Personnel Reduction and Change of Government Function,” *Journal of Contemporary China* Vol. 10, No. 29 (2001), p. 556.

⁶⁰ Dali L. Yang, “Rationalizing the Chinese State: The Political Economy of Government Reform,” In Edited by Chien-min Chao and Bruce J. Dickson, *Remaking the Chinese State* (London; New York: Routledge, 2001), p. 21

⁶¹ Lan (1999: 35); Yang (2001: 23)

Figure 2-1: Territorial and Organizational Structure of State Administration



Sources: Lieberthal (2002: 173; 178)

The 1998 Administration Reform

While the Chinese central leadership has continuously sought to streamline administrative structure and separate government from enterprise since the 1988 reform, substantial progress was not achieved by 1998. The government restructuring program was firmly pushed by pragmatic reformer Zhu Rongji, who assumed office as the premier on March 1998. The reform gave rise to a path-breaking result in administrative structure. The number of ministries was reduced from 40 to 29, and the size of government employee at the central government was slimmed down by 47.5%, meaning that nearly 16,000 staffs were dismissed out of the total 33,000.⁶² Downsizing the personnel was seen to be critical, since government funded salaries of administrative staff government was 33 million in 1998.⁶³ At the local level, of the 1999 reform plan to cut the size of government was also implemented. One provincial estimate says that “if the provincial government staff size was cut by half of 20,000,

⁶² Wai (1999: 56)

⁶³ Chan and Drewry (2001: 557)

the savings would amount to 3 billion yuan per year.”⁶⁴ There was reported resistance from local officials, particularly counties and township where job opportunities were relative few.⁶⁵ Yet, given the high cost of staffing of sub-national governments, structural streamlining was inevitable.⁶⁶

Through the 1998 reform, 15 ministries and commissions were eliminated, and four state agencies were established.⁶⁷ Streamlining the bureaucracy was particularly remarkable for abolishing or downgrading number of industrial ministries that directly managed state industries during the planned economy. The Ministries of Coal Industry, Metallurgical Industry, Machine-building, and Textile were downgraded to state administration (*guojia ju*) under the leadership of the State Economic and Trade Commission.⁶⁸ Central oversight over state sectors was maintained, although the principle of “*zhengqi fenkai*” was concurrently emphasized to promote the development of a market economy. Before the 2003 reform, SETC as a powerful macroeconomic steering body took charge of 1) industrial policy formulation and implementation; 2) oversight the overall management of state firms including the design of SOE reform; 3) guiding technical innovation and introduction.⁶⁹ After 2003, SETC’s responsibility for the making, enforcing, and regulating of industrial policy was taken over by the NDRC (renamed from SDPC in

⁶⁴ Yang (2004: 43)

⁶⁵ Chan and Drewry (2001: 561)

⁶⁶ Yang (2004: 43)

⁶⁷ Newly emerged bodies are State Commission of Science, Technology and Industry for National Defense, Ministry of Information Industry, Ministry of Labor and Social Security, and Ministry of Land and Natural Resources. Chan and Drewry (2001: 571)

⁶⁸ Yang (2004: 37)

⁶⁹ It was formally established in 1993, and six ministries in charge of domestic industries along with three bureaus, two industrial associations, and two SOEs were directly were incorporated into the SETC.” Extensive discussion on the rise and fall of SETC, see, Joo Youn Jung, “When Neoliberal Economies Meet Globalization: The Transformation of Interventionist States in East Asia,” Ph. D Dissertation (Stanford University, 2006), p. 97.

2003); managerial control and oversight over state enterprises were transferred to SASAC.

One major exception to this was the creation of the Ministry of Information Industry (MII) in 1998. While I discuss the rise of MII in detail in Chapter 4, it is important to note at this stage that this Ministry was established not to intervene in the daily business of telecom carriers, as had been the norm in the past, but to enhance and monitor competition in the market. Although the MII represented industrial bureaucracy, the function of the government was shifting from daily management of enterprises to macroeconomic regulator. This was one of the important goals of the 1998 state restructuring. The transformation of the former planning body SPC into the State Development and Planning Commission (SDPC) also exhibits the changing nature of the government. The SDPC was no longer directly involved in the business management of state enterprises. Instead, it became responsible for providing the macroeconomic development strategies and direction. By eliminating the bureaucratic control, the central leadership tried to accomplish substantial progress in separating government from business. Yet in practice, key investment decision or personnel of state firms are still determined by the state institutions.

The 2003 Government Reform

The focus of the 2003 reform, which was the second batch of the 1998 reform, is to “promote the bureaucratic coherence by reducing institutional conflicts of

interests,”⁷⁰ whereas the 1998 reform has put a great emphasis on streamlining the bureaucracy by cutting the number of ministries and personnel. The most prominent part of the 2003 reform was the creation of SASAC and functional division of SETC into SASAC and SDPC.⁷¹ In doing so, the Central Enterprise Work Committee that had supervised the central large state firms was reorganized into the SASAC in 2003.⁷² While SASAC is neither a ministry nor a commission “whose ministers must receive NPC approval,”⁷³ under the direct leadership of the State Council (*guowuyuan zhishu jigou*) SASAC exercises the powerful control over the most profitable central state firms. In effect, separating the regulatory control of SETC in 2003 contributed to consolidating the functions of the SASAC and the SDPC by transferring its bureau on state firms to the SASAC and on industrial policy and macroeconomic planning to the SDPC, which was renamed as the NDRC in 2004.⁷⁴ As a result, the previously fragmented authority over state firms and macroeconomic control came to be integrated into comprehensive state institutions.

The Changing Nature of Economic Governance

China’s regulatory state is growing in the field of both economic and social regulation, but there is no consensus as to the changing nature of Chinese state

⁷⁰ Yang (2004: 60)

⁷¹ The detail explanation on SASAC is presented in Chapter 3 and 4.

⁷² Barry Naughton, “The State Asset Commission: A Powerful New Government Body,” *China Leadership Monitor*, No. 8 (2003), p. 8.

⁷³ Yang (2004: 60-62)

⁷⁴ *Ibid*

emanating from the governance reform.⁷⁵ At one end, giving much credit to the effects of administrative reforms since the late 1990s, some argue that the function and structure of Chinese government tend to be rationalized and have made a genuine progress toward the market-oriented economy.⁷⁶ Others argue that the Chinese state has degenerated from the East Asian developmental model into a decentralized predatory state.⁷⁷ Situating this study between them, those sharply contrasting perspectives help me better understand and identify the nature of Chinese state, particularly the patterns of economic governance, and why and how *complex* forms of state regulation emerge in the Chinese industrial economy.

The View from Mainland China

The subject of “regulation” (*jianguan*) is also central among influential scholars working on China’s regulatory reform in mainland China. Zhang Xinzhu, director of the Research Center for Regulation and Competition in CASS, comments that reform of the regulatory system is very difficult, because it demands the redistribution of public authority and social resources.⁷⁸ While scholars in universities and government think-tanks agree with the newly emerging regulatory governance in China’s

⁷⁵ Yang (2004); Shaun Breslin, 2004, “Capitalism with Chinese Characteristics: the Public, the Private, and the International,” Working Paper No. 104, The Asia Research Center; Pearson (2005); Heilmann, “Regulatory Innovation by Leninist Means: Communist Party Supervision in China’s Financial Industry,” *China Quarterly* (2005a); “Policy-Making and Political Supervision in Shanghai’s Financial Industry,” *Journal of Contemporary China*, 14 (45), November (2005b); Wang (2006)

⁷⁶ Yang (2001)

⁷⁷ Minxin Pei, *China’s Trapped Transition : The Limits of Developmental Autocracy* (Cambridge; London: Harvard University Press, 2006)

⁷⁸ Zhang Xinzhu, *Zhongguo Jichu Sheshi Chanye de Guizhi Gaige yu Fazhan* [Regulatory Reform and Development of China Infrastructure Industries] (Beijing: *Guojia Xingzheng Xueyuan Chubanshe* [State Administration Institution Publishers], 2002), p. v.

industrial economy, their assessments of *de facto* regulation tend to be largely divided into two groups. One is those who put a great emphasis on the effect of “institutional” reforms in the regulatory system that have created a specialized public agency for regulation.⁷⁹ Scholars in this strand argue that the functions of regulator and operator are clearly separated according to the principles of “*zhengqi fenkai*.”⁸⁰ In the case of the telecom service business, for instance, Zhang Xinzhu firmly argues that the official regulator, the Ministry of Information Industry (MII), is entirely separated from the management of telecom firms, while it is not independent from government because the MII is part of government.⁸¹ In addition, Gao Shiji, another scholar specializing in regulation of infrastructure industries, argues that even though regulatory reforms in China have contributed to accelerating the transition of the socialist market economy, institutional environments for the market mechanism still remain insufficient.⁸² Gao Shiji particularly highlights the need for improvement of the legal system and administrative efficiency in order to meet the demands from the development of a market economy.⁸³ Moreover, as China is rapidly transformed into a modern industrial society, Gao Shiji argues that state regulation is indispensable

⁷⁹ They include: Zhang Xinzhu (Chinese Academy of Social Science, CASS), Gao Shiji (Development Research Center of State Council, DRC), and Ma Jun (DRC).

⁸⁰ Interview with Zhang Xinzhu in the Research Center for Regulation and Competition of CASS, Beijing (February 9, 2006)

⁸¹ *Ibid*, and the follow-up interview with Zhang Xinzhu by email (July 20, 2007)

⁸² Gao Shiji and Qin Hai, “*Cong Zhidu Bianqian de Jiaodu Kan Jianguan Tixi Yanjin he Jianguan Guojia Xingqi: Guoji Jinglian de Yi Zhong Quanshi he Zhongguo de Gaige Shijian Fenxi* [From the View of Institutional Transition Looking at the Improvement of Regulatory System and the Rise of Regulatory State: Explanation from International Experience and Analysis of China’s Reform and Practice], Paper prepared for the OECD’s *Governance in China* (2004), Unpublished manuscript, pp. 27-28.

⁸³ Gao Shiji, “*Cong Fada Guojia Zhengfu Jianguan Zhineng de Kuozhang Licheng Kan Shichang Jingji Zhong Zhengfu Zhineng Yanjin* [Looking at the State in the Market Economy from the Historical Process of the Function of State Regulatory in the Advanced Country], Forum : *Zhongguo Zhengfu Tizhi Gaige* [Chinese Government System Reform], Zhejiang, China (June 9-10, 2007), see <http://www.chinareform.org.cn/cirdbbs/dispbbs.asp?boardID=12&ID=131038> (Access: August 12, 2007)

because market failure is more likely to occur. Establishing a specialized regulatory institution is strongly required to help build up the market-oriented economy system. This creation of a modern regulatory system is more desirable when it is legally-based, which would be the starting point toward the establishment of a constitutional government.

On the other hand, scholars in the other group, although they commonly acknowledge the rise of the regulatory state as a new mode of economic governance in China, pay more attention to the “obstacles” to the practice of regulation, such as the powerful influence of the party and a continuing sticky government-enterprise nexus, which lead to constrain the independence of the regulator.⁸⁴ Zhou Qiren, specializing in infrastructure regulation at Beijing University, argues that regulatory agencies in China have never been independent from the party-state.⁸⁵ For instance, since both senior officials in the telecom regulator MII and top executives of the service carriers are appointed by the party, they cannot be free from the party given their tenure. As such, despite the efforts of the government to build up the regulatory system, such as abolishing numerous administrative approval procedures and establishing regulatory agencies, Yu Hui in CASS addresses that the Chinese government does not have the capacity to conduct *de facto* regulatory reform, due to few experts and specialized regulatory agencies, the lack of public law, and weak transparency and accountability in public policy.⁸⁶ Furthermore, in contrast with Zhang Xinzhong’s argument, the government is not separated from enterprises, which

⁸⁴ They include: Zhou Qiren (Beijing University), Yu Hui (CASS), Kan Kaili (Beijing University of Post and Telecommunications)

⁸⁵ Interview in Beijing University (December 19, 2005)

⁸⁶ Interview in Beijing (January 20, 2006)

seriously affects the independence of the regulator.⁸⁷ In order to enhance the independent function of a regulator, Yu Hui puts emphasis on the need for substantial separation of government and enterprises and establishes a public hearing for public policy decisions (i.e., price).⁸⁸ For effective state regulation, improvement in the legislative system and in administrative lawsuits is particularly underscored.⁸⁹

The Recentralized Regulatory State

The model of regulatory state tends to emerge as a brand-new benchmark in explaining China's changing nature of governance since the 1998 state reform. The regulatory state model argues that China's rationalized government structure and changed function of state agencies contribute to enhancing the efficiency and transparency of the government. It also divests the sticky bonds between state and enterprises. At the head of the regulatory state model, Dali Yang states that the central leadership's firm efforts to reform the government by streamlining and downsizing bureaucracy would lead to a reshaping of the state-business nexus. This, in turn, will level the economic playing field.⁹⁰ Yang claims that "China has made real progress

⁸⁷ Yu Hui, "Jianguan Re de Leng Sikao," Forum : *Zhongguo Zhengfu Tizhi Gaige* [Chinese Government System Reform], Zhejiang, China (June 9-10, 2007), <http://www.chinareform.org.cn/ad/2007-16/> (Access : August 11, 2007)

⁸⁸ Yu Hui, "Zhongguo Dianxin: Sheilai Guanzhi Guanzhizhe" [China Telecom: Who Controls the Controlled] *Zhongguo Jingji Shibao* [China Economic Times] (November 3, 2000)

⁸⁹ Cheng Tao, "Dianxin Lifa Shouguan: Zhuanfang Dianxinfa Lifa Zhuanjia Zixun Weiyuanhui Yu Hui," *Nanfang Zhuomo* [Southern Daily] (December 2, 2003)

⁹⁰ Yang (2004: 14)

toward making the Chinese state into a regulatory state suited to a functioning market economy.”⁹¹

He views that the central government, by virtue of recentralized power, closed a number of industrial ministries and economic bureau through the reforms of 1998 and 2003. Regulatory bodies, responsible for encouraging and monitoring fair competition in the market, were established. Yang believes that the creation of regulatory agencies indicates an important step towards strengthening the regulatory state. He predicts that China finally leads to “a modern limited government.”⁹² In particular, public hearings over utility prices, competitive bidding for public projects, and the auction of land or mineral resources gives rise to a buyer’s market as a new mechanism for market governance in China. According to Yang, these changes have made a great contribution toward transforming the relations between government and business as well as making the business environment transparent.⁹³ As such, the growing market competition has weakened existing sticky bonds between state institutions and firms, and will eventually separate state institutions from business.⁹⁴ For effective market regulation, the capacity of central government has been enhanced by making strong vertical bureaucratic hierarchies.⁹⁵

Although his arguments rightly point out considerable effects of institutional reform on the changing nature of Chinese state, Yang oddly remains silent about the pivotal political body, the Party. How does the Chinese Communist Party (CCP)

⁹¹ Yang (2004: 18)

⁹² Yang (2004)

⁹³ Yang (2004: 17-18)

⁹⁴ Yang (2004: 18)

⁹⁵ On the other hand, Andrew Mertha argues soft centralization in that “although bureaucracy is centralized from the township/county to the provincial level, they remain decentralized between the centre and the province” *The China Quarterly* 184 (December 2005), p. 295

harmonize or conflict with a newly rising regulatory mechanism that may potentially challenge its vested prerogatives? While some argue that the party's mobilizing capability is declining resulting from the ideological downfall and rampant cadre corruption,⁹⁶ the top position of both government and enterprises are still dominated by the party. Given the continued power of the party organs in China's political and economic life, its functioning is a key variable in explaining the changing relations between government and business. The party factor also demonstrates how the practices of Chinese regulatory mechanism are different from the conventional type of regulatory state.

Moreover, Yang argues that "the ties between state institutions and enterprises began to weaken, which eventually divests state institutions of their business operation." Yet how could we have substantial changes in the relations between state and business under the continued state ownership? According to my observations in the field, key strategic industries are neither privatized nor decentralized due to the party-state's vested interests. The central government tightly regulates their assets and the personnel. In addition, Yang contends that Chinese producers in "most" industrial sectors do business in buyer's markets, but the most profitable commanding heights (i.e. oil or telecom service) are under the central control. Central state institutions, not the market, decide the price and the market entry.

The party-state still deeply remains involved in the appointment of senior officials in regulatory bodies and executives of SOEs.⁹⁷ To be sure, the wholesale administrative redesigns provide institutional foundations for regulatory governance,

⁹⁶ Pei (2006)

⁹⁷ Interviews in Beijing (December, 2005)

and show the Chinese leadership's strong will for the reform. But the unsolved puzzle remains: how do two major institutional legacies of the Communist regime, the party-state and dominant public ownership, harmonize with the regulatory structure in China? In sum, the *recentralized* regulatory state is emerging as a new mode of economic governance in China. Yang overlooks the potential diversity in the implementation of regulation. By comparing two strategic industries, auto and telecom, I suggest the contours of China's regulatory state are varied. Ownership forms, state-enterprise relations and links between state institutions vary according to the specific case. Given the complex nature of Chinese political economy, the regulatory state in China is highly multifaceted.

The Decentralized Predatory State

While there have been academic debates on the causal relations between decentralization and corruption,⁹⁸ scholars who study transitional regimes in former socialist state agree that decentralized political and economic authority are likely to produce increasing rent-seeking and predation.⁹⁹ Minxin Pei argues that, as a

⁹⁸ While some argue that decentralization is more likely to reduce corruption due to enhanced accountability, others argue that increased discretion and incentives from decentralization lead local officials to more opportunities for corruption. For the former, see Paul Seabright, "Accountability and Decentralization in Government: An Incomplete Contracts Model," *European Economic Review* 40 (1996): 61-75. For the latter, see Van Rijckeghem and Beatrice Weder, "Corruption and the Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?" *IMF Working Paper WP/97/73* (Washington, D.C.: IMF, 1997)

⁹⁹ Joel S. Hellmann, "Winners Take All: The Politics of Partial Reform in Post-communist Transition," *World Politics* 50, No. 2 (1998): 203-234; Federico Varese, "The Transition to the Market and Corruption in Post-socialist Russia," *Political Studies* 45, No. 3 (1997): 579-596; Solinick (1996: 209-238)

consequence of decentralized political-economic institutions resulting from the gradual reform strategies, the party-state's capacity to mobilize and monitor agents has declined considerably. The rampant corruption of local cadres shows the problem of governance deficit. Pei concludes that the Chinese state has become a "decentralized predatory state."¹⁰⁰ Focusing on the cadre responsibility system at the local level (township), however, Maria Edin finds that the Party is not declining, but *remaking* its organization (governing institutions) and "reinventing itself."¹⁰¹ Furthermore, Edin points out that while decentralization and fiscal reform have allowed local agents to enjoy more autonomy than before, the party selectively exercises its political control over cadres; "decentralizing control of the ordinary cadres but recentralizing control over the leading cadres."¹⁰²

Pei's decentralized predatory state model contrasts sharply with the regulatory state model, which gives much credit to the effects of state reforms and the growing market forces. Pei argues that China's gradual reform strategies, which aim to secure the party-state's political control confronting institutional and legal reforms, have provided the ruling elites with the leeway to co-opt emerging business elites. This enables party officials to protect their political prerogatives. Commenting that the East Asian development model is exceptional in that the "helping hand" does not turn into the predatory practices, Pei holds that the Chinese state always had much

¹⁰⁰ Pei, (2006: 40)

¹⁰¹ Maria Edin, "Remaking the Communist Party-State: The Cadre Responsibility System at the Local Level in China," *China: An International Journal* 1, No. 1 (March 2003): 1-15.

¹⁰² Edin (2003: 7)

possibility of becoming a “grabbing hand” for rent-seeking because of decentralized political authority and property rights.¹⁰³

Four institutional factors, according to Pei, are indicated as critical variables to bring about the decentralized predatory state in China. They include the decentralization of property rights, the declining monitoring capability, the availability of new exist options, and the erosion of ideological norms. During the past two decades, economic reforms have delegated much managerial authority to local governments such as the property rights, fiscal resources, and administration.¹⁰⁴ Such decentralization has considerably influenced the nature of Chinese state. In principle, the decentralization of property rights was introduced in post-socialist states in order to grant local state agents incentives, which was ultimately expected to increase state assets. Yet Pei claims that in China’s case, “the combination of lack of clarity of property rights and decentralization of such rights” provided local officials and managers of local SOEs with many chances to appropriate the rents.¹⁰⁵ Furthermore, administrative decentralization undermined the effective supervision of local cadres as well as daily decision-making power over local business. Pei’s model suggests that with the decentralization of property rights, fiscal, and administration functions have formulated “powerful incentives for local authorities to adopt predatory policies and practice.”¹⁰⁶

¹⁰³ Pei (2006: 34)

¹⁰⁴ Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993); Gordon White, *Riding the Tiger: The Politics of Economic Reform in Post-Mao China* (Stanford, Calif.: Stanford University Press, 1993); Jia Hao and Lin Zhimin, eds., *Changing Central-Local Relations in China: Reform and State Capacity* (Boulder, Colo.: Westview Press, 1994); and Victor Nee, "Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights and Mixed Economy in China," *Administrative Science Quarterly* 37 (March 1992).

¹⁰⁵ Pei (2006: 41)

¹⁰⁶ Pei (2006: 14)

In my view, however, the model of decentralized predatory state is apt to overstate the effects of the policy of decentralization. First, in theory, even though there is a high correlation between decentralized property rights and rampant predation, local agents do not always have incentives to strip assets. This is because the loss of state assets will critically affect the future tenure of local officials. Top executives of major large local state firms are directly appointed by the central state agency coordinated with the central party. Hence the decentralization of property rights in China does not necessarily result in decentralized predation. Second, administrative decentralization is certainly inclined to weaken the central party-state capacity to monitor local cadres and increase transaction costs. Instead, the centre strengthens the macro-level regulatory control of “strategically important issues.”¹⁰⁷ As Christopher Hood et al. have commented, “[t]he lessening of regulation at one level may be accompanied by re-regulation at another.”¹⁰⁸ Given that most important business projects still require the central approval, decisive authority continues to be in the hand of the center although much decision-making authority has been delegated to local officials. Lastly, Pei gives the example of the telecom service sector to show how the ruling elite’s rent-seeking to protect vested interests gave rise to inefficiency and waste of national resources during the reforms.¹⁰⁹ In contrast with Pei’s argument, China’s telecom service sector is one of the most profitable industries¹¹⁰

¹⁰⁷ Edin (2003: 2)

¹⁰⁸ Christopher Hood et al., *Regulation inside Government: Waste-Watchers, Quality Police, and Sleaze-busters* (Oxford: Oxford University Press, 1999), p. 194.

¹⁰⁹ See, Pei (2006: 102-109)

¹¹⁰ Barry Naughton, “Claiming Profit for the State: SASAC and the Capital Management Budget,” *China Leadership Monitor*, No. 18 (Spring 2006)

and has always had its personnel, budget and investment strictly controlled by the central authority.

The Regulatory State, Chinese Style

Located at the intersection of these two opposite views, some models bring the Party back in as a key variable to shape the patterns of economic regulation.¹¹¹ The Party is a pivotal political institution in underlining China's regulatory state. Continued public ownership of strategic firms and growing power of comprehensive government commission (i.e., SASAC) are closely related to vested interests of the Party. Given that the role of the Party has been rarely investigated in conventional models of regulation, the variable would be useful in illuminating how China's practice of regulation is distinctive from existing frameworks.

Taking a more cautious position in identifying the nature of China's regulatory system, Margaret Pearson focuses on the function of independent regulatory agencies in governing strategic industries.¹¹² Unlike Dali Yang's estimation, Pearson finds that although China's central leadership has rationalized administrative structure, established regulatory bodies, and separated government from business, these institutional reforms have not yet led to a *remake* of the Chinese party-state into a globally-advised regulatory state. Drawing on six case studies of infrastructure and financial service industries, Pearson contends that the independent functions of regulatory institutions are constrained by the continued state ownership,

¹¹¹ Pearson (2005); Heilmann (2005a; 2005b)

¹¹² Pearson (2005)

the power of comprehensive state commissions and the party organs. Moreover, the regulator's bureaucratic origins and authority are ambiguous. Unlike the conventional regulatory reforms that focus on privatization, Pearson points out that the Chinese government maintains state ownership. In fact, the Party has been attempting to promote corporate governance of state firms in order to augment the value of crucial state assets.

Moreover, not only have government restructuring programs created regulatory agencies; they have also strengthened the regulatory oversight of comprehensive state commissions at the center, the NDRC and SASAC, "which are in charge of planning and state asset supervision."¹¹³ The independent functions of regulators in China are considerably constrained by superior state commissions. Normatively, China's regulatory regime encourages competition in the market. But Pearson argues that orderly competition structured by the state, favoring "small number of dominant, state-chosen and state-owned players to protect the party-state's considerable financial and social interests in these key assets."¹¹⁴

Most importantly, while Yang's model of regulatory state is overall "muted" on the role of the Party in remaking the Chinese economic regulation, Pearson pinpoints the Party as one of key institutional factors. She finds that the Communist Party keeps exerting the political control through the right of personnel in both state institutions, including regulators, and state firms. As Sebastian Heilmann has commented, "The practice of Communist Party control and the role of secretive Party

¹¹³ Pearson (2005: 304)

¹¹⁴ Pearson (2005: 298; 315; 332)

organs in economic regulation belong to the least understood key elements of China's political economy.”¹¹⁵

Given the importance of the Party in making policy and supervision, Heilmann, focusing on the financial industry, accounts for how the Party organs actually have an effect on economic regulation in China. Heilmann argues that the centralization of financial market regulation and supervision in the late 1990s could have been achieved through the Party's personnel authority and political supervision.¹¹⁶ By the creation of the Central Financial Work Commission, the Chinese party-state could effectively centralize financial regulation and control the performance of senior executives in financial firms and state financial regulatory bodies. Rather than passively accepting its declining monitoring and mobilizing capacity, the Party has actively confronted the changing environment in order to maintain its authority of personnel and supervision, which has been the most powerful means of political control. However, studies confined to highly centralized infrastructure or financial service industries show some limitations in accounting for China's industrial regulation in general, because the Chinese leadership has employed different strategies and regulatory systems across the sectors.¹¹⁷ Hence varied forms of state regulation are likely to set in China's industrial economy.

¹¹⁵ Heilmann (2005: 4)

¹¹⁶ Heilmann (2005: 2). On the other hand, Victor Shih emphasizes the factional rivalry as a key variable in accounting for the centralization of the financial industry in China. See, “Authoritarian Power Imperatives and the Chinese Banks,” presented at the American Political Science Associations Annual Conference, San Francisco, August/September, 2001.

¹¹⁷ Pearson also calls for industrial sectors selected for the study of regulation in China need to be expanded into non-strategic or strategic sectors, which have no efforts of regulatory institutions, to uncover the overall nature of Chinese market governance in transition. Pearson (2005)

A Soft/Hard Regulation Model

Drawing on Pearson's centralized but limited regulatory state model,¹¹⁸ I propose a model of soft and hard regulation to better capture and understand complex patterns of central oversight in China's strategic industries. By expanding the sector into strategic but *decentralized* industries, the forms of state regulation are systematically compared with highly centralized strategic sectors. This soft/hard regulation model above all sheds light on the various forms of regulatory governance within one country. Simply put, central oversight from the center is commonly identified across strategic industries regardless of strong local components. Yet the patterns of regulation are varied because of not only inherent sectoral differences, but also the governing structure, level of ownership and the role of foreign investors marked by issue areas.

To some extent, the concept of soft versus hard regulation is *relative* when more than two industries are compared. Soft regulation is a type of central regulatory mechanism employed in the "decentralized strategic" industry. In a soft regulation model, first, the manner of oversight from the center is often "invisible" through floating supervising groups. There is no formally designated regulator, but the central party-state directly monitors the business of major local state firms.

Second, when the sector has a strong decentralized governing structure in terms of administration and ownership, regulatory control from the center is much looser than in centrally-owned state industries. In other words, even though the

¹¹⁸ Here "limited" means that the practices of regulation in China's infrastructure and financial service sectors do not conform to the independent regulator model, which is advised by international institutions.

policies of decentralization tends to weaken central oversight due to the powerful authority of local governments, the centre still exercises soft/invisible control over the major local state firms. It demonstrates that decentralization does not necessarily lead to “the lack of central regulatory oversight,” and offers us a new way to look at the varied types of state regulation in China’s state industries. Lastly, a soft regulation model exhibits more or less relaxed control over market entry, which allows private firms to gradually spring up. Thereby, although state firms are given a more favorable business environment (i.e., land, information, or human resources) than private ones, competition comes to be more market-driven with less government control.

Table 2-1: Comparing Soft versus Hard Regulation

	Soft Regulation	Hard Regulation
Central regulatory oversight	Invisible	Formal
Main state ownership forms	Local SOE	Central SOE
Market entry	Relaxed control → Private and foreign-invested firms	Strict control → No private, foreign-invested firms

Compared with soft and invisible regulation, a model of hard regulation emphasizes central control by formal regulator based on various types of legal regulation such as *guiding*, *yijian*, and *jueding*.¹¹⁹ Here “hard” means that regulatory supervision from the center in state industries is tight, in that not only the market structure but also the personnel and budget management of enterprise are determined and monitored by

¹¹⁹ Even though they are not de facto “law,” they are issued by the State Council or other central government agencies and provide government and enterprises with a kind of legal grounds.

central regulatory institutions. Hard regulation can be employed because the most strategic and profitable firms in China are under the central state ownership, which is related to the second feature of hard regulation. In fact, the SASAC as a stake shareholder directly supervises and controls the assets, budget, and personnel management of central state firms. The increasing role of comprehensive state commissions is one of the most important and distinctive features of China's regulatory mechanism compared with conventional approach that has focused on the independence of formal regulator.¹²⁰

In this model, local firms simply remain subordinated to the central firms, and their major business decisions (i.e., the price) should be first approved by the central office of the firms. Asset management is supervised not by local authorities but by staffs from the central regulator. This hierarchically centralized structure governing central state firms weakens the regulatory power of local governments. Third, market entry is strictly controlled by the central regulatory institution in order to structure the market with a small number of state firms. The norm of competition is encouraged and emphasized, but it is not driven by the market. Instead, it is planned and designed by central regulatory institutions.

The forms of regulation in China's state sectors become more complicated when the sector has both central and local state firms. Even in the same industry, the Chinese government employs different regulatory mechanisms: while the central control over local state firms is invisible and looser than in central state firms, central firms are tightly supervised by central regulatory institutions. It shows that although strategic state industries converge on "centralized oversight" as other scholars of

¹²⁰ OECD (2002); Vogel (1996); Pearson (2005); Chung (2003); Philip Andrews-Speed et al (2000)

China find,¹²¹ I argue that specific manners of state control are varied between and within industries. A soft and hard regulation model, which I propose in this dissertation, helps understand complex regulatory governance inside Chinese industrial economy.

V. Chapter Conclusion

In recent years, the body of literature on China's regulatory state has grown. However, the existing literature reveals some limitations in explaining the complex systems of regulation inside the Chinese industrial economy. The state-business nexus in China is very dynamic, not only across industries, but also within specific sectors. Therefore, it would be less relevant to conclude that the changing nature of Chinese state is a single-type of "regulatory" or "predatory" state. In this chapter, by introducing a soft/hard regulation model I have attempted to challenge the existing analytic frame and assumptions of the regulatory state in China and to help better understand the varied types of state regulation in China's strategic state sectors.

In doing so, first, I have introduced two contrasting macro-level approaches: Yang's minimalist regulatory state and Pei's decentralized predatory state. Taking a macro-level approach, Yang overemphasizes the effects of government reforms and concomitant separation of state and enterprise on remaking China modern state. Pei highlights the "dark" side of reforms, such as rampant corruption and rent-seeking.

¹²¹ Pearson (2005); Kun-Chin Lin, "Disembedding Socialist Firms as a Statist Project: Restructuring Chinese Oil Industry, 1997-2002," *Enterprise & Society: The International Journal of Business History* (January 2006); Mertha (2005)

He claims that the capacity of the central party-state is declining and that it has become a decentralized predatory state. However, I suggest that they are less useful in accounting for the complex mechanism of China's economic regulation in state industries, for they fail to recognize how the party has been continuously revamping its function and organs in order to maintain the political control in both government and business.

Secondly, I have presented Pearson's analysis of China's regulatory state, situating in between the above opposite models. Focusing on the most strategically significant infrastructure and financial service industries, Pearson evidences that how China's key political-economic institutions (i.e., state ownership or the party) and strategic policies have contributed to create different practices of regulatory state from the conventional independent regulatory model. Parallel to this approach, Sebastian Heilmann also demonstrates how the Party organs have played a pivotal role in recentralizing regulatory control in the financial industry. Both Pearson and Heilmann agree to the fact that the regulatory state is emerging as a new mode of economic governance, but, in contrast with Yang or Pei, they neither overlook nor treat the Party as a passive actor. Instead Pearson and Heilmann persuasively point out how the political control of the Party associated with the continued state ownership has an effect on shaping the centralized regulatory governance in China.

However, these central state sector-focused studies offer, limited explanations for the overall regulatory mechanism in China's industrial economy. I have proposed a soft/hard regulation model in the context of central state control. The model aims to capture the diversity inside economic regulation in China when the sector is expanded

into strategic but decentralized industries. I have argued that the pattern of soft regulation occurs when the sector has strong local components but is under the central oversight. Yet the manner of central party-state regulation is often invisible and loose due to the powerful local authority through administration and ownership. On the other hand, central state firms in key industries are tightly and directly supervised by the central regulation institutions. I conceptualize this pattern as hard regulation. Furthermore, when the sector has mixed forms of ownership such as central, local, and private firms, both soft and hard regulation are identified together.

Lastly, while the Chinese government has been making great efforts to institutionalize market governance, the strong invisible hand of the party is playing a critical role in formulating new mechanism of market governance. The legacies of Communist institutional structure have been giving rise to variation in systems of regulation in China. This path dependent institutional evolution has a significant effect on making the regulatory state, the Chinese style. Rather than “one-size-fits-all” mentality,”¹²² I suggest that China’s regulatory structure has much more complexities and varies depending on where we look at.

¹²² Yukyung Yeo and Margaret M. Pearson, “Regulating Decentralized State Industries: China’s Auto Industry.” Paper presented at the Workshop on Decentralization and Varieties of Regulatory Capitalism in China, City University of Hong Kong, January 30, 2007, p.3.

Chapter 3

CENTRALIZED MIXED REGULATION: THE AUTOMOBILE INDUSTRY

*“Local actors were of course important in the story of Chinese reforms.
But they were important as actors in a game directed from Beijing.”*

- Cai and Treisman (2006)¹

I. Introduction

One of the most rapidly growing sectors, China's auto industry holds a remarkable record. In 2005, its domestic sales totaled 5.92 million vehicles, and by taking up 10% of the market share, China achieved the second largest auto market in the world.² Compared with the global market share in 2001, which remained only 4%, it seems to signal that China, after the U.S. and tied with Japan, could become the next global auto power. Since the reform and open policy in 1978, the Chinese leadership targeted the automotive industry as a key sector that would contribute to modernizing and invigorating the retarded planned economy. Moreover, its multiplier effect over other industries, such as the chemical, machinery, electronic, and steel sectors, has made the Chinese leadership set a high priority on the development of the auto industry.

¹ Hongbin Cai and Daniel Treisman, “Did Government Decentralization Cause China's Economic Miracle?” *World Politics* 58 (July 2006), p. 533.

² *Zhongguo Qiche Gongye Nianjian* (China Auto Industry Yearbook), 2005; Jian Sun, 2006 “China: The Next Global Auto Power,” *Far Eastern Economic Review* 169 (2), p. 37.

In this chapter, I argue that the regulatory mechanism in China's automotive industry exhibits four main characteristics. First, and most importantly, even though automobile manufacturing in China is dominated by decentralized administration and public ownership, there is centralized regulatory power in governing local auto businesses. Yet the manner of central oversight over local state firms is invisible and loose compared with central SOEs, due to strong local public ownership. Second, the forms of central oversight in the sector are also varied among local state-owned auto producers as well as between central and local state firms. While the central state-owned enterprise First Automotive Works (FAW), similar to telecom service carriers, is tightly controlled by central regulatory power, central oversight over local auto manufactures is relatively soft through indirect and informal channels. Hence mixed forms of regulation are likely to be set in governing the automobile business in China. Across localities, furthermore, state auto firms in Shanghai are monitored by an invisible floating regulatory body from the central party-state, whereas Beijing's state-run auto producers are implicitly and indirectly checked by the central top leadership who nominates the mayor and the party secretary of Beijing.

Third, noting that the role of the party in China's industrial regulation has been either less discussed or devaluated, I discover that the party continues to maintain significant levers of control through the party committee (*dangwei*) in both government and state enterprises. In both central and local automotive businesses, the party committee dominates the boards of directors, thereby exercising a critical *political* control over major business decisions as well as over personnel. In particular, high ranking party member entrepreneurs in state firms may flout the

formal public agencies and procedures in regulation, preferring to interact directly with top executives in the State Council. Finally, the National Development and Reform Commission (NDRC) plays the role of regulatory “watchdog” in the automotive sector by holding the authority to approve market entry, foreign investment partners, and large-scale business projects. Since most major auto manufacturers are local state-owned, local level Development and Reform Commissions (DRC) under the leadership of local governments exert direct influence on local automotive businesses by providing industrial support for land or infrastructure building. Yet regardless of the level of ownership, auto industrial policies, various regulations, and the final stamp of approval from the NDRC for major projects are of high importance to automotive entrepreneurs in China.

In a theoretical context, mixed forms of central regulation in China’s auto industry show that, unlike Minxin Pei’s decentralized predatory state model, the central party-state does not lose its regulatory capacity in the sector. Rather, the party deeply penetrates into both government and automotive enterprises through formal or informal channels, and oversees personnel and asset management in order to secure their vested interests. This also means that China’s recent streamlining and rationalized bureaucratic structure, whose effects on the nature of the state often tend to be over-evaluated, does not necessarily lead to transforming the state-business nexus into modernized economic governance, as Dali Yang anticipates. Instead, the growing regulatory power of comprehensive state commissions over automotive enterprises never conforms to the idea of either minimalist or decentralized state capacity. The continued political control from the central party-state contributes to

creating centralized but varied patterns of regulatory oversight in China's auto industry. A model of soft/hard regulation that I propose in this study attempts to explain these complexities in regulating China's auto business.

In this chapter, after introducing the historical evolution of auto industrial development policies in China, I explain the structure of governmental authority at both the central and local levels, focusing on the major state institutions involved in the automotive sector. The chapter then proceeds to present three cases of auto SOEs and map out each pattern of regulatory oversight from the center. Aiming to capture and explain the regulatory architecture of the sector, I propose a soft and hard mixed form of regulation in China's automobile industry.

II. The Nature of China's Auto Market

Beijing's emphasis on automotive sector development is not a new issue, but has accounted for much work over the last two decades. The development of the auto industry in China is important because it closely relates to the growth of other industries, including the chemical, steel, machinery, and service industries, making it a so called "comprehensive industry" ("*zhonghe hangye*"). According to one research study that examines the correlation between industry and macro economic growth, the major contribution of four sectors, machinery, auto, steel, and electronics, to China's industrial growth recorded 33 percent in 2000. This proportion increased to 48 percent in 2003.³ While the contribution of the automotive sector to the national

³ Chen, Qingtai et al. 2004. *Yingjie Zhongguo Qiche Shehui* [The Coming of Auto Age in China] (Beijing: Zhongguo Fazhan Chubanshe), p. 12.

economy was estimated at around 0.8 percent in 2006, the central government is attempting to increase it to 2.5 percent during the eleventh five year plan.⁴ In this section, I introduce how the sector has been developed and the role of industrial policy in China's automobile manufacturing development.

Historical Evolution

After Mao's visit to the Soviet Union in 1949, China's first auto firm, the First Automotive Works (FAW), was built in 1953 in Changchun in northeast China. Its auto production was launched with the memorable 'Liberation (*jiefang*)' truck in 1956.⁵ Due to a lack of capital and technology, however, the Chinese auto industry heavily relied on the Soviet Union's technical assistance. Following FAW, the Shanghai Automobile Assembly Plant was set up in 1958, and the Second Automotive Works (now Dongfeng) in 1969.⁶ During the early stages of development, China's auto manufacturing was limited to heavy and light trucks, buses, and jeeps, mainly for transportation or military use. There was passenger car production, but only for government affairs or officials, not for private purchase. As late as the mid 1980s, the private purchase of automobiles was not allowed. This was the major obstacle to the development of the auto industry in China over the pre-reform era.

⁴ Zhao, Bo, "Qiche Chanye Jiegou Tiaozheng Guojia Fagai WeiJijie de Ti," March 20, 2006. Access at: <http://auto.sohu.com/20060320/n242368472.shtml>

⁵ 2004 FAW Annual Report

⁶ Larry D. Qiu. 2005. "China's Automotive Industry," p. 2. See, <http://www.bm.ust.hk/~larryqiu/>

Since 1978, the development of China's auto industry has been accelerated with economic reforms.⁷ The auto industry, particularly passenger car production, was newly emphasized because of its "multiplier effects" on related manufacturing industries, such as steel, electronics, and glass.⁸ It was also perceived as a key foundation for building up a modern economic system. However, the moderated governmental policy for market entry in the early 1980s led most provinces to establish their own automobile manufacturing plants. As a result, the number of auto vehicle firms increased from 53 in 1976, before the reform, to 114 in 1985, to 122 in 1995, settling at 117 in 2004.⁹ This fragmented industrial structure caused the central government to recognize the need for a consolidation policy to improve productivity and economy of scale. The auto industry was targeted by top leaders, such as Jiang Zemin and Zhu Rongji, as the priority sector for restructuring in 1992.¹⁰ In 1987, the central government designated three large-scale auto firms and three small ones ("sanda sanxiao") as major passenger car assemblers for the key production base, and market entry was again restricted by the central government in 1989. They included FAW, SAW, and SAIC as the three large firms and Beijing Jeep, Guangzhou Peugeot, and Tianjin Auto as the three small ones. These consolidation efforts were reaffirmed in China's first auto industrial policy in 1994, and were again stressed by the central government in the new auto industrial policy in 2004.

⁷ While there was the auto industry in China, its overall development began after the open and reform policy since the 1980s. Institute of Industry Economics of Chinese Academy of Social Science (CASS), 2004 *China's Industrial Development Report (Zhongguo Gongye Fazhan Baogao)*, p. 220

⁸ Eric Harwit, *China's Automobile Industry: Policies, Problems, and Prospects* (Armonk, N.Y.: M.E. Sharpe, 1995), p. 36

⁹ China Automotive Technology Center, 2005 *China Automotive Industry Yearbook (Zhongguo Qiche Chanye Nianjian)* (Tianjin: Zhongguo Qiche Jishu Yanjiu Zhongxin, 2005)

¹⁰ Yasheng Huang, "Between Two Coordination Failures: Automotive Industrial Policy in China with a Comparison to Korea," *Review of International Political Economy* Vol. 9, No. 3 (2002), p. 546.

Another important feature during the 1980s was to encourage foreign investment in the form of the Joint Venture (JV). To develop the auto industry, which required intensive capital and highly advanced technology, the Chinese top leadership adopted the policy of “exchange technology with market” (“*huan jishu he shichang*”). Through the JV production system, the Chinese government expected that there would be a great learning effect for local auto firms in terms of technology development and managerial skills, although it has now been evaluated as a failure.¹¹ The first JV auto firm, the Beijing-Jeep Corporation, was created by the Beijing Automobile Corporation and the American Motors Corporation (AMC) in 1983. After Beijing-Jeep, SAIC and FAW each set up JV firms with Volkswagen in 1985 and 1991, respectively. In 2005, the number of foreign auto firms having a JV with Chinese OEMs had increased to nine.¹² Although JV foreign investment was highly encouraged as a development strategy, the Chinese government clearly stated strict regulations for technology transfer, products lines, and the stock share rate of the enterprises.

Given the globalizing production and supply networks in the auto industry, in fact, China’s JV development strategy is seen to be inevitably necessary.¹³ To cope with the rising development cost resulting from rapid technological change, major auto assemblers have adopted global production networks where multiple suppliers

¹¹ This was early acknowledged by the government and auto firms, and it is why new auto industrial policy in 2004 emphasizes the need for “independent innovation” (*zhizhu chuangxin*) to produce Chinese own auto brand.

¹² Shanghai Auto Industry Corporation. 2005. *China Auto Industry Development Research* (*Zhongguo Qiche Gongye Fazhan Yanjiu*), pp. 31- 53.

¹³ Yeo and Pearson (2007: 9)

meet and work together on a single product.¹⁴ The rising demands for extensive resources and advanced technology have led small automotive firms, both assemblers and suppliers, to be integrated into the global manufacturing system in the auto industry.¹⁵ In 2001, 13 auto assemblers produced more than 1 million cars and they accounted for 87% of the world auto production.¹⁶

Since the late 1990s, moreover, China has experienced two internal and external transformations that have affected the industrial management of the auto industry. Internally, there was extensive administration reform in 1998, and externally, China joined the WTO in 2001. As a consequence of the state reforms, governance structure has become more integrated into a comprehensive state agency, the NDRC, which contributes to consistent policy-making and implementation.¹⁷ Externally, WTO membership has led the Chinese government to release its former protection measures in stages, such as high tariffs or quotas, to meet negotiated agreements with the US and Europe.

¹⁴ Thun (2006: 214 -217); also for more detailed discussion on the global supply network and production system in the auto industry, see Shahid Yusuf and M. Anjum Altaf, and Kaoru Nabeshima, *Global Production Networking and Technological Change in East Asia*. (Washington D.C.: The World Bank, 2004); Francisco Veloso, "The Automotive Supply Chain Organization: Global Trends and Perspectives," Working Paper (Cambridge: Massachusetts Institute of Technology, 2000)

¹⁵ Thun (2006: 216)

¹⁶ John Humphrey and Olga Memedovic, "The Global Automotive Industry Value Chain: What Prospects for Upgrading by Developing Countries." UNIDO Sectoral Studies Series Working Paper, pp. 11-13

¹⁷ In the past, there were three major central state agencies to manage the auto industry in China: the SPC, the MMI, and CNAIC. Their division of labor was not clear and often overlapped.

Table 3-1: Market Concentration in Automobile Manufacturing, 2002 and 2005

2002		2005	
Sedan Manufacturer	Market Share	Sedan Manufacturer	Market Share
SAIC-VW	23.9%	SAIC-GM	10.3%
FAW-VW	16.5%	Beijing- Hyundai	7.8%
SAIC-GM	8.8%	Guangzhou- Honda	7.8%
FAW-Tianjin Xiali	7.7%	SAICm-VW	7.7%
Dongfeng- Shenlong	6.7%	FAW-VW	7.1%
Concentration	62.1%	Concentration	40.7%

Sources: Interview at Beijing-Hyundai JV, Beijing (February 2006).

Automotive Industrial Policy in China

Industrial policy is often perceived as an indicator showing direct state intervention in the market, because it has been used as a key instrument to allocate resources to specific target sectors. In implementing industrial policies, fiscal subsidies (i.e. bank loans or tax exemptions), export credits, and import restrictions have been widely granted to favored sectors and firms by the government. For this reason, industrial policy has been treated as a “window” to reveal the role of the government in economic management, regulation, and control of markets. Throughout the reforms since the 1980s, Chinese government and researchers have paid attention to the role of industrial policy in steering the economic development of Japan and South

Korea.¹⁸ Learning from its neighbors, the SPC in the early 1990s promulgated a series of industrial policies for selected pillar industries.¹⁹ Even today, traditional East Asian style industrial policy is favored by China in some respects. China's recent effort is its emphasis on creating large business groups by merging inefficient small enterprises ("*Zhuada Fangxiao*") in order to build up "vertically integrated and globally competitive national champions."²⁰

With institutional reforms and integration into the global economy during the 1990s, the Chinese state highlights the notion of a "socialist market economy" and the changing function of industrial policy from direct control and allocation of resources to macro control and regulation. Hence, industrial policy in China could be defined as a guideline for long and mid term development direction and strategies to achieve substantial goals in a specific sector, as in the automotive industry. China's auto industrial policy presents a general development plan and policy goals, in order not to provide specific auto manufacturers with preferential benefits in business. While some argue that the automotive industrial policy at the national level has little meaning due to difficulties in effective enforcement at the local level, it still has significant implications for both local and foreign entrepreneurs in designing their own business plans. In other words, although policy implementation across regions has been fragmented, the national automotive industrial policy from the center is the most important guideline for both local governments and auto firms. For instance, the

¹⁸ Peter Nolan, *China and the Global Economy: National Champions, Industrial Policy, and the Big Business Revolution* (New York: Palgrave, 2001); Ling Liu, *China's Industrial Policies and the Global Business Revolution: The Case of the Domestic Appliance Industry* (London: Routledge, 2005); Interview with Zhao Ying in Institute of Industry and Economics, CASS, Beijing (October, 2005)

¹⁹ Industries include electronics, chemicals, machinery, telecommunications, construction, transport, and petroleum. Liu (2005: 25)

²⁰ Edward S. Steinfield, "Market Vision: The Interplay of Ideas and Institutions in Chinese Financial Restructuring," *Political Studies* 52 (2004: 272)

SAIC-VW, the second largest auto SOE based in Shanghai, has established the Department of Auto Industrial Policy Analysis within the group to study the national auto industrial policy.²¹

In the policy-making process, China's automotive industry tends to show a pluralized mechanism by opening up policy drafts to enterprises before final documentation. Although the ultimate decision is made by the NDRC, it is an important route to exchanging opinions concerning new policies between government and business. This coordination between the central government and auto entrepreneurs has contributed to the policy-makers having a better understanding of the concrete conditions and demands from business. It is also beneficial for auto manufacturers to obtain an opportunity to keep track of what the center wants as well as to reflect their opinions to the government. In this manner, although policy-making in the auto industry tends to be top-down, Chinese automotive enterprises are asked to come and reflect their opinions about the draft for better policy decisions. In general, the center, particularly the NDRC, reviews three or four rounds before the final draft, and these open hearings are arranged by the NDRC.²² Both state-owned and private automotive enterprises are invited to join the discussion, but ideas and opinions from private firms are taken into less consideration than those from SOEs.²³ Foreign auto firms are rarely allowed to participate in these meetings; they usually reflect their opinions through their Chinese JV partners.

²¹ Interview with SAIC-VW senior manager in Shanghai, (March 9, 2006) The difference is found between Chinese scholars and entrepreneurs: while scholars in general devalue the role of auto industrial policy, most entrepreneurs, working in both state-owned and private enterprises, underscore its necessities and roles.

²² Interview with Tang Yiyi in SAIC-GM, Shanghai (Feb 2006)

²³ Interview with Jian Sun in Shanghai, March 10, 2006.

III. The Structure of Governmental Authority for Regulation

At the Central Level

Before the 1998 Reform: The auto sector had been regulated by four central governmental agencies: the State Council, the State Planning Commission (SPC),²⁴ the Ministry of Machinery Industry (MMI), and the China National Automotive Industry Corporation (CNAIC).²⁵ Under the leadership of the State Council, the SPC as the macroeconomic “planner” formulated and issued long-term economic plans and policies, including automotive industry policy. By clearly specifying policy objectives and regulations for technology, investment, and finance in the automotive industry, the SPC could exert substantial control over foreign JV partners. While the SPC was not involved in the daily business of the auto industry, it retained the authority to finally approve two key issues: Sino-foreign joint ventures and investment projects valued at over 1.5 billion yuan.²⁶ However, despite a super-ministerial agency rank, the authority of the SPC was constrained by the fragmented overall state authority overseeing the auto industry. In effect, the SPC was “not independent from other ministries and enterprises and simply brings together requests from other ministries.”²⁷ There was also a change in the SPC’s directorship during the 1980s. The SPC had been administered by the vice-minister but came to be transferred to a lower level cabinet rank.²⁸ As such, the SPC before the 1998

²⁴ The SPC was later renamed as State Development and Planning Commission (SDPC), and currently National Development and Reform Commission (NDRC)

²⁵ Harwit (1995: 46 – 55)

²⁶ Harwit (1995: 46)

²⁷ Huang (2002: 553-554)

²⁸ Huang (2002: 568, fn. 42)

government reform was not a regulator, but rather a coordinating body in governing the auto sector.²⁹

At the ministerial level, the MMI reserved the specific authority for automotive enterprises. By holding the ownership of central automotive firms, the MMI appointed the senior managers of large centrally-owned auto firms (i.e., FAW and Dongfeng). It also had the right to set technical standards, issue production licenses, and restrict market entry.³⁰ Subordinate to the central MMI, the CNAIC was mainly responsible for supervising the auto industry as a central government agency.³¹ As two central state auto producers obtained separate lines in the state plan, central auto firms became free from CNAIC in 1984, instead of “directly subordinated to the SPC.”³² As a result of the policy of decentralization during the 1980s, in 1987 the CNAIC was degraded to a federation that basically provided auto firms with business consultation, but lacked enforcement power.³³ Thereby, the authority of CNAIC was not strong enough to exercise effective regulatory control.

In sum, before the 1998 administration reform, the structure of government authority was fragmented. The SPC, as a comprehensive state body, lacked binding force over other central commissions, ministries and enterprises. Furthermore, the equal bureaucratic ranking of the central MMI with provincial governments was an

²⁹ Yeo and Pearson (2007: 10)

³⁰ Huang (2002: 554-555)

³¹ Thun (2006: 108)

³² Yeo and Pearson (2007: 10)

³³ The name of the CNAIC (China National Auto Industry Corporation, *Zhongguo Qiche Gongye Gongsì*) was changed into the China Auto Industry Association (*Zhongguo Qiche Gongye Lianhehui*) by the State Council ratification in May 1987. Its former authority over planning or personnel in managing the auto industry was limited to provide the auto firms with consulting service. The National Information Center of Chinese Economy Information Network (*Zhongguo Xinxi Zhongxin Zhongguo Jingji Xinxiwang*), 2003 China Industry Development Report: Auto Industry (*Zhongguo Hangye Fazhan Baogao: Qicheye*), p. 16.

obstacle to effective policy implementation in China's auto industry.³⁴ Therefore, there was no effective institutional environment to prevent "rent-seeking and over-investment by local governments, which were strongly motivated to capture economic interests."³⁵ Hence, Beijing's consolidation policy before state reform was seen to be ineffective.

After the 1998 Reform: Aiming to streamline the bureaucracy, China's 1998 administrative reform abolished a number of ministries that directly managed industries. The former key state planning body, the SPC, was transformed into the State Planning and Development Commission (SPDC) as a more comprehensive agency. As of 2003, the SDPC was again renamed as the National Development and Reform Commission (NDRC) to highlight the changing function of the government from "planner" to "regulator" of a market-oriented economy. As a core watchdog in the automotive industry, the NDRC is responsible for making long-term planning and industrial policy, technology innovation, and final investment approval.³⁶ The former MMI was first integrated into the State Economic and Trade Commission (SETC) in 1998. With the dismemberment of SETC in 2003, its authority over industrial policy, market entry, and regulation of investment and technological innovation was transferred to the NDRC.³⁷ As another function of the MMI, the right to appoint

³⁴ Liberthal and Oksenberg (1988); Huang (2002)

³⁵ Yeo and Pearson (2007: 11)

³⁶ Shi Yaodong and Zhi Bi. 2004. "Condition, Problem, and Factors of the Governmental Management System in China's Auto Industry," (*Woguo Qiche Chanye Zhengfu Guanli Tizhi de Xianzhuang, Wenti, yu Chengyin*), Development Research Center of the State Council Internal Report, p. 3.

³⁷ Yang (2004: 40)

managers of the central auto firms was first housed in the SETC, and then transferred to the central SASAC.

The post-1998 regulatory system has affected the auto industry in two respects. First is the re-engineered NDRC, not as a planner but as an integrated regulatory body. Its authority is more comprehensive than the SPC by integrating the work of the former MMI and other defunct industrial ministries. In addition, the bureaucratic rank of the NDRC is higher than other ministries or provincial governments, which contributes to maintaining independence in the course of policy decision and implementation. As did its predecessor, the NDRC formulates and implements national auto industrial policy, and has the final authority to approve new JV investment projects or market entry of local OEMs. Specifically, the Department of Industry Policy (DIP) within the NDRC is in charge of drafting policies for the auto sector. DIP studies and analyzes the condition of industrial development, and makes policy recommendations for future direction based on national long-term developmental strategies and goals. In policy enforcement, DIP substantially supervises the enforcement of industrial policies.³⁸

The other important change resulting from the state reform is the creation of the SASAC, which is mainly responsible for the management of crucial state assets and the personnel of state firms. State asset management comprises the raising of equity capital and competitiveness, and risk management to prevent loss. Since most auto manufacturers in China are either central or locally state-owned, SASAC is capable of maintaining effective regulatory control over automotive industrial

³⁸ See, at <http://cys.ndrc.gov.cn/jgsz/default/html> (Access: February 11, 2006)

management.³⁹ In supervising the automobile market, the central SASAC has the formal authority only for two central state firms (the FAW and Dongfeng Group); other auto SOEs are supervised by the local SASAC. The central SASAC in principle has no formal rights to supervise and monitor the business of local state firms.

At the Local Level

Although policy decision-making is ultimately made by the central authorities, China's decentralized political and economic structure in the automobile industry is most remarkable. In particular, local government's substantial autonomy in managing the business of the automotive industry is closely related to its property rights over local auto firms. By the mid 1990s, before the administration reform, local governments had a distinctive internal structure for the automotive sector. It was common for the city mayor to exert critical influence on the planning, finance, and personnel of local auto enterprises, and at least one vice mayor was in charge of developing the auto industry as an official task.⁴⁰

The power of municipal commissions, such as the Planning or the Economic Commission, varied in each city. While the Auto Industry Leading Small Group in Shanghai, under the direct reins of the mayor, played a predominant role in both coordinating government bodies and guiding local automotive firms (both assembly and supply firms), in Beijing and Guangzhou the Economic Commission was the

³⁹ While there are private firms in supply and component parts, only two private enterprises in the passenger car OEMs of the Chinese auto industry. They are the Geely Holding Group Corporation and the Lifan Group.

⁴⁰ It appears now that their special efforts have greatly contributed to the development of the auto industry in Shanghai, Beijing, and Guangzhou, and it was particularly prevalent during the 1980s. For example, in the late 1980s, Beijing vice mayors, Zhang Zemin and Wu Yi; Shanghai vice mayors in 1985, Huang Ju and Wu Bangguo; Guangzhou vice mayor in 1985, Xie Shihua. Harwit (1995: 55-57)

main institutional body to regulate the performance of automotive firms.⁴¹ Due to a fragmented institutional structure, the Auto Offices in both Beijing and Guangzhou could not have separate status as a governmental organization. The auto office in Guangzhou belonged to the Ministry of Machinery and Electronics of Guangzhou municipal government, and the auto office in Beijing was affiliated with the Beijing Automotive Industry Corporations (BAIC) as the head office.⁴² That is, before the 1998 government reform, institutional structure for the auto industry was not unified and varied across regions, which reflected fragmented regulatory control over automotive firms.

The 1998 government reform contributed to integrating the formerly fragmented and overlapped administrative functions into two comprehensive commissions at the local level: the local DRC and SASAC. In principle, the local DRC and SASAC have no direct relationship with the central NDRC and SASAC; they are organized and directed by provincial and municipal mayors.⁴³ As such, local DRC and SASAC report directly to the provincial or municipal mayor, not to the central NDRC or SASAC in Beijing. In personnel matters, for example, the directors of the Shanghai municipal Development and Reform Commission and the Shanghai municipal SASAC are appointed by the Shanghai city mayor, neither the central NDRC nor the central SASAC. Although major projects still require approval from the central government, the business of local auto firms is supported and supervised by local governmental agencies.

⁴¹ Thun (2006: 110-117; 151-155); Harwit (1995: 55 -57)

⁴² Thun (2006: 151-154)

⁴³ One entrepreneurs working in Guangzhou-Honda says that the NDRC in Guangzhou remains the agent of the central NDRC, but in principle there is no direct relations between central and local NDRC and SASAC. Interview in Guangzhou (March 2006)

China's auto industry policy-making is centralized, but local governments may not necessarily strictly implement the policies.⁴⁴ In other words, local governments may make decisions for their own benefit rather than following the national auto industrial policy, although some items are classified as "central government approval is required," such as new market entry or a new JV project. Moreover, since policies, regulations, and financing for local auto firms are decided by the local DRC, local auto firms including JVs are directly supported and supervised by the local DRC, not the central NDRC.

Another state commission emerged in 2003.⁴⁵ As the central SASAC does, the local SASAC is mainly responsible for the management of crucial state assets and personnel for the local auto firms. Top executives and senior managers of SAIC and BAIC are appointed by the Shanghai or Beijing SASAC. In governing the local auto industry, the authority of local governments comes from the property rights over the local auto firms, which allows the local SASAC to have the right of personnel management. It is a significant source of political control over the auto business.⁴⁶

IV. The Patterns of Regulation: Three Cases

The institutional context governing China's auto industry is dynamic across localities and enterprises. While most automobile manufacturers, except recently established

⁴⁴ Interview with Jian Sun by email (June 2006). He is vice President of A.T. Kearney Greater China, Shanghai Office; the auto industry specialist.

⁴⁵ See, Shanghai and Beijing official government website.
<http://www.shanghai.gov.cn/shanghai/node8059/CityAgencies/userobject22ai20.html> (Access: Dec. 2006)

⁴⁶ Huang (2002: 555)

private auto producer Geely in Zhejiang province, are state-owned, they exhibit diverse forms of ownership and governing structures in terms of central and local government relations, or inter-governmental relations. In the forms of ownership, there are central state-owned, local state-owned, foreign-invested, and private producers. In order to explore the mechanism of regulation and its patterns, I explore auto firms that are located in different political and economic institutional contexts. For this purpose, three major auto SOEs are examined here: one is centrally-owned (FAW) and the others are owned by local governments (SAIC and BAIC). But because the two local state firms are also divergent in the manner of central oversight, this presents another dynamic in the auto industry in China.

CASE ONE: FAW Group

An Example of Hard Regulation in the Auto Business

First Automotive Works (FAW) Group Corporation,⁴⁷ located in Changchun, in northeast China's Jilin Province, is a historic symbol for the Chinese auto industry. In 1953, it was constructed in Changchun, a strong industrial base since the Japanese occupation of 1931 to 1945, with a focus on machinery industries. Changchun also serves as a transportation hub linking the Chinese inland and offering favorable business opportunities.⁴⁸ At the early developmental stage, FAW only produced trucks and then slowly expanded its business into light trucks and passenger cars. The

⁴⁷ Unless otherwise specified, FAW here means FAW Group Corporations, and not individual firms within the Group, such as the JV FAW-VW

⁴⁸ Thun (2006: 172); Tomo Marukawa, "The Contradictions of Industrial Groups: A Case Study of the First Automobile Works Group," *China Perspectives* No. 23 (1999), p. 18.

production of passenger vehicles was accelerated by signing the establishment of a large scale JV passenger car manufacturing with German Volkswagen Automobile Company in 1991.⁴⁹ Putting a great emphasis on the production of passenger cars, FAW merged with Tianjin Xiali Auto firm in 2002 by acquiring a 50.98 per cent stake, and signed a historic JV agreement with Japan's Toyota for a strategic and cooperative relationship.⁵⁰ As a third JV partner, another Japanese auto firm, Mazda, signed a JV company with FAW Group Corporation in 2005. The FAW-Mazda JV firm cooperates with a focus on sales of the Mazda brand in China, and its equity is composed of 25 per cent from Mazda, 5 per cent FAW Group, and 70 percent from FAW Car (*yiqi jiaoché*).⁵¹

As of 2006, FAW Group consists of thirty wholly-owned subsidiaries (*quanzi gongsi*) and eighteen share-holding companies (*konggu gongsi*), which include foreign-invested JV firms.⁵² Likewise, while FAW is a central-government firm (*zhongyang qiye*) meaning that the central government retains the property rights as an owner, FAW consists of two different types of state ownership: wholly state-owned and share-holding enterprise. According to the 1994 Company Law, wholly state-owned means that there is only one state-owned investment entity. Therefore, the state is the sole owner of the enterprise. A share-holding company is defined by the proportion of shares each shareholder holds; the state need not be the majority (over 51%) owner though it can still be the largest share holder.”⁵³ Hence FAW

⁴⁹ 2004 FAW Group Corporation Annual Report

⁵⁰ FAW official website, see http://www.faw.com/international/toyota_history.jsp (Last access, Nov. 2006)

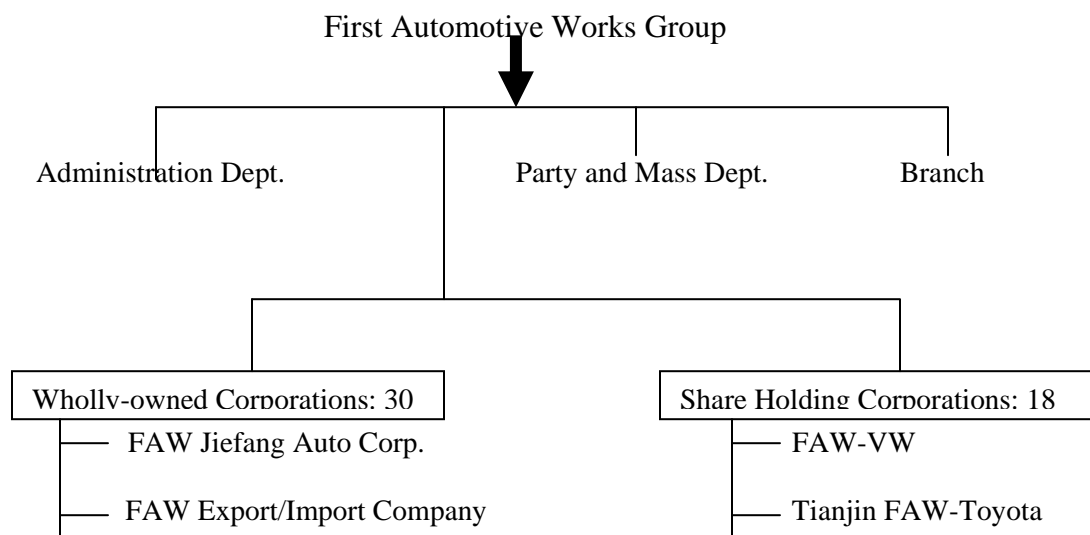
⁵¹ See, <http://www.faw.com/international/Mazda.jsp> (Last access, Nov. 2006)

⁵² FAW 2006 Annual Report

⁵³ Shu Y. Ma, “The Chinese Route to Privatization: The Evolution of the Shareholding System Option,” *Asian Survey* Vol. 38, No. 4 (April 1998), p. 381.

retains the assets of 30 wholly-owned subsidiaries as a single investment entity, while share-holding companies in the FAW Group (i.e., FAW-VW) may have multiple and dispersed shareholders. Despite this dispersion of ownership within the FAW Group, the management of assets is supervised by the central SASAC as the owner of FAW. The Group's annual production capacity recorded over one million units in 2005.⁵⁴ The auto industry has contributed to 52 per cent of the industrial output in Changchun city, and FAW is not only the main system (*zhuti*), but also a driving force (*longtou*) in developing the automotive industry in Changchun.⁵⁵

Figure 3-1: FAW Structure



Sources: FAW 2006 Annual Report; China Auto Industry Statistics (2005: 353)

⁵⁴ Te Ken, "Changchun: A City of Opportunity," *China Daily* (May 30, 2006)

⁵⁵ Thun (2006: 173); Le Yahui et al. "The effect of WTO entry on Changchun Auto Industry," (*Jialu WTO dui Changchun Qiche Gongye de Yingxiang*), *Social Science Strategy Line (Shehui Kexue Zhanxian)* May 2001, p.109.

For people living in Changchun, FAW appears to be more than a workplace. It is not simply a company to go to for work, but rather a “backbone” of their lives because it provides employees and their family members with housing, school, and medical facilities. In fact, the first impression when traveling in Changchun is “the automobile city.” On my way to the FAW-VW firm by taxi, ten minutes from the Changchun train station, I could see a town of the FAW Group Corporation. Most buildings or shops relate to FAW: FAW elementary and middle schools, FAW apartment residence, and FAW hotels. FAW Group Corporation is indeed a crucial economic and social ground for Changchun residents. One female working in the *Journal of China Auto Industry* affiliated with FAW says, “My parents and I are all working in FAW subsidiary companies, and we are very proud of FAW and cannot imagine Changchun without FAW.”⁵⁶ It seems that FAW, not the Changchun municipal government, is deeply enmeshed in residential life.

Table 3-2: Main Economic Data of FAW

	2002	2003	2004
Sales of Vehicle (unit)	580,356	902,329	1007,471
Sales of Income (100 million yuan)	845.10	1,076	1,175
Profits (100 million yuan)	43.03	65.8	45.8
Long-term Investment (10 thousand RMB)	n.a	1,264,374	392,294
Total Assets (10 thousand RMB)	n.a	10,619,287	10,236,249

Sources: 2003, 2004 FAW Annual Report

⁵⁶ Interview in Changchun (Nov. 2005)

Centralized Regulatory Power

In this section, I discuss the mechanism of the state regulation of FAW and identify tightly centralized oversight. Central state ownership, the significance of political rank in the party, and the party committee in both government and state firms have all contributed to create centralized regulatory power in FAW.

Central Ownership, Incompetent Local Government

In governing business in China, central ownership makes a difference in the following four aspects: funds, tax, assets, and personnel management. Since FAW belongs to the central government (specifically SASAC plays the role of owner in practice), the tax from FAW is the state tax (*guoshui*) for the central government's tax revenue. When FAW needs additional funds, it is able to take a loan from the State Bank, usually with a lower interest rate.⁵⁷ Due to the special position of FAW in China's auto industry, one Chinese scholar working in a government research institution refers to FAW as "the First Son (*zhangzi*)" of the Chinese auto industry.⁵⁸ This means that regardless of the financial situation of the firm, FAW receives special attention and support from the Changchun municipal government, central state agencies such as NDRC and SASAC, and top leaders of the CCP; loans from the State Bank are guaranteed by FAW's special position in the sector.⁵⁹ While FAW remittance goes straight to the central revenue, the Changchun municipal government

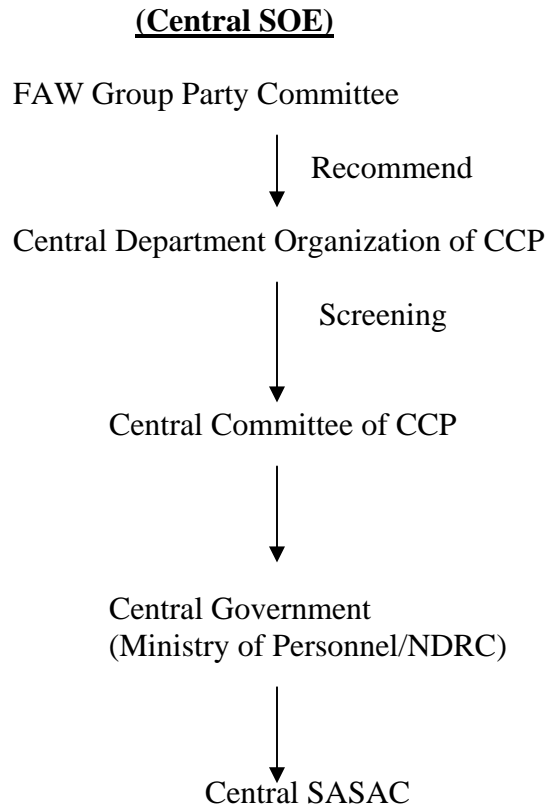
⁵⁷ Email interview with Sun Jian who is the vice President of A.T. Kearney, Shanghai Office and mainly charge of offering business consulting to major local OEMs. (December 28, 2006)

⁵⁸ Email interview, Development of Research Center of the State Council, Beijing (January 4, 2007)

⁵⁹ *Ibid*

supports the development of the auto industry, for automobile manufacturing is the major source of local revenue and employment. Before the 1998 administrative reform, senior managers of FAW were appointed by the Ministry of Machinery Industry, now downgraded to the State Bureau of Machinery Industry under the NDRC.⁶⁰

Figure 3-2: The Personnel Process in FAW



Sources: Interview in Shanghai (March 2006) and Beijing (December 2005); Christopher McNally (2002), “Strange Bedfellows: Communist Party Institutions and New Governance Mechanism in Chinese State Holding Corporations,” *Business and Politics*, 4 (1), p. 100

⁶⁰ Huang (2003: 274)

The central SASAC has the final and formal stamp of approval for the appointment of senior managers and supervises the business management of FAW.⁶¹ But the internal process of personnel is much more complicated. A nomination is first made by the Party Committee of FAW Group, and then the central party department of organization (DO, *zhongzubu*) carefully screens the career background to see whether there are any problematic issues for the appointment. This cadre evaluation process by the DO has been conducted in appointing not only Party and governmental officials, but also senior managers of SOEs.⁶² After that, the DO officially recommends to the CCP Central Committee and the central government (Ministry of Personnel). After going through these evaluation procedures, the SASAC may have a final candidate to appoint. While the central SASAC has formal authority to appoint top executives, as well as board members of management in central state firms, its decision only remains a “rubber stamp because the top leaders have already discussed it through informal meetings.”⁶³ Therefore, the central leadership can choose the right people who have great loyalty to the Party and the capacity to achieve whatever the center has as a priority. Thereby, SOE executives and senior managers selected by the central party-state pay closer attention to the national guidelines than to the enterprise’s incentives and productivity. The Changchun municipal government’s lack of ownership for FAW has extensively constrained the opportunities to appoint firm managers who would be concerned with how FAW may contribute to local

⁶¹ Interview with DRC scholars in Beijing (Nov. 2005)

⁶² The cadre evaluation by the department of organization focusing on the administrative monitoring is studied well by Yasheng Huang, “Administrative Monitoring in China: Institutions and Processes,” *China Quarterly*, no. 143 (September 1995); *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations during the Reform Era* (Cambridge: Cambridge University Press, 1996)

⁶³ Interview in DRC, Beijing (November 2005); in SAIC-VW, Shanghai (March 2006)

economic and social development. In addition, as Thun (2006) points out, the lack of ownership and capital has made the Changchun government incapable of making long-term business plans and securing local supply firms. Thus the role of the Changchun government has been entirely confined to making a “favorable business environment” for FAW.

Significance of Political Rank

Much literature argues that China’s 1998 administrative reform and emerging regulatory state agencies demonstrate the Chinese leadership’s strong will to rationalize policy-making and implementation by legalizing formal state agencies and procedures.⁶⁴ However, FAW shows that informal politics and political rank rather than institutionalized formal procedures are still influential. As a central state firm, the organizing structure of FAW is distinctive from other large auto SOEs. While the president of SAIC or BAIC is basically under the reins of the mayor of Shanghai or the Beijing municipal government, the president of FAW is wholly free from the Changchun municipal government and its party committee, and can directly communicate with the State Council. It is not because of the central ownership of FAW, but because of the political rank of FAW president, *Zhu Yanfeng*, in the Communist Party.⁶⁵

After serving as the president of First Automotive Passenger Car Holding Corporation Ltd. and vice president of the FAW Group in 1997, Zhu Yanfeng took

⁶⁴ Yang (2004)

⁶⁵ A number of interviewees, both officials and entrepreneurs, point out his influential power in the auto business in China, because of his political rank in the Party.

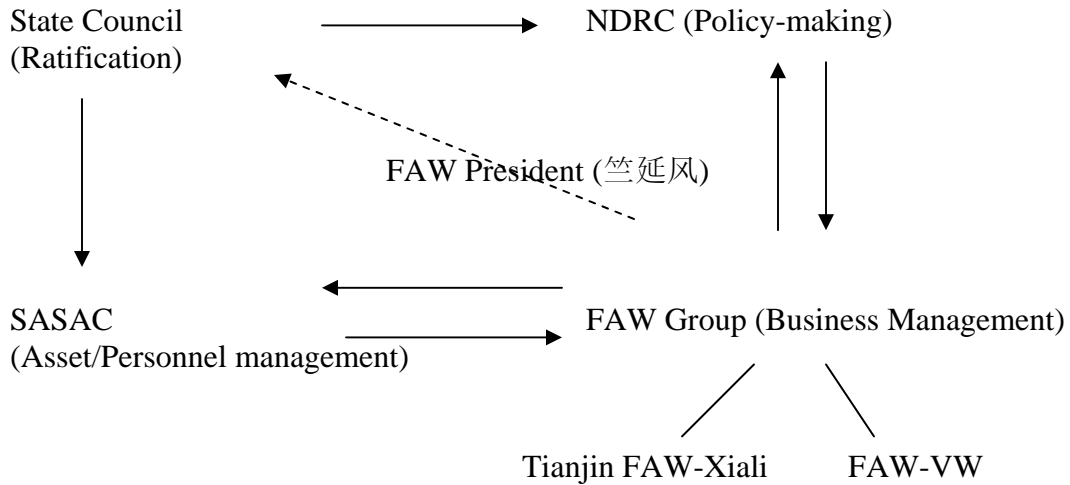
office as the president of both the FAW Group and FAW-VW in 1999.⁶⁶ As a member of the Communist Party, Zhu is deputy secretary of the party committee in FAW and serves as an alternate member of the Central Committee of the Communist Party, elected at the 16th NPC in 2002. It is a very powerful position in that there is a high probability of becoming the ranking member of the Central Committee of the Communist Party of China (CPC). One Chinese scholar working in the DRC comments that Zhu is remarkably high among state sector enterprise presidents, and it is a very rare case.”⁶⁷ Due to his high political rank in the CPC, although central SASAC is officially supposed to supervise the business management and performance of central state firm FAW, its monitoring function in practice remains perfunctory. President Zhu may go directly to the State Council to consult on a variety of issues. One large auto SOE manager even argues that “no matter what happens to FAW, they will be fine because Zhu is too high for governmental agency to control.”⁶⁸

⁶⁶ FAW Annual Report 2004; also see, <http://auto.sina.com.cn/news/2006-03-03/1204171024.shtml>

⁶⁷ Interview in Beijing (November 2005; March 2006)

⁶⁸ Interview in Shanghai (March 2006)

Figure 3-3: The Centralized Regulatory Structure for FAW



Sources: Based on interviews in FAW Headquarter and FAW-VW in Changchun (October 2005; March 2006) and the DRC in Beijing (December 2005)

The figure above illustrates the internal dynamics between central state agencies and FAW, and how the management system actually works. FAW is under the directorship of two major central bodies: NDRC and SASAC. In theory, there is no direct channel for central state firms to reach the State Council; however, the special position in China's auto industry of both FAW and president Zhu has lead to creating this distinctive governing mechanism. Furthermore, since both the mayor and the party secretary of the Changchun municipal government are lower than the president of FAW in the Communist Party rank, they are actually incapable of asking the president of FAW to report on business projects or financial circumstances. It would be questionable to expect that the central SASAC is capable of effectively monitoring FAW's asset management, because its assets are directly supervised by Zhu. SASAC,

and local governmental officials are not powerful enough to challenge the authority of FAW's president.

Dominant Role of the Party Committee

As the 1994 Company Law endorsed the shareholding system (*gufenzhi*) as “the mainstream reform program for state-owned enterprises,” the Chinese party-state establishes the board of directors and issues shares to diverse entities as well as the state, attempting to enhance the separation of government and enterprise (“*zhengqi fenkai*”). Even though FAW-VW is a central state firm with a foreign investor, most key business decisions are discussed and made by the board of directors. Yet this board of directors is dominated by members of the party committee. This shows that although the Chinese leadership has been trying to modernize the enterprise system, converting completely state-owned enterprises into shareholding enterprises, the party deeply embedded in the corporate mechanism is the main obstacle.

While FAW has organized a modernized system of board members and directors, its top positions are occupied by members of the party committee. The leading members of FAW consist of nine executives; one president and eight vice presidents. The president, Zhu Yanfeng, is deputy secretary of the Communist Party Committee and also an alternate member of the CCP (*zhonggong zhongyang houbu weiyuan*). Among the eight vice presidents, there is a hierarchy. Number two, Zhao FangKuan, is secretary of the Communist Party Committee serving as senior economist, and number three, Ma ZhenDong, is deputy secretary of the Communist

Party Committee, secretary of the Discipline Committee, and the chairman of the labor union, playing the role of senior political and ideological engineer.⁶⁹ Even though the board members have regular meetings to discuss a variety of business plans, the final decision is significantly influenced by the preferences and ideas of the top executives. As Dickson notes (2003: 43), “to make sure that the party continued to play an active and influential role in SOEs, most SOEs in Shanghai adopted ‘internal regulations’ that half of the members of the party committee must also be members of the board of directors and that at least one-third of the members of the party committee be managers with the enterprise.”⁷⁰ This also occurs in the case of FAW-VW in Changchun. The board of directors (*dongshihui*) in FAW-VW consists of 16 members, comprising seven German and nine Chinese senior managers. Its chairman (*dongshizhang*) is Zhu Yanfeng, who serves as the president of FAW Group Corporation, and the vice chairman is German professor Folker Weissgerber, as of 2003. Among the nine Chinese board members, four are members of the party committee in either Changchun city or Jinlin province, where Changchun city is located.⁷¹ As long as the majority of Chinese board members consists of members of the party committee, the modernized management system of enterprise remains perfunctory, and its substantial operation hinges upon the party committee.

⁶⁹ 2004 FAW Annual Report

⁷⁰ Bruce Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change* (Cambridge: Cambridge University Press, 2003), p. 43.

⁷¹ They are Xu Jianyi, Qin Huanming, Zhang Pijie, and An Tie cheng. See FAW – VW 2004 Annual Report, p.3. Individual career profiles as the member of the party committee are also found the following links, see <http://www.southcn.com/news/china/hrcn/rsdifang/200412280416.htm>; <http://www.china.org.cn/chinese/zhuanti/chwls/1062042.htm>

CASE TWO: SAIC Group

An Example of Soft Central Regulation in the Auto Industry

The advanced machinery industry, production technology, and auto-parts production experience have given Shanghai a favorable environment and a competitive edge for the auto industry.⁷² Shanghai has comparatively better infrastructure and investment conditions than other automotive manufacturing regions, and its coastal location has made the city a hub for investment and export. Therefore, regardless of the geographic location of their headquarters, most auto firms in China have installed at least one office in Shanghai.

In terms of sales and profits, SAIC⁷³ is the second largest auto manufacturer after FAW, recording sales of 843,000 units, 10 billion yuan revenue, and 107 billion yuan total assets in 2004.⁷⁴ By establishing joint ventures with Volkswagen (SAIC-VW) in 1985 and General Motors (SAIC-GM) in 2002, the SAIC Group has organized “a comparatively complete production system for passenger cars.”⁷⁵ In order to enhance modernized corporate governance and be listed on the stock market in Hong Kong, the SAIC Group restructured itself and established SAIC Motor Corporations Ltd. in December 2004.⁷⁶ Thereby, important financial management

⁷² Victor F. S. Sit and Weidong Liu, “Restructuring and Spatial Change of China’s Auto Industry under Institutional Reform and Globalization,” *Annals of the Association of American Geographers* Vol. 90, no. 4 (2000), p. 657.

⁷³ Unless otherwise specified, SAIC after 2004 means SAIC Motor Corporations Ltd., not individual firms within the Group, such as SAIC-VW or SAIC-GM.

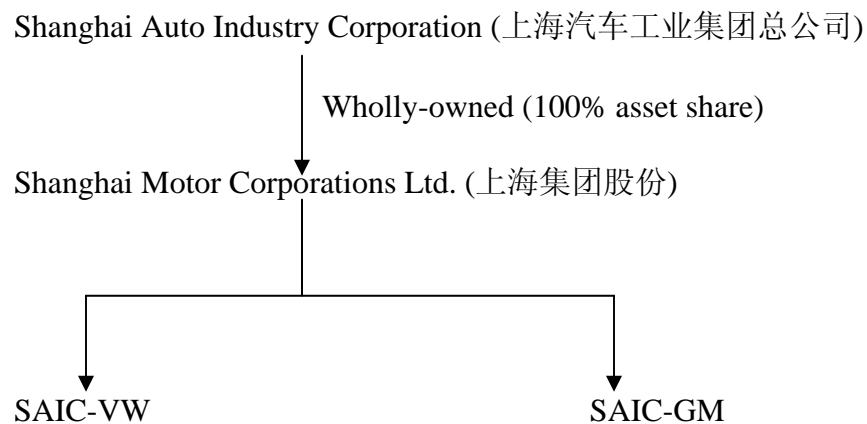
⁷⁴ SAIC 2004 Annual Report

⁷⁵ Yeo and Pearson (2007: 20)

⁷⁶ Interview in SAIC Motor Corporation Ltd., Shanghai (March 2006)

was transferred to SAIC Motor Corporations, and the former SAIC Group was now simply engaged in advanced manufacturing and modern service issues.⁷⁷

Figure 3-4: The Structure of SAIC Group



Sources: Interview in SAIC, Shanghai (March 2006)

In the late 1990s, 75 percent of the SAIC Group was owned by the Shanghai government,⁷⁸ but now it is wholly-owned by the Shanghai municipal government. The authority to supervise asset management of the SAIC Group was retained by the Shanghai Economic Commission, and was then moved to the Shanghai SASAC in 2003.⁷⁹ As in other regions, SAIC for the Shanghai government has served as not only a major resource for employment and revenue, but also an industrial base for the development of related industries, such as the steel, iron, and chemical sectors. In sum, compared with the central state-owned FAW, SAIC shows a different pattern of regulation due to strong local components. Despite the decentralized government authority and the property rights, there is invisible but significant regulation from the

⁷⁷ *Ibid.*

⁷⁸ Thun (2006: 103)

⁷⁹ Interview in Shanghai (March 2006)

center. In the following section, I explain each central and local regulatory mechanism for the major local auto producer SAIC.

Table 3-3: Main Economic Data of SAIC

	2002	2003	2004
Sales of Vehicle (unit)	390,508	612,216	610,641
Sales of Income (10 thousand yuan)	7,119,620	9,729,364	10,006,301
Net Profits (million yuan)	n.a.	71.8	171.09
Long-term Investment (10 thousand yuan)	1,439,479	1,316,503	1,069,609
Total Assets (10 thousand yuan)	5,965,192	7,544,732	10,687,234

Sources: 2003 and 2004 SAIC Annual Report; Sales of vehicle here only include passenger cars

Invisible Central Oversight

SAIC is *formally* owned and regulated by the Shanghai municipal government, but its personnel and business management is under substantial control from the central party-state at the same time. In other words, while SAIC is a local-government firm, the central party-state exerts invisible but considerable regulatory control. In governing the business of SAIC, it appears that the central and Shanghai governments have different functions. The central government exerts regulatory control to protect

and enhance the value of crucial state assets, whereas the Shanghai government directly supports SAIC with various preferential policies for steering the local economy.

Regulatory Control from Local Government

The Shanghai government, like other local governments, considers the auto industry to be a strategic sector and an important source of revenue and employment in the local economy, and therefore provides a variety of benefits, such as land, tax, or supply fees.⁸⁰ In addition, compared to the Changchun municipal government's role in FAW, the Shanghai municipal government has effective levers of control over both SAIC and foreign investors by holding the property rights for SAIC. This implies that the authority to allocate financial resources, assets, and personnel management lies in the Shanghai government. Through these controls over finance and personnel, the Shanghai municipal government is able to keep powerful instruments to govern the business of SAIC. Although new JV projects or market entry still require approval from the NDRC, the central state institutions do not have the authority to supervise and intervene in the business of SAIC, because its ownership belongs to the Shanghai government.

Under the reins of the Shanghai city mayor, the Shanghai Development Reform Commission (DRC) provides SAIC with a macro direction for industrial development plans and regulations in line with national industrial policies. Although

⁸⁰ Interview in SAIC-VW in Shanghai (March 2006)

new JV partners or large scale business projects require central approval,⁸¹ the Shanghai DRC has more direct influence on the business of SAIC than the National Development and Reform Commission (NDRC),⁸² for the Shanghai DRC retains the power to allocate financial and material resources in the Shanghai auto industry. For SAIC, the necessary funds for building infrastructure, factories, and R&D facilities for the development of technology come from the Shanghai DRC, not the central NDRC. One of the sources for these funds is taxes from local auto firms, and this is why local governments endeavor to develop the auto industry. In principle, all automotive enterprises in China should pay 33% of their total profits as tax. Within this amount of money, 60% was formerly remitted to the central NDRC and 40% to the local-level DRC,⁸³ but now both the central and the local DRC each receive 50% of the tax.⁸⁴ In addition, the Shanghai DRC is in charge of the review and approval of significant auto investment projects, except for new foreign JVs and projects costing over 10 billion. Likewise, the business of SAIC, such as issues of finance, investment, and technology, is basically coordinated with the Shanghai DRC, not the central NDRC.

As another governmental arm of regulation at the local level, the Shanghai SASAC is mainly responsible for supervising the SAIC Group's asset and personnel management. As indicated earlier, personnel management is often considered to be a powerful means of political control.⁸⁵ As to finance, SAIC Motor Corporation,

⁸¹ In both cases of Beijing-Hyundai and SAIC-GM, Hyundai and GM were decided by the top leaders at the center, neither Beijing nor Shanghai government. Interview in Beijing-Hyundai, Beijing (November 2005); Interview in SAIC-GM, Shanghai (March 2006)

⁸² Interview in SAIC Headquarter in Shanghai (March 2006)

⁸³ Interview in Beijing-Hyundai in Beijing (Feb 2006)

⁸⁴ Interview in Fudan University in Shanghai (March 2006)

⁸⁵ Shirk (1993); Huang (1996)

restructured by SAIC in 2004, is mainly responsible for the asset management of the whole group of SAIC. This means that auto firms subordinate to SAIC, such as SAIC-VW or SAIC-GM, have to report their balance sheet including fixed, tangible, and total assets to SAIC Motor Corp. After collecting general information on SAIC, SAIC Motor Corp directly informs the Shanghai SASAC; Shanghai SASAC then communicates with the central SASAC. There is no formal route for SAIC Motor Corp to directly interact with the central SASAC; it must be through the Shanghai SASAC, because SAIC is a locally-owned auto firm, not central government-owned. In addition, top executives and senior managers of SAIC are appointed by the Shanghai SASAC. Indeed, because SAIC is wholly-owned by the Shanghai municipal government, the central government has no formal right for personnel appointment. The final nomination is made by the Shanghai SASAC, though nominees are first recommended by the SAIC party committee (*dangwei*), and then closely inspected by the Shanghai Organization Department of the CCP. Successful candidates are reviewed at the second-round by the Shanghai party committee and then referred to the Shanghai SASAC through the Shanghai DRC.

From the Central Government: “Invisible/Soft Regulation”

Although it is mainly the Shanghai government exercising regulatory control over the business management of SAIC, it does not mean that SAIC is completely free from central regulation. The central leadership has allowed local governments to enjoy flexibility in governing local auto firms as a developmental strategy for competition,

while it always keeps an indirect but powerful mechanism for regulation.⁸⁶ The central government's regulatory control over SAIC is mainly through three channels: personnel, the approval of business projects, and supervision.

Personnel Management: In SAIC, top executives and senior managers are appointed by the Shanghai SASAC. Just as in FAW, although the final nomination is made by the Shanghai SASAC, nominees are first recommended by the SAIC party committee (*dangwei*), and then closely screened by the Shanghai Organization Department of the CCP.

Some contend that when local interests conflict with national interests, local government and enterprises would ignore the central demands if the situation relates to the issue of local economic development.⁸⁷ Yet this can be easily back tracked given that “the central government still appoints mayors who, in turn, appoint the top management of SOEs.”⁸⁸ Moreover, both local officials and senior executives of local SOEs try to follow what the central government plans to achieve, because their future promotion is evaluated around that measure. According to one senior SAIC engineer, “the main concern of the president of SAIC is not substantial growth of the firm through developing its own technology and brand, but future tenure. In order to impress the central high leadership, which will affect a better position after the SAIC presidency, the SAIC president wants to achieve a great outcome during the tenure. However, while developing its own technology/brand requires eight years at least to develop and commercialize in the market, the SAIC president usually works

⁸⁶ Interview in Beijing, DRC (November 17, 2005)

⁸⁷ Wu Zhong, “Beijing Gives Local Government More Say,” *Asian Times* (October 18, 2006)

⁸⁸ Yeo and Pearson (2007: 23)

approximately five years. Eight years is very long for state firm presidents to demonstrate their capacities to the central leadership. Hence, SAIC top executives strongly prefer making JVs with foreign auto manufacturers that can provide SAIC with advanced technology and necessary capital investments within a short time.”⁸⁹ This illustrates that although the central government does not retain *formal* authority in the personnel of the local auto state firms (SAIC), “the central control over promotion of top management of local SOEs remains influential.”⁹⁰

Business Management; Even though the Shanghai DRC and the Shanghai SASAC are the main state agencies in making final decisions, their industrial policies and management of local state firms should be based on national directives of industrial, enterprise, and regulatory policies. Since the 1980s, decentralized administrative institutions and ownership have indeed granted substantial autonomy to local governments, particularly at the provincial and municipal levels. But the power of local government has been inevitably constrained by the institutional structure designed by the central party-state. No matter how much local governments increase discretion in their fiscal and corporate governance, they are basically local “agents” appointed by the center in order to implement effectively what the central government attempts to do.⁹¹ One senior manager working in SAIC-VW comments that “although we are a local JV-SOE owned by the Shanghai government, the central NDRC rather than the Shanghai DRC exerts critical influence over our long- and mid-term business plans and management. To be a winner in both domestic and international markets,

⁸⁹ Interview in SAIC, Shanghai (March 2006)

⁹⁰ Yeo and Pearson (2007: 24)

⁹¹ Interview in SAIC, Shanghai (March 1, 2006)

studying central policies and regulations is very important for auto firms in China even though implementation is fragmented. Interestingly, while officials and scholars in Beijing argue that the central government has no authority to intervene and influence local auto businesses, in practice most local entrepreneurs strongly emphasize the power of the central government, even though indirect and loose, rather than local authorities.⁹²

Supervision: In practice, there is “the least known but perhaps most significant informal channel for central regulation of SAIC.”⁹³ Not by formally organized public agencies and procedures, SAIC is closely monitored by the central supervising group, which is called “*xunshizu* (巡视组).”⁹⁴ The idea was first initiated by the CCP Central Committee in 2001 to combat the growing corruption from high level local cadres and was approved by the State Council in 2003. Its official role is to “supervise the selection of provincial or lower levels of local leaders” by an inspection team organized by the CCP Central Committee and the 31 provincial party committees.⁹⁵ Yet they actually have been supervising not only local cadres (elites), but also the performance of local auto SOEs. In other words, it is a formal institution for monitoring high level cadres (*lingdao ganbu*), but its supervision over SAIC is

⁹² Interview in Beijing-Hyundai, Beijing (November 2005); Guangzhou-Honda, Guangzhou (March 2006); Shanghai-GM (March 2006); Shanghai-VW (March 2006)

⁹³ Yeo and Pearson (2007: 24)

⁹⁴ Cheng Li name *xunshizu* inspection team to review nominated candidates for the provincial cadres, but I will term this as “floating supervising body” focusing on its regulatory control over major SOEs in China. With respect to the “official” function of *xunshizu*, see Cheng Li, “Reshuffling Four Tiers of Local Leaders: Goals and Implications,” *China Leadership Monitoring: Goals and Implications* No. 18 (2006) p. 3.

⁹⁵ Cheng Li (2006: 3); see,

http://www7.chinesenewsnet.com/gb/MainNews/SinoNews/Mainland/xhw_2004_03_11_19_55_14_175.html (Access: Oct. 25, 2006)

invisible.⁹⁶ As to organizing members, there is a difference between official documents and information from interviews. While “*xunshizu*” is in theory organized by the current CCP Central Committee and the party committee from each of the 31 provinces, this floating body, according to my interviews, consists of 6 ~12 retired CCP cadres. They visit major auto state firms directly and supervise both central and local auto firms. Their major task is to oversee business plans, balance sheets, and board meetings of the auto SOEs. Although it is not a formal regulatory institution, this group has the right to monitor whether automotive SOEs conceal some profits and remind them of what the center wants. Likewise, *xunshizu* in the auto industry “functions as a non-authorized use of authority used for regulatory power.”⁹⁷ It is a kind of “third-party” between the state and auto businesses for regulatory control.

⁹⁶ *Xunshizu*’s supervision has been extended from cadre elites at the provincial level to the business management of key SOEs, and its monitoring of the business management has come to be more formalized based on the Party’s guidelines. In 2004, the Central Committee of the CCP and the Department of Organization established *xunshizu* for the financial industry in order to strengthen the regulation of the financial structure. See, “The Central Committee and the Department of Organization Establish *Xunshizu* for State-owned Firms,” (“*Zhongjiwei yu zhongzubu zujian guoqi xunshizu*”), <http://www.chinanews.com.cn/news/2006-04-13/8/716449.shtml> (Last Access: March 8, 2007).

⁹⁷ Yeo and Pearson (2007: 25)

Figure 3-4: The Regulatory Structure of SAIC



Sources: Interviews in Shanghai (March 2006); SAIC Group, SAIC-VW, and SAIC-GM

⁹⁸ This was created by SAIC Group in December 2004, holding all the assets and business of SAIC Group. SAIC Motor Corporations Ltd. is expected to “play a strategic role in helping SAIC achieve its global ambitions.”

CASE THREE: BAIC Group

An Example of Soft Central Regulation in the Auto Industry

In spite of China's first foreign JV auto firm, the Beijing-Jeep established in 1984, Beijing's automotive industry has not been very successful. A number of issues have been pointed out as causes of the failure. They include: 1) the fragmented organizational structure inside BAIC, 2) the lack of strong will and leadership in the Beijing municipal government, 3) Beijing city's inconsistent industrial policies, 4) a weak industrial base for the manufacturing industry, and 5) the lack of trust in foreign partners resulting from inexperience with foreign firms.⁹⁹ Until the early 1990s, BAIC had taken the lead in the Chinese auto industry, but its dominant position was eclipsed and is still maintained by SAIC and FAW.¹⁰⁰

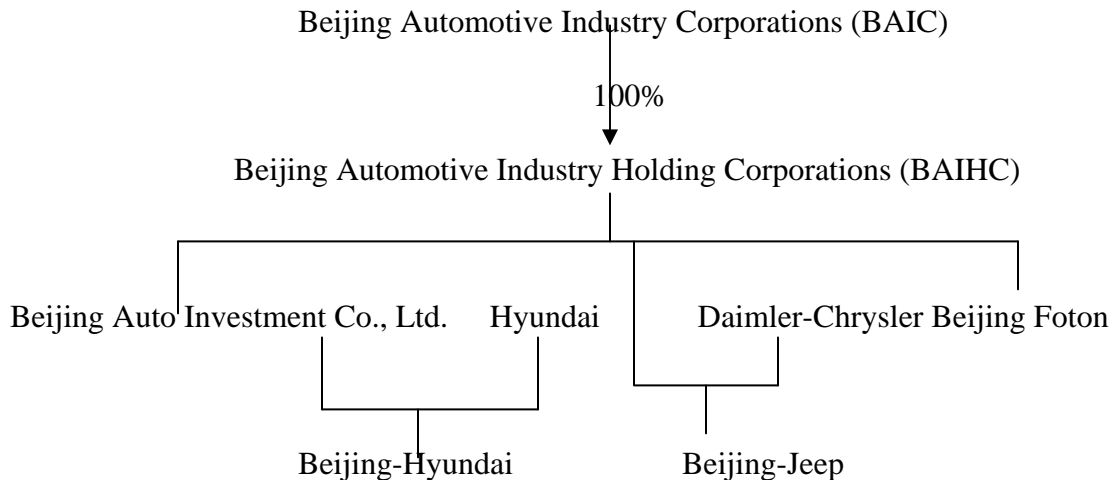
Compared with Changchun or Shanghai, Beijing has never been a great location for the auto industry, not only because the land on which to build the assembly factories and related industries is extremely expensive, but also because Beijing city is a center of culture and history, not a heavy manufacturing industrial base. Yet despite the early failure and the unfavorable environment for auto manufacturing, the growth of BAIC has been remarkable of late. From BAIC's case, it can be seen that the Beijing municipal government's function has been critical in revamping automobile manufacturing in the city. As in SAIC, the Beijing DRC provides the firms with benefits for land and funding if needed, and Beijing SASAC

⁹⁹ More discussion, see Jim Mann, *Beijing Jeep: How Western Business Stalled in China* (New York: Simon and Schuster, 1989); Harwit (1995)

¹⁰⁰ In 1990, sales revenue of BAIC was RMB 4.12 billion and SAIC's was RMB 3.61 billion. The situation is completely changed according to the 1997 sales revenue record. While BAIC recorded RMB 8.87 billion, SAIC gained RMB 40.4 billion. Huang (2003: 264)

supervises the asset management of the Group. From the center, while SAIC is monitored by invisible party-state *xunshizu*, BAIC is indirectly checked by Beijing city officials who are concurrently working for the central party-state.

Figure 3-5: The Structure of BAIC



Sources: Interview in Beijing-Hyundai Corporation, Beijing (November 18, 2005); *China Automotive News [Zhongguo Qiche Bao]* (February 20, 2006), p. C 6.

Central Oversight through Overlapped Authority

New Attempt

Since the late 1990s, the Beijing municipal government has come to seriously consider developing the auto industry due to its potential economic effects on modernizing other manufacturing sectors and industrial growth in Beijing. Indeed, after the establishment of the Beijing-Hyundai JV, 37.3 percent of the industrial growth of Beijing in 2003 was achieved by Beijing Auto Industry Holding

Corporations (BAIHC, a new name for the former BAIC).¹⁰¹ Regarding economic performance in 2004, BAIHC achieved 36.5 billion yuan in total assets, 530 thousand units in sales, and its sales revenues attained 48 billion yuan.¹⁰² Among Chinese auto enterprises, BAIHC gained 10.47% of market share and came to be the number four player. Particularly, Beijing-Hyundai Motor Company (BHMC) ranked number five in the passenger car market in China.

The auto industry was not the “core” concern for Beijing leadership. As Thun and Segal (2001) point out, Beijing’s bureaucratic and economic structure are more favorable to the IT industry,¹⁰³ and the Information Technology industry has been targeted as the most strategic field in Beijing. However, as the bubble in China’s IT industry began to decline from its peak in the early 2000s, the Beijing municipal government set out modifying its industrial development plan, moving the emphasis from the IT industry to the manufacturing industry, particularly the automobile.¹⁰⁴ Despite the previously noted “unfavorable” environment, the auto industry again attracted close attention not only from local government but also from the central leadership.

In the course of development, Beijing was looking for a new foreign auto manufacturing partner to create a JV firm with BAIHC. This conveniently coincided with Hyundai Motor Company’s business scheme in the Chinese market. In fact, Hyundai had tried to form a JV with a Chinese auto producer in 1997, but it did not

¹⁰¹ “Three Carmakers Prop up Beijing’s Auto Expansion in 2003,” *Xinhua News Agency* (Feb 6, 2004)

¹⁰² *China Auto Industry Yearbook* 2004. p. 77

¹⁰³ Segal and Thun (2001)

¹⁰⁴ Interview with director of Beijing Auto Investment Corporation, Mao Hai in Beijing (November 10, 2005); interview with Korean senior managers in Hyundai Auto Investment Holding Corporation, Beijing (November 18, 2005)

materialize because other foreign manufacturers were evaluated as more competitive by the Chinese government and the auto firms.¹⁰⁵ In 2001, Wu Bangguo, a vice premier of the State Council, conceived the necessity for the development of the auto industry in Beijing. Wu Bangguo arranged a meeting with Jung Mong-Gu, the president of Hyundai Motor Corporations (HMC), and Jia Qinglin¹⁰⁶ in Beijing.¹⁰⁷ At the meeting, they immediately agreed to establish a JV between BAIHC and HMC. In April 2002, they signed a contract which would be effective for thirty years, and outlined specific principles, goals, and scope for the partnership.¹⁰⁸ The idea of making the Beijing-Hyundai JV firm was mainly initiated and supported by the central leadership in coordination with the Beijing municipal government.

Structure of BAIHC

Beijing Automotive Industry Holding Corporation is a state-owned large scale automotive enterprise, serving as the center of the Beijing auto industry development and of human resources. As of 2006, thirty two auto producers are affiliated with BAIHC, including supply manufacturing, auto related service and trade, and investment firms.¹⁰⁹ The Beijing municipal government is attempting to make automobile manufacturing a pillar industry of Beijing's economy. Cheng Lianyuan,

¹⁰⁵ Interview with Mao Hai in Beijing (November 10, 2005). Mao mentioned that in the late 1990s FAW, Dongfeng, and Guangzhou Auto Industry Corporations were considering JV with Hyundai but they thought that Hyundai was not bad but would be not the best choice for them. In the end, FAW decided Toyota as a new JV partner; Dongfeng

¹⁰⁶ As of 2001, Jia Qinglin served as the secretary of the CPC Beijing Municipal Committee and the member of the political bureau of the CPC Central Committee. Now he is member of the Standing Committee of the political bureau of the 16th CPC Central Committee and the chairman of the Chinese People's Political Consultative Conference (CPPCC) National Committee. See, <http://english.people.com.cn/data/people/jiaqinglin.shtml> (Access: Nov. 1, 2006)

¹⁰⁷ Interview with Mao Hai, Beijing Automotive Investment Corporation Ltd (November 10, 2005)

¹⁰⁸ "Beijing Motor Corporations Cooperates with ROK's Hyundai," *People's Daily* (April 30, 2002)

¹⁰⁹ Ibid.; "Beijing Auto Industry Holding Corporations (*Beijing Qiche Gongye Konggu Youxian Zeren Gongsi*)," *People's Daily* (Sept. 14, 2006) Access: Nov. 1, 2006

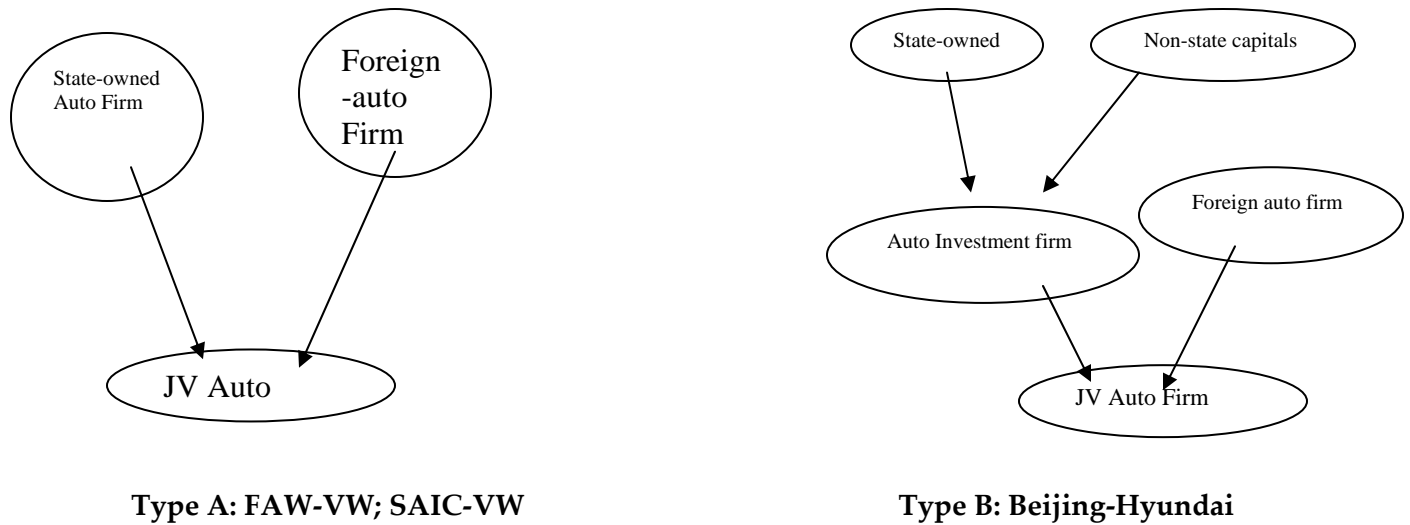
director of the Bureau of Industry Promotion in Beijing, attributes Beijing's recent auto sector growth to Beijing-Hyundai Motor Corporation (BHMC), Beijing-Jeep, and Beijing Foton.¹¹⁰ They are key players in BAIHC, but my discussion will be focused on BHMC whose annual production capacity reached approximately 300,000 vehicles; total sales were 233,668 vehicles in 2005.¹¹¹

Although there are variations in the rate of investment assets among Sino-Foreign JV auto firms, most JV passenger car producers have been set up in similar ways: 50 percent of assets from the Chinese mother enterprise, and the other 50 percent from the foreign JV auto partner. As we examined earlier, FAW-VW is organized by FAW Group (50%) and Germany's VW (50%), and SAIC-GM is constructed by SAIC Group (50%) and the U.S. auto firm, GM (50%). However, the ownership structure of BHMC, which has been the engine of the increasing development of BAIHC since 2002, is distinctive from other JV auto firms in China.

¹¹⁰ "Three Carmakers Prop up Beijing's Auto Expansion in 2003," *Xinhua News Agency* (Feb. 6, 2004)

¹¹¹ Beijing-Hyundai Motor Company (BHMC) Internal Report, Beijing (Feb 2006)

Figure 3-6: Comparison with traditional JV Auto Firms with New One in China



Sources: Qian Pingfan, DRC of the State Council, Beijing (March, 2006)

BHMC is a JV firm between Korea's Hyundai Motor firm and a newly established Beijing Auto Investment Enterprise (BAIE), not BAIHC. BAIE consists of various shareholders: the mother corporation, BAIHC (23%), and other stockholders including private ones (77%). In other words, although BAIE is a state-owned auto firm because its largest shareholder is BAIHC, which is wholly-owned by the Beijing government, the non-state investors are also extensively involved in investment resources. These non-state investors can participate in the business management and operation of BAIC.

One official in the Development of Research Council of the State Council highlights two potential benefits of this new form of ownership structure.¹¹² One is that this new system may contribute to reducing state intervention in business

¹¹² Qian Pingfan, Beijing (March 2006)

management. The power of the government in business as a chief stockholder will decrease gradually, for the government is not the single owner, and there are other voices. These incremental changes may result in substantial SOE reform in the near future. The other potential benefit is that the increase of non-state investment capital may lead to the diversification of capital in the Chinese passenger car industry not wholly-owned by the state. If so, why was this type of investment corporations in the auto industry attempted in Beijing, not Shanghai? According to one official in Beijing, the central government has less expectation from Beijing's tax revenue than from other industry-centered cities such as Shanghai.¹¹³ Free from these pressures, the Beijing municipal government could experiment with ownership structure and, therefore, allowed BAIHC with other non-state investors to create a new type of state-owned investment enterprise.

Regulatory Mechanisms from Local Government

Beijing Auto Industry Holding Corporations (BAIHC) is a local state firm formally owned by the Beijing municipal government. This means that Beijing city retains the whole asset share of BAIHC. By integrating the previously fragmented regulatory authority, the Beijing municipal government has two comprehensive commissions: Beijing Development and Reform Commission (BJ-DRC) and Beijing Municipal State-owned Assets Supervision and Administration Commission (BJ-SASAC). Beijing SASAC plays the role of owner on behalf of Beijing city, and is responsible for supervising the management of assets and business operations in BAIHC and its

¹¹³ Interview with Ma Mingjie in DRC, Beijing (February 2006)

affiliate Beijing-Hyundai.¹¹⁴ While BJ-DRC/SASAC have more direct and powerful influence on BAIHC than the central SASAC, if business projects are expected to have an enormous effect on the overall society, Beijing-Hyundai reports to both central NDRC/SASAC and BJ-DRC/SASAC.¹¹⁵ In addition, top executives of BAIHC are appointed, evaluated, and removed by BJ-SASAC through legal procedures.¹¹⁶

Under the leadership of the Beijing city mayor, Beijing-DRC provides BAIHC with a variety of preferential policies in order to make BAIHC competitive with both domestic and international enterprises in China. Some argue that “interventionist instruments of industrial policy were either unavailable or unattractive to officials in Beijing,”¹¹⁷ but Beijing Municipal Bureau of Industrial Development (*Beijing shi gongye cuzin ju*) officially introduces the details of preferential policies and their potential benefits in attracting more foreign investment and enterprises.¹¹⁸ In theory, while BJ-DRC is in charge of enhancing comprehensive coordination, and *reducing* routine microscopic administration,¹¹⁹ BJ-DRC maintains

¹¹⁴ *China Auto Industry Yearbook (Zhongguo Qich Gongye Nianjian)* 2005. p. 76; Also refer to the official website of Beijing Municipal Government, <http://www.ebeijing.gov.cn/Government/Organizations/t1570.htm>

¹¹⁵ Interview with Fan Bi who is senior manager of Beijing Auto Investment Corp., Ltd. (February 17, 2006)

¹¹⁶ Interview with Mao Hai in Beijing Automobile Investment Corp. Ltd., (November 2005). Also see, “Beijing Municipal State-owned Assets Supervision and Administration Commission,” <http://www.ebeijing.gov.cn/Government/Organizations/t1570.htm>

¹¹⁷ Segal and Thun (2001: 578)

¹¹⁸ Bureau of Industry Development in Beijing Municipal Government presents the full accounts of the auto industry structure, development advantages and resources as well as preferential policies. See, <http://www.bjid.gov.cn/ywwz/auto/autoAdv2.asp> (Access: Oct. 31, 2006)

¹¹⁹ Beijing Municipal Commission of Development and Reform (*Beijing Shi Fazhan he Gaige Weiyuanhui*), “Introduction to the Functions of the Beijing Municipal Commission of Development and Reform,” <http://www.bjpc.gov.cn/english/>

influential levers of control over local auto manufacturers by regulating sources of funding for land and infrastructure building, taxes, and human resources.¹²⁰

For example, the Beijing-Hyundai JV auto firm has been taking great advantage of three kinds of preferential policies from BJ-DRC.¹²¹ First is the financial support to purchase land and to build infrastructure for auto production in the city. In order to help construct auto factories in Beijing, where the land is highly expensive compared to other regions, the Beijing municipal government assisted Beijing-Hyundai's purchase of the land. Beijing-Hyundai's manufacturing factory in Shiyan was originally "Beijing Qingsing Qiche Gongsi," which was built in 1998 on 1,600 thousand acres of land, and cost 160 billion yuan for building infrastructure. In 2001, this factory was taken over by Beijing-Hyundai at a price of 45 billion yuan through BJ-DRC's financial support. Another preferential policy is the "two year exemption, three year reduction" tax policy ("*liangnian mian, sannian jian*"). This was designed to encourage the inflow of foreign direct investment and capital into China's auto industry by providing JV auto firms with advantages in the tax structure. In China, all automotive manufacturing enterprises are responsible for paying 33 percent tax from their annual profit revenue: 30 percent is remitted to the central and 3 percent is remitted to local governments. JV auto firms do not need to pay any tax for the first two years, which makes a big difference between JV auto firms and indigenous manufacturers in the end.¹²²

¹²⁰ Interview with Mao Hai, Beijing Automobile Investment Co., Ltd., Beijing (November 10, 2005)

¹²¹ Interviews from Mao Hai, Fan Bi, and Ko Jaejung in Beijing

¹²² Including private auto firm, they argue that since the market structure itself in China is not fair, we cannot compete with massive JV auto firms.

The final source of regulation is human resources. To recruit highly qualified engineers and technicians in BAIE, the Beijing city government provided BAIE some assistance in employing advanced engineers and technicians from other auto firms. Thereby, BAIHC or Beijing-Hyundai, under the support of BJ-DRC, could attract excellent human resources from other auto firm such as FAW or Dongfeng.¹²³

Regulation from the Central Government

While Beijing Auto Industry Holding Corporations (BAIHC) is a local state firm owned by the Beijing municipal government, there is central oversight that exercises indirect control over the business of Beijing auto enterprises. First, the center may oversee and exert indirect control over the appointment of top executives and senior managers in BAIHC. Although BJ-SASAC retains the right to appoint the president of BAIHC, given that BJ-SASAC is organized by the mayor, who is nominated by the central party, there is influential central oversight over personnel in Beijing's auto state firms.

Second, it must be noted that "the central and Beijing governments are sometimes hard to distinguish and appear to act together."¹²⁴ The line between the central government and the Beijing government is often ambiguous, and key posts such as the mayor or the party secretary of the municipal party committee are directly nominated by the central party.¹²⁵ In doing so, the central party-state keeps its eye on Beijing city's automotive business without an invisible central supervising agency as

¹²³ Interview with Mao Hai in Beijing Automobile Investment Corp Ltd., Beijing (Nov. 2005)

¹²⁴ Jane Duckett, *The Entrepreneurial State in China* (London: Routledge, 1998), p. 35.

¹²⁵ Brian Hook eds., *Beijing and Tianjin: Towards a Millennial Megalopolis* (Hong Kong; Oxford: Oxford University Press, 1998), p. 34.

seen in Shanghai's auto enterprises. To be sure, governors, mayors, and party secretaries in other provinces or cities are also appointed by the central party-state. Yet the difference is that the Beijing municipal government is more particularly tied with the central party-state than are other provinces and cities.¹²⁶ In many cases, Beijing's government and party leaders concurrently serve as members of the Central Committee of the CCP and Politburo.¹²⁷ Most of them have tended to be promoted straight to the center, unless their performance in Beijing is not satisfactory. This has implicitly encouraged local leadership to be more responsive to central policies in order to give a good impression to the central leaders for future career promotion.

Furthermore, as addressed in the 2004 auto industrial development policy, the central government may regulate the sector through the right of approval for new JVs, business projects costing over 10 million USD, and new market entry. In effect, central leadership is deeply involved in invigorating Beijing's auto industry. Beijing set about accelerating the development of automobile manufacturing as a key strategic sector not by Beijing municipal government's initiative, but rather by the top leadership at the center. When BAIHC searched for a new foreign JV partner, the central government was involved from the very beginning of negotiations, not just at the final approval stage. For example, in comparison with French auto maker Renault's 6 years of negotiations with BAIHC, Korea's Hyundai signed a contract soon after the meeting between the vice premier of the State Council, Wu Bangguo, and the president of Hyundai Group, Jung Mong-Gu. As such, the decision of a

¹²⁶ *Ibid*

¹²⁷ Hook (1998: 35)

foreign partner for Beijing Automobile Investment Corp. was not determined by Beijing city, but the central top leaders.

V. Chapter Conclusion

In this chapter, I have explained the pattern of regulatory control identified in China's auto industry by examining three major auto SOEs. It has been well acknowledged that domestic political and economic institutions generate various forms of regulatory mechanisms in a global economy, but even within China's auto industry the forms of regulation are varied, not only between central and local state firms, but also even between local producers. In explaining centralized regulatory power in the Chinese auto industry, I have introduced the concept of "mixed regulation." In the context of central oversight, asset and personnel management in local state firms SAIC and BAIC are monitored by invisible central regulatory power, whereas central state firm FAW is tightly supervised by formal public agencies. In this study, I distinguish these varied patterns of central control: the former is "soft" regulation, while the latter is "hard" regulation. Hence, soft and hard mixed forms of regulation are identified in China's auto industry.

CHAPTER 4

CENTRALIZED HARD REGULATION: THE TELECOM SERVICE INDUSTRY

I. Introduction

Like the automobile industry, China's telecom service is certainly a key strategic sector that has been rapidly achieving both development and reform over the past two decades.¹ Since 1998, the growth rate of the telecom industry has been maintaining more than 20%; the sales value has increased from 156.2 in 1998 to 111,576 billion yuan as of 2005.² This rapid development of the telecom industry is directly correlated to a series of regulatory reforms which were launched in 1994 by establishing China Unicom, and accelerated by the creation of the regulatory Ministry of Information Industry (MII) and the WTO entry in 2001. The telecom service industry provides us an excellent comparison with the auto manufacturing sector, in that it shows how the Chinese state governs these two strategically important but very different industries. The automobile and telecom service sectors have differences in historical pathways, forms of ownership and governing structure, as well as sectoral characteristics.

¹ "Guozhiwei Mingque Dianxin Hangye Wei Guoyou Jingji Yankong Yangye," *Beijing Yuele Xinbao* (December 12, 2006)

² Cheng Li, 2006, "China's Telecom Industry on the Move: Domestic Competition, Global Ambition, and Leadership Transition," *China Leadership Monitors*, No. 19 (Fall), p. 3

In this chapter, I argue that the new regulatory mechanism in China's telecom industry has four main features. First, despite regulatory reform and growing market forces, central state control still continues. But, both the actor and the manner of control are remarkably changed through regulatory reform. While the old regime was a state-run monopoly system where the Ministry of Post and Telecommunications (MPT) was the main actor in controlling the telecom business as operator, the new mechanism is a state-overseeing oligarchy structure in which the number of operators has increased but is confined to six firms. In addition, it is tightly supervised by SASAC as the new actor for continued state control. By enacting various legal regulations and rules, SASAC has been expanding its intervention in the telecom market, from asset management and personnel to budget and investments. Compared with the softly central oversight in the auto industry, I conceptualize the pattern of regulation in the telecom sector as "centralized hard regulation." The authority of oversight is centralized, in that local governments have no substantial right to make policy decisions, for all leading telecom firms are owned by the central government; local telecom firms are simply local units of central firms. Hard regulation here refers to tight state control over the business of industry through formal state institutions by rules. As I have pointed out earlier, therefore, the focus on how SASAC, not the MII, regulates the telecom operators more clearly shows the nature of the regulatory state in China's telecom industry.

Previous studies that investigate a changing mode of economic governance in the telecom industry have focused on the function and bureaucratic origins of the MII,

or its relationship with telecom enterprises.³ To appreciate how the Chinese state governs the telecom industry, however, we need to pay close attention to the SASAC, which is playing actual “boss (*laoban*)” of telecom operators, and its growing power of managing the business of telecom firms. On the surface, the MII as a regulatory institution (*jianguan jigou*) exists to encourage and oversee fair competition, but, above that, substantial control over the telecom business comes from the powerful comprehensive state agency, SASAC. Its empowerment is also interrelated with tight central state ownership of telecom firms and continued strong control of the party organs.

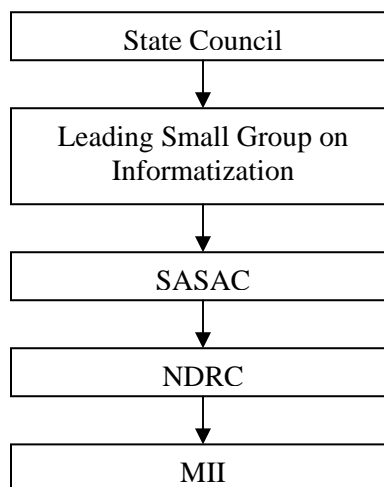
Second, while it is often not explicitly visible, the party organ is deeply enmeshed in both enterprises and government, and exercises considerable influence on the operation of the firms. Through the right of personnel selection, the party may control the high-level officials of the MII and the senior executives of telecom firms. Although there are many efforts toward corporate reform in China’s telecom sector, the party committee in telecom corporations still dominates the board of directors; the party secretary of the head of the party committee holds the chairmanship of the board concurrently with the president of the firm. Moreover, in 2003, SASAC evolved from the Central Enterprise Work Commission (*zhongyang qiye gongzuo weiyuanhui*), which was under the direct leadership of the Standing Committee of the Politburo of the CCP. Given this bureaucratic origin, the empowerment of SASAC in managing the telecom sector is also associated with the continued hand of the party in business.

³ Pearson (2005); Pei (2006)

Third, the function of the MII to oversee the sector is constrained not only by the powerful influence of SASAC and the party organs, but also by the NDRC and the State Council. The MII is mainly responsible for facilitating and supervising fair competition in favor of consumer interests in the telecom market, but the playing field and rules of the game are formulated by the top central state institutions. The telecom service fee, market entry, telecom industrial policies, and the structure of the market are ultimately finalized by the top governmental bodies.

Finally, above the comprehensive commissions and ministries, the Leading Small Group on Informatization (*xinxihua lingdao xiaozu*), directly underneath the State Council, make the authoritative policy decision for the reform and development of the information industry, including the telecom sector. It is the least known governing state body, but shows the strategic significance of the sector placed upon it by top Chinese leadership.

Figure 4-1: Bureaucratic Structure in the Telecom Service Industry after 2003



Therefore, the story of China's telecom service regulation shows that strategic industries, similar to the auto sector, are governed by centralized oversight, even though the industries have significant differences in both their governing structures and their forms of ownership. Compared with centralized soft/invisible regulation in the auto industry, the pattern of hard regulation in the telecom industry demonstrates the *complexities* of China's regulatory mechanism within the centralized economic governance. Theoretically, the model of a regulatory state governing the telecom industry in China is likely to conform to neither Dali Yang's centralized but minimalist state favoring the buyer's market, nor Minxin Pei's decentralized predatory state. Rather, the form of centralized hard regulation falls somewhere in between these two extremes. On the one hand, the empowerment of SASAC over the MII manifests tight central state control over the telecom business to secure crucial state assets, which would never lead to minimal party-state intervention, as Yang proposes. On the other hand, the centralized political authority and property rights in the telecom industry could greatly reduce the possibility for rent-seeking. By holding the right of personnel selection in both central state institutions and telecom firms, the party maintains the levers of control in managing the sector.

The telecommunications industry consists of service and equipment parts, and the services are divided into basic and value-added services.⁴ In this study, my

⁴ Telecommunications service is divided into two categories: basic telecommunication and value-added services. Basic telecom service include "all telecommunication services, both public and private that involve end-to-end transmission of customer supplier information" Examples are: 1) voice telephone; 2) packet-switched data transmission; 3) circuit-switched data transmission; 4) telegraph; 5) facsimile; 6) private leased circuit services; 7) analog/digital cellular/mobile telephone; 8) mobile date; 9) paging; 10) satellite-based mobile; 11) fixed satellite services. See, "WTO: Telecommunications Services Coverage," http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_coverage_e.htm (Access: July 18, 2007). Value-added telecom services are for which "suppliers add value to the customer's information by enhancing its form or content or by providing for its storage and retrieval." Ibid. They

research focus is on basic telecom services, particularly voice telephone services including cellular/mobile telephone service. These cover local, long distance, international, and wire-based services. I do not look at paging or telegraph services in the basic services.

In this chapter, after introducing the old regime governing China's telecom industry before the reform, I explain internal and external challenges that led the Chinese government to conduct a comprehensive restructuring program and its successive procedures in China's telecom markets. The chapter proceeds to discuss the new regulatory architecture of the sector and proposes centralized hard regulation as the specific form of the regulatory state in China's telecom service industry. It then details two policies: price and market entry.

II. State-run Monopoly: the Old Regime

Until the 1970s, the telecommunications system had been mainly used for semi-military and administrative needs.⁵ As a consequence, China's telecom industry was fairly backward, resulting from a lack of technology and investment capital, and inefficient management. Since the 1980s, the Chinese top leadership has perceived its critical importance as an infrastructure industry in order to boost future economic development and to enhance the standard of living. Through various preferential policies, such as tax reduction, back loans, or high installation fees, the Ministry of

include: on-line data processing, on-line data base storage and retrieval, electronic data interchange, email, and voice mail.

⁵ Yan Wan, 2001, "Sector Reform," In edited by Jintong Lin et al., *Telecommunications in China: Development and Prospects* (New York: Nova Science Publishing), p. 161.

Post and Telecommunications (MPT), the former regulator and operator before the reform, began to take advantage of financial resources in developing the sector.⁶ Accelerated by government policies, China's telecom industry has developed rapidly. The revenue from the industry was 2 billion yuan in 1985, increasing to 11 billion yuan in 1990, 120.9 billion yuan in 1996, and 210.36 billion yuan (USD 25.3 billion) in the first five months of 2004.⁷ Apart from telecom development policies from the government, fast growth was attained by the sustained stable development of the national economy and the rise of the national income since the early 1990s.

Prior to the 1998 regulatory reform, the major feature of China's telecommunications regime was the state-run monopoly system. By integrating China Telecom into a commercial arm, the MPT had regulated the overall telecom market and at the same time operated the business of the telecom industry. While the SPC was the highest level economic planning commission in China, it had little influence on managing the telecom industry. Not only because the SPC was not independent from other ministries, but also because the MPT held the control of the national communications infrastructure, the development of the telecom industry was basically planned, regulated and operated by the MPT.⁸

⁶ Since China was seriously deficient in investment capitals for telecom industry in the early stage of development, the Chinese government made up a deficit by charging high rate installation fees for telephone lines. During the 7th Five year plan (1986-1990), the installation fees and sub-charge took up 30% of the total investment capitals in the telecom industry; over the 8th Five year plan (1991-1995), it grew up to 50%. Wan (2001: 163)

⁷ Chen Xiaohong, 1999, "Zhongguo Dianxinye: Zhengce, Chanye Zuzhi de Bianhua ji Kugan Jianyi," *Guanli Shiji (Management World)*, No. 1, p. 131; "Ministry to Enhance Supervision on Telecom," *China Business Weekly* (July 12, 2004)

⁸ Lynn Crisanti, "Untangling China's Datacom Networks," *The China Business Review* Vol. 24, Issue 5 (Sep/Oct 1997): 38-41; Huang (2002: 554)

The MPT was also in charge of finance and strategic development planning for the industry. To encourage the rapid growth of the “crown jewel”⁹ of the telecom industry, the Chinese government provided the MPT with jurisdiction over installation fee decisions and various preferential policies, such as tax reduction or exemption and privileges in bank loans.¹⁰ This monopolized provider, the MPT, had made basic telecom service, including the fixed-line, mobile service, and data transmission, very expansive but low-quality. It is said that, by the late 1990s, the installation cost for a fixed-line for urban Chinese people was nearly the same as one month’s pay. As an effort to improve the situation, in 1988 other related ministries such as the Ministry of Electronic Industry (MEI), the Ministry of Electronic Power (MEP), and the Ministry of Railways (MR) asked the State Council to organize a rival service provider, China Unicom.¹¹ Yet due to the strong resistance of the MPT, it was not until Deng’s southern tour in 1992 that they realized the importance of some domestic competition. Thus, in 1993, China Unicom’s development was finally approved by the State Council. Following this, Jitong Communication Corporation was established in 1994 as another player in order to provide Internet services. Due to the MPT’s resistance and unfair policies to keep up its vested interests, the market was still nearly monopolized by China Telecom. But the establishment of China Unicom and Jitong demonstrates that the top Chinese leadership was conscious of the need and importance of introducing competition in the telecom market. Since then, the Chinese government has undertaken successive structural reforms to *create* market competition.

⁹ “Into the Crucible,” *The Economist*, (November 3, 2001)

¹⁰ Wan (2001: 162-163; 167)

¹¹ Pei (2006: 103)

On the other hand, in 1994, the MPT's operation arm, the Directorate General of Telecommunications, came to be legally registered in the State Administration of Industry and Commerce as a separate system operator named China Telecom. But the substantial separation of government from the telecom business did not appear yet; China Telecom worked closely with the MPT (regulator) until the MPT was merged into the MII in 1998. It was generally perceived that "MPT has not yet been separated into regulatory and commercial branches, and still regulates and operates within traditional broadcasting, electronics, and telecoms boundaries."¹²

In regulating local telecom business, the geographical and administrative structure of governmental authority was organized in three levels. At the central level, the MPT guided and supervised the overall industry. Local units of the MPT, known as Post and Telecommunications Administrations (PTAs) were established at the provincial and municipal levels. Under the leadership of provincial/municipal PTAs, post and telecom bureaus (PTBs) were set up at prefectural levels.

Under the system of dual leadership (*shuangzhong lingdao*), provincial/municipal PTAs were administered by both the central MPT and local governments simultaneously. By decentralizing decision-making authority and financial responsibility to the local levels, the MPT allowed local governments to make local telecom development plans and direct investment. Yet it was schemed not to transform but to maintain the pre-existing hierarchical structure. All revenues from telecom services were first collected by the MPT, and then redistributed to each PTA,

¹² Crisanti (1997)

while the MPT kept hold of much of this revenue.¹³ Monopolized authority for the distribution of revenue between the MPT and the PTAs demonstrated a hierarchically centralized management of the telecom industry. It demonstrates that “the PTAs were essentially provincial-level MPT with parallel bureaucratic and economic interests,”¹⁴ even though there were bureaucratic tensions between the MPT and the PTAs.

III. Reform and New Challenges

The creation of a regulatory agency, the Ministry of Information Industry (MII) in 1998, and the following market restructuring clearly signal the launch of substantial reforms in China’s telecom industry. The reforms were driven not only by internal demands and changes, but also by external forces, such as the requirements of WTO accession and a global wave of regulatory reforms. Internally, the 1998 administrative restructuring program, which abolished or integrated a number of industrial ministries to streamline the former inefficient bureaucratic structure, facilitated the establishment of the new regulatory body, the MII. There were demands to institute a regulatory agency responsible for overseeing the growing competition in the telecom market. Externally, the most significant impetus to push the reform was the WTO accession.

The telecom service industry in China had been exclusively closed to foreign investments. However, the Chinese government could not delay opening its telecom service market, because one of the entry requirements for WTO membership is the

¹³ Milton Mueller and Zixiang Tan, *China in the Information Age: Telecommunications and the Dilemma of Reform* (Washington, D. C.: Center for Strategic Studies, 1997), p. 43.

¹⁴ *Ibid*

Basic Telecommunications Agreement (BTA).¹⁵ The BTA stipulates the immediate opening of the telecom service market to foreign investments, and specifies the maximum ratio of the ownership of foreign firms within six years. Upon entry, foreign firms may take up 50% ownership of the value-added service firms in 2 years, and 49% ownership in the mobile and fixed-line service in 5-6 years.¹⁶ BTA regulatory reforms also require the implementation of transparent and fair criteria for service licensing and the building-up of an independent regulatory body. This would be the most challenging issue for the Chinese government: meeting a global standard. In addition, incoming foreign telecom giants after WTO entry provided the Chinese government with a strong stimulus to create large-scale telecom firms that would be capable of competition with foreign giants.¹⁷

Internally, the rise of the MII, replacing the MPT and assuming both the former regulatory agency and monopoly operator, is notable. This also contributed to reducing the bureaucratic tensions between the MPT and other ministries (i.e. MEI or MR) regarding the MPT's monopoly. Given that China Unicom had been always in unfavorable competition with China Telecom backed up by the MPT, integrating two competitive ministers, the MPT and the MEI, into the MII ultimately promotes fair competition in the telecom market. A second feature of the reform is the attainment of the separation of government and business (*zhengqi fenkai*). By completing the separation of China Telecom, which had been already under way in the period of the

¹⁵ See, the WTO official website on the telecommunications sector, http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm (Access: April 17, 2007)

¹⁶ Bing Zhang and Mike W. Peng, 2000, "Telecom Competition, Post-WTO Style," *The China Business Review* (May-June), p. 14

¹⁷ This comment is from Zhang Xinzhu who closely works as the telecom policy-maker, and is director of Research Center for Regulation and Competition, the Chinese Academy of Social Science, "Netcom Expects Major Gains from Telecom Restructuring," *China Daily* (September 4, 2001)

MPT, the MII no longer operates the daily business of telecom companies. Instead, the MII intensifies the regulatory authority to encourage and oversee fair competition and takes charge of drafting most policies and rules (i.e. service fees or market competition).¹⁸ Finally, China's emphasis on competition in the telecom market was implemented by the continuous restructuring of the sector, including the successive break-up of China Telecom and the entry of new players. Despite the creation of China Unicom and China Jitong, the market was predominated by China Telecom. In 1998, in the mobile services, the market share of China Unicom only remained 6% while China Telecom accounted for 94%.¹⁹ Concerned about this limited competition and unbroken monopolized structure, the Leading Small Group on Informatization (*xinxihua gongzuo lingdao xiaozu*) under the Zhu Rongji's leadership pushed forward carrying out further restructuring reform. Its major goal is to break up China Telecom's monopoly and bring about more effective competition.

The first round of restructuring was finalized by the State Council in 1999 after the MII proposed four different drafts.²⁰ The major issue for the government was not to introduce new players, but to break up China Telecom, because the creation of new operators, China Unicom and China Jitong, was assessed as not very successful in changing the market structure. In breaking up the monopoly of China Telecom, there were various suggestions and debates from government-funded institutions, universities, and consulting companies. The focus of these debates was "how" to split it up, horizontally or vertically. A horizontal break-up suggests the

¹⁸ Interview, in BUPT, Beijing (December 2005)

¹⁹ Zhang and Peng (2000: 12)

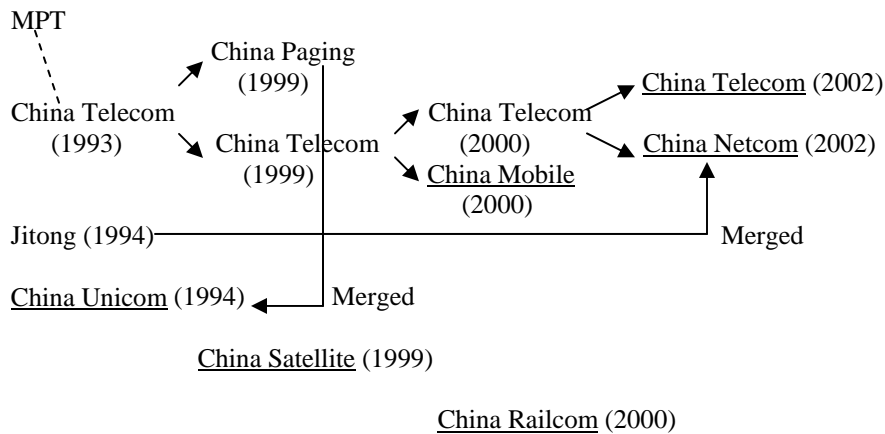
²⁰ Scott Yunxiang Guan, *China's Telecommunications Reforms: From Monopoly Towards Competition* (New York: Nova Science Publishers, Inc., 2003), p. 21.

split of the elephant-like China Telecom into small local-unit telecom firms by region, allowing China Telecom to maintain its former comprehensive services. On the other hand, a vertical split highlights the functional divisions of China Telecom that dominated fixed-line, mobile, satellite, and paging services. By adopting a vertical break-up, China Telecom was divided into three companies, each with a different service area: China Mobile in the wireless services; China Satellite for the satellite business, and new China Telecom in the fixed-line telephone and internet services.²¹ State efforts to break up China Telecom's long history of monopoly gave business licenses to new players. Two new basic service providers launched basic service in 2000: China Netcom and China Railcom. Both aimed to compete with China Telecom, but their target services were different. China Netcom operated internet service and provided IP telephony and other value-added services. In the fixed-line service, China Railcom was in charge of local and long distance fixed line services.²²

²¹ Qingjiang Kong, 2001, "China's Telecom Regulatory Regime on the Eve of WTO Accession," *Issues & Studies* (July/August), 37 (4), pp. 165-166

²² China Netcom has distinctive internal enterprise structure from other telecom service SOEs. It consists of "four state-owned share holders that managed to receive \$325 million in equity investment from Goldman Sachs and News Corporation through a private placement." Pei (2006: 105)

Figure 4-2: Restructuring China's Telecom Market



* Underlined carriers are current six major firms

Sources: Wang Xudong, "Some Issues on Informatization in China and Research in CIS," Center for Informatization Study (CIS), CASS (April 2004)

Despite the break-up of China Telecom and the creation of new service providers, China Telecom still accounted for more than 90% of the market share in local network service; two competitors, China Netcom and China Railcom, called for an additional break-up of China Telecom to create more effective competition. These two companies lobbied for a second break-up of China Telecom,²³ but a number of telecom analysts and experts suggested the creation of new service providers or the improvement of a regulatory mechanism for effective oversight rather than another break-up of China Telecom. In December 2001, the State Council decided on a second-round split of China Telecom into two firms: China Telecom and China Networks Communications Group (China Netcom), created by the union of the

²³ Guan (2003: 27)

former China Netcom and Jitong Communications.²⁴ Both provide fixed-line service, but while China Telecom is in charge of services for 10 provinces, including the north (Beijing, Tianjin, Hebei, and Shanxi) and northeast areas (Liaoning, Jilin, and Heilongjiang), and Henan and Shandong, China Netcom provides services in less developed northern provincial regions.²⁵ Kan Kaili, telecom expert at Beijing University of Post and Telecommunications, did not agree with the idea of a second break-up of China Telecom, and warns of the potential possibility of the rise of “regional monopoly” rather than increasing competition.

In effect, before the State Council made the final decision to divide China Telecom into North and South, the SDPC in May 2001 notified several telecom experts to attend an open discussion regarding the China Telecom break-up. At the meeting they recognized that the main issue was not whether the second-round break-up of China Telecom was profitable, but *how* to break up China Telecom. Specifically, the Leading Small Group (*lingdao xiaozu*), directly under the State Council, played a key role in the planning and enforcement of splitting China Telecom into North and South.²⁶ The Leading Group was directed by the prime minister and consisted of six party-state officials. Led by the MII, the Ministry of Finance (MoF), the Organization Department (DO) of the CCP, the SDPC, and the SETC organized the Leading Group, and each member of the Leading Group assumed a specific responsibility: the MoF was responsible for managing the state assets; the DO appointed the top executives of South-Telecom and of North-Netcom;

²⁴ “Fangan huo Guowuyuan Pizhun Zhongguo Dianxin Zhengshi Huafenwei Nanbei Liangbufen,” http://it.sohu.com/97/03/it_article5710397.shtml (Access: April 16, 2007)

²⁵ *Ibid*

²⁶ The origins, constitution, and functions of the Leading Small Group of Informatization are discussed in detail later.

the MII took on drafting policies.²⁷ Yet the most important part is the decision of the top executives of the firms, for one MII official said that the successful development of companies ultimately rests on who the president of the firm is.²⁸ One telecom expert/economist at Beijing University asserts that continuous break-up schemes cannot introduce substantial competition in China's telecom market unless the price is set in open-market competition, and private enterprise and capital are allowed to enter.

Table 4-1: Comparison of the Telecom Regime

	Before reform	After reform
Operator	MPT	SASAC (boss) / Six Firms
Regulator	MPT	MI
Owner	Government	Government / Shareholders

Sources: Interviews in BUPT, DRC, CASS (Institute of Industry Economy, Institute of Law), Beijing (December 2005 and January 2006)

IV. New Regulatory Mechanism

The new regulatory architecture consists of four leading state institutions: the State Council, the MI, the NDRC, and SASAC. Compared with the old regime dominated by the MPT, there are more state actors; their division of labor is transparent,

²⁷ Wan Lijian, 2001, "Gepa Liyi Longzheng Hudou Zhongguo Dianxin Fenzhe Niandi Quzhong RuweiShan," 21 *Shiji Jingji Baodao*, (December 31)

²⁸ *Ibid*

although it is often overlapped. In this section, I first introduce the overall structure of central oversight and their major functions, and then discuss the primary characteristics of the new regime, which will give insight into the form of the regulatory state in the telecom industry. Unlike Dali Yang's model, which hypothesizes the appearance of the modernized minimalist government in China's market economy, the new regulatory mechanism illustrates how the party-state maintains its levers of control over telecom firms, despite government and corporate reforms since the late 1990s.

The Structure of Central Authority

The Ministry of Information Industry (MII)

While the 1998 state restructuring program abolished or downgraded most industrial ministries from ministry (*bu*) to bureau (*ju*) under the supervision of the comprehensive state institution (i.e. SETC), the creation of the Ministry of Information Industry (MII) by merging the MPT and the MEI is an exceptional case.²⁹ The MII is established to be mainly responsible for supervising (*jianguan*) the *overall* telecom market as the regulator.³⁰ The MII concurrently takes on certain government functions for the development of the information industry. The MII drafts industrial policies and various rules for regulatory control, and exercises control

²⁹ Yang (2004: 37)

³⁰ "Research on the Government Management Problem in the Natural Monopoly Industry: Study of the Government Management System in the Telecommunications Industry," ("Longduanxing hangye de zhengfu guanzhi wenti yanjiu"). 2003. *Economic Research Reference (Jingji Yanjiu Cankao)*, 25. p. 5; Liu Shijin and Feng Fei. 2006. *Monopoly Industry: A Stronghold Drive for Reform (Longduan hangye: gaige gongjian)*, [Beijing: China Water and Telecom Publisher], pp. 228-229.

(*guanzhi*) over price, cooperating with the NDRC.³¹ Although the MII is the key regulator in the telecom service sector, the functions of oversight are shared with other state agencies, such as the NDRC, the Ministry of Finance, and the Industrial and Commercial Bureau. (*gongshang guanliju*). Therefore, the independent functions of the MII are structurally constrained.

Table 4-2: Telecom Regulation

Content of regulation	Regulator
Market entry	MII, Industrial and Commercial Bureau, NDRC
Price	MII, Ministry of Finance, NDRC, wujiaju
Services quality	MII, Bureau of Technology Regulation

Sources: Liu Shijin and Fei Feng. 2006. *Longduan Hangye Gaige Gongjian* [The Reform in the Monopoly Industry]. Beijing: Zhongguo Shuili Shuidian Chubanshe, p. 229.

The governing structure of telecom regulation is a hierarchically organized, central-provincial dual system. At the local level, the former Post and Telecommunication Administrations (PTAs) at the provincial/municipal levels were dismissed.³² Based on “Notice Regarding Building Local Telecom Management Structure Scheme” issued by the State Council in 2000, provincial- and municipal-level Communications Administrations (*shengji dianxin guanli ju*) were newly established, mainly to leverage regulatory oversight over the business of local telecom firms and to “set up a nationwide supervision system for its profitable telecom sector.”³³ They are also in

³¹ Interview with Wu Hong, the faculty of Beijing University of the Post and Telecommunications (BUPT), Beijing (December 2005)

³² Su Jinsheng, “China Telecom Industry: Reform, Development and Regulation,” Telecommunications Administration Bureau of the Ministry of Information Industry, unpublished (Access: July 20, 2007)

³³ “China Starts Comprehensive Supervision of Telecom Sector,” *People’s Daily* (August 29, 2001)

charge of securing fair access to public telecom utilities and coordinating economic and service relations among telecom firms across localities.³⁴ While the new system puts more emphasis on the regulatory task of protecting fair market competition, local communications administrations exhibit similar structural and functional relationships with the MII and local governments. Similar to the former PTA regime, communications administrations at the provincial/municipal levels are under dual leadership (*shuangzhong lingdao*), but it is clearly addressed that the primary leadership is held by the MII in regulating the local telecom industry.³⁵ Provincial/municipal communications administrations on behalf of the MII supervise, as long as local telecom firms follow the various policies and rules set by the head offices. They are organized by officials directly dispatched by the MII, and implement central policies and rules at the local level. Telecom markets at the county and township levels are supervised by the provincial/municipal communications administration.³⁶ Local governments have only advising authority (“professional relationship,” *yewu guanxi*) over local telecom administrations, which are as good as local agents of the MII.³⁷

³⁴ Shanghai Communications Administration (*Shanghai Tongxin Guanliju*) website (Access: July 20, 2007)

³⁵ See, Shanghai City/Beijing City/Guangdong Province Communications Administration’s official websites as the examples of major telecom localities.
<http://www.bca.gov.cn/filelist.jsp?officeid=gjjj&catalogid=aboutus> ;
<http://www.gdca.gov.cn/about/index.asp> (access: 07/20/2007)

³⁶ Liu and Fei (2006: 228)

³⁷ Subject Division Group for the Research of the Governmental Control over the Natural Monopoly Industry. 2003. “Dianxinye de Zhengfu Guanzhi Wenti Yanjiu” [Studying the Problem of the Government Control over the Telecommunications Industry]. *Jingji Yanjiu Cankao* [Economic Research Reference] 25, p. 4.

The NDRC in the Telecom Industry

Compared with the automobile industry, the NDRC plays a lesser role in the telecom sector because more state institutions are involved in governing the sector. However, the NDRC still remains important as a supra-ministerial commission with respect to two issues. First, the NDRC is responsible for making telecom industrial policy, and has the right to review various policies and rules drafted by the MII and to suggest its own policy recommendations to the State Council, which retains the final authority to approve.³⁸ Since the NDRC does not specialize in the telecom industry, policies are drafted by the MII. As a macro economy coordinator, the NDRC harmonizes telecom industrial policies with the overall development of other industries.

The other function is to set telecom service prices. Because the service fee in the basic infrastructure (i.e. telecom) exerts a great influence on the social stability and the national economy, the NDRC is actively involved in the policymaking process of the service fee, coordinating with the MII.³⁹ At the national level, the NDRC and the MII discuss and make decisions about telecom prices on the condition that the State Council approves. At the provincial level, the telecom service fee is set by a provincial price bureau (*wujia ju*), which is under dual-subordination from both the NDRC and provincial governments. The local price bureau cooperates with local governments, but they are under the direct leadership of the NDRC. While local governments and the local price bureau take into account the developmental condition of the local economy when they set telecom prices, their final decisions are basically grounded on the national policies.

³⁸ Development Research Center (DRC) of the State Council, Internal Report (2005); Interview with Wu Hong in BUPT, Beijing (December 2005)

³⁹ *Ibid.*, p. 14.

The SASAC

The SASAC is a state institution that supervises the management of state assets in state enterprises. It was established in 2003 under the State Council, and its primary job is to secure and increase the value of crucial state assets by monitoring and restructuring the 159 centrally-owned SOEs (*zhongyang qiye*).⁴⁰ In the telecom sector, SASAC supervises the assets management of the six centrally-owned telecom service firms: China Telecom, China Netcom, China Mobile, China Unicom, China Railcom, and China Satellite. Given that taxes from the telecom service firms account for 42% of the national economy, SASAC's supervision of the telecom service firms' assets and profits is strongly required as the practice of shareholder. By directly dispatching asset management teams, SASAC regularly monitors either the loss or the increase of state assets.⁴¹ Also, six telecom service firms annually report their financial status, such as revenue, profit, tax, assets to SASAC. SASAC takes charge of "managing" state assets to increase their value. In doing so, SASAC is allowed to design the restructuring plan, and the reshuffling of the telecom firms is mainly undertaken through merger. The director of SASAC, Li Rongrong, has continued to state that the domestic telecom sector will "definitely" be restructured.⁴² Since all six telecom service firms are central SOEs, local level SASAC has no formal authority to supervise the business of central telecom firms at the local level.

⁴⁰ The number of the central SOE was 196 in 2003, but it decreases by 159 in 2007. See, <http://www.sasac.gov.cn/zyqy/qymf/default.htm> (Access: March 14, 2007)

⁴¹ Interview in BUPT (Dec. 2005)

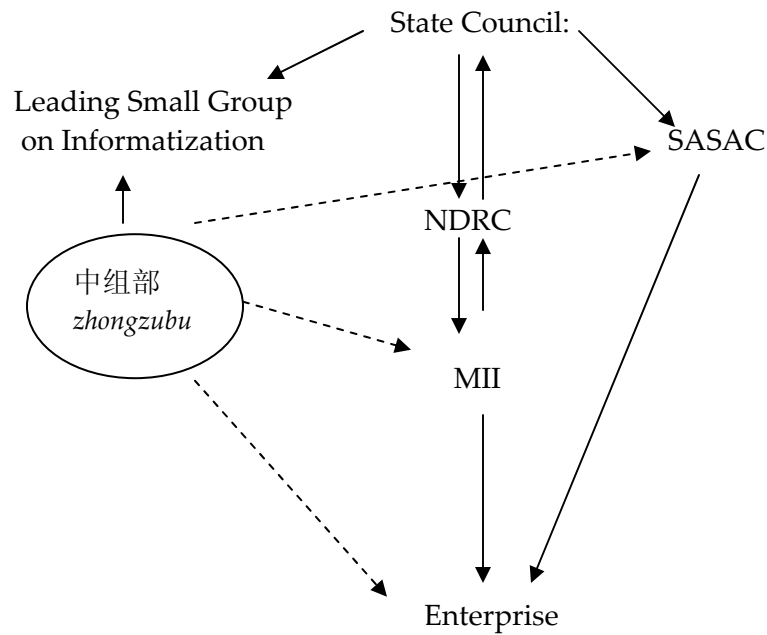
⁴² "More State-owned Firms could Merge," *China Daily* (August 3, 2005)

Another role of the central SASAC is to appoint the top executives and senior managers of the telecom firms. Although the appointment is first recommended by the Party Committee of each firm and the Department of Organization of the CCP, the formal right of personnel management in telecom firms is in the hands of the central SASAC.⁴³ In addition, SASAC retains the authority to ask government officials or the top and senior executives of the six leading telecom firms to move their positions, and this actually occurred to in 2004. The case is not confined to the major telecom service firms. In effect, one senior manager in Putian Telecom, one of the major telecom equipment firms in China, was working in China Telecom, but he had to move his job to Putian although he did not wish to.⁴⁴

⁴³ Interview in CASS, Beijing (Feb. 2006); Also see, John Ure. 2006. "Study on the Future Opportunities and Challenges of EU-China Trade and Investment Relations: Study 10 Telecommunications Service" p. 29.

⁴⁴ Interview in Putian, Beijing (Feb. 2006)

Figure 4-3: Governing Structure of Telecom Industry



* “-----” indicating personnel decision

Sources: Based on the author’s interviews in Beijing, China (December 2005; January – February 2006)

Likewise, each function of SASAC and the NDRC shows that SASAC holds more concentrated powerful regulatory control than the NDRC in the telecom service sector. In order to supervise the management of crucial state assets from the profitable telecom sector more effectively, SASAC is given a more extended scope of regulation in governing the business of telecom firms. While I will extensively discuss the growing power of SASAC later, in the telecom sector, SASAC has charge of not only asset and personnel management, as in other central SOEs, but also market restructuring and budget control. In addition, the central SOE-dominated structure of the sector contributes to empowering the function of SASAC. On the other hand, the NDRC in the sector is less powerful than SASAC due to the

overlapped authority in regulation. In contrast to the auto industry, where the NDRC may make the final decisions on market entry or major investment projects, the NDRC in the telecom service sector shares the regulatory control with the MII concerning setting service fees and making industrial policies.

The State Council

Finally, and most importantly, the State Council holds the most powerful authority in governing state industries in China, because most significant policies are required to receive final approval from the State Council. Even though the MII is the official state agency responsible for the regulatory control of the telecom industry, the State Council is a much more powerful government body than the MII.⁴⁵ The role of the State Council in the telecom industry is particularly notable in that market entry, service fees, and the restructuring of the market are controlled and finally determined by the State Council. Especially, new market entry is wholly decided by the State Council based on Regulation on Telecom Management (*dianxin guanli tiaoli*) and Government Statue of the State Council (*guowuyuan zhengling*). As to the service fee, both the MII and the NDRC are allowed to design and suggest their own policies to be considered, but the final decision-making authority is the State Council. While the MII attempts to set service fee policies considering overall market competition and consumer demands, the NDRC suggests the level of service fee that is compatible with maintaining macroeconomic development and stability. However, the final decision on the service fee is made by the State Council, neither the MII nor the

⁴⁵ Subject Division Group for the Research of the Governmental Control over the Natural Monopoly Industry (2003: 7)

NDRC.⁴⁶ Excepting the protection of consumer interests, the State Council and the Central Enterprise Work Group (*zhongyang qiye gongwei*), restructured into the SASAC in 2003, affect a relatively larger influence on regulatory policies and control than the MII.⁴⁷

Centralized Hard Regulation in China's Telecom Industry

The MII and its separation of China Telecom has been regarded as a benchmark to show changing government-business relations in the telecom industry. The MII as a regulator encourages fair competition and oversees the business of telecom firms by various rules. Yet the newly established SASAC serves as an overseer of telecom firms and is becoming the dominant actor in telecom regulation. Originated from the Central Enterprise Work Group (*zhongyang qiye gongwei*), which was under the direct leadership of the Standing Committee of the Politburo of the CCP,⁴⁸ SASAC controls personnel as well as supervises the state assets of large telecom operators. SASAC is exerting more substantial influence on the operation of telecom firms than the MII.⁴⁹ In identifying how the Chinese state governs the telecom service industry, that is, the government-business relations in the sector, therefore, we need to pay more attention to the rapidly growing power of SASAC in managing the telecom industry. As the primary characteristic of the new regulatory mechanism, this section discusses the empowerment of SASAC and its means of control, the continued strong

⁴⁶ Liu and Fei (2006: 229)

⁴⁷ Subject Division Group for the Research of the Governmental Control over the Natural Monopoly Industry (2003: 14)

⁴⁸ Naughton (2003: 8)

⁴⁹ FN. 47

voices of the party organs, the roles of the Leading Small Group of Informatization, and thereby the limited power of the MII. Then, two policies, price and market entry, are examined to exhibit how the central party-state employs strict control over the telecom industry in China.

Empowering the SASAC

In the case of China's telecom regulation, the empowerment of SASAC is particularly remarkable as a new powerful state institution. As the new overseer of telecom service firms, understanding the roles and influence of SASAC on the telecom firms is critical in accounting for how the telecom industry is governed in China. This also illuminates the larger relationship between government and strategic state industries in the Chinese political economy.

Since the regulatory reforms, the dismantling and restructuring of the MPT into the MII and the separation of China Telecom from the MII in 1999 are seen as efforts by the Chinese government toward regulatory governance in the telecom service industry. Yet, the persistent public ownership in the sector invites another form of state control, and particularly its centralized state ownership has been empowering SASAC in governing the business of telecom firms. While the Chinese leadership contends that the division of China Telecom from the MII presents the successful implementation of the "separation government from business" (*zhengqi fenkai*), SASAC as the new overseer of the firms is deeply engaged in the overall management of telecom firms, as well as in organizing the market structure. The

power of SASAC in the telecom service sector comes from exclusively centralized state ownership, which makes it possible for SASAC to create a mechanism for coherent central control over the telecom firms. While foreign investors are steadily open to China's basic telecom service, still rare, privately-owned firms are not allowed to be service carriers. As Lance Gore early argues, "the significance of continued public ownership is that it ties enterprises vertically to the state's command structure through state agencies to whom property rights are delegated. This vertical tie allows the organizational structure of the party-state to continue to structure the otherwise market economy."⁵⁰

In principle, SASAC is designed to be responsible mainly for supervising the management of crucial state assets of central SOEs, but its functions come to be more and more comprehensive in the telecom market. One Chinese telecom scholar even warns against overwhelming intervention of SASAC in the telecom industry and holds that many problems in the industry result from SASAC's overstepping in the management of the telecom industry.⁵¹ He argues that the growing role of SASAC in the telecom sector is problematic, for SASAC basically does not comprehend the operation of the telecom business area.⁵² The major means of control that SASAC employs are: 1) restructuring (*zhongzu*), 2) control over budget management, and 3) personnel.

⁵⁰ Lance Gore, 1999, "The Communist Legacy in Post-Mao Economic Growth," *The China Journal*, 41 (January)

⁵¹ Kan Kaili, "The SASAC Should Stop Going Beyond Its Authority over the Management of Telecom Industry Development," (Feb 28, 2007), <http://www.cwww.net.cn/control/2007/2/57870.htm> (Access: March 25, 2007)

⁵² *Ibid*

SASAC's TOOLS OF CONTROL

Restructuring (*chongzu* 重组): Through a series of regulatory reforms in China's industrial economy, one of the crucial indications of movement toward a market-oriented economy is a transformation of the mode of economic governance from direct governmental control to a rule-based regulatory mechanism. Rather than relying on state planning or price controls, state institutions make an aggregate effort to reform and steer the economy through "market forces." As the new supervisor of telecom firms, SASAC has already started to address the importance and need for the structural adjustment of the telecom market. In April 2005, the head of SASAC, Li Rongrong, pointed out the problem of duplicated investment among the six telecom firms, which, he perceived, becomes unfavorable for the overall development of the telecom industry, as well as for preparing incoming 3G (third generation) mobile communications services.⁵³ With the creation of an official ordinance in December 2006, SASAC ensures the importance of enhancing the structural adjustment of large state-owned enterprises in order to facilitate an effective resource distribution of enterprises. In particular, this document emphasizes that SASAC will continue to push forward and complete the reform and restructuring of the telecom, electricity, and civil aviation industries.⁵⁴ SASAC reaffirms in "The Review of 2006 Work of Planning and Development and the Thought on 2007 Major Task" its vigorous

⁵³ "The SASAC's Head Li Rongrong: China's Telecom Industry Should be Restructured," (*Guoziwei Zhuren Li Rongrong: Zhongguo Dianxinye Kending Yao Zhongzu*) *Beijing Evening News* (*Beijing Wan Bao*), April 18, 2005.

⁵⁴ "Guanyu Tuijin Guoyou Ziben Tiaozheng he Guoyou Qiye Zhongzu de Zhidao Yijian," December 18, 2006, <http://finance.sina.com.cn/g/20061218/11133173443.shtml> (Access: March 27, 2007)

efforts to enhance the strategic adjustment of telecom enterprises and to encourage market competition.⁵⁵

Rumors of splits and mergers of the telecom service carriers have been growing since 2005. There was a proposal to merge the leading four firms into two carriers. According to this plan, China Mobile and China Netcom would be merged into one company; China Unicom and China Telecom would be integrated into another firm.⁵⁶ On the other hand, the NDRC suggests the split of China Unicom's GSM (Global System for Mobile communications) and CDMA (Code Division Multiple Access) networks and merging with China Telecom and China Netcom, which provide fixed-line services but are eager to start mobile service business. This proposal was not adopted.

The supervisory SASAC often emphasizes the need and importance of structural adjustment in the telecom market to formulate effective competition and enhance the value of crucial state assets. Based on a recently released regulation, SASAC will continue to push forward the completion of reform and restructuring in the telecom industry.⁵⁷ Although one high official of the MII states that "China Unicom will not be split and merged into other companies, and we have no specific plan to restructure,"⁵⁸ the formal authority to control the operation of telecom firms is in the hands of the SASAC. As clearly specified in Li Rongrong's official statement, the aim of SASAC is to make the central state-owned enterprises large-scale national

⁵⁵ "2006 Nian Guihua Fazhan Gongzuo Huigu Ji 2007 nian Zhongdian Gongzuo Silu" March 6, 2007, <http://finance.sina.com.cn/g/20070306/11431246652.shtml> (Access: March 27, 2007)

⁵⁶ It is not clearly identified where this plan comes from. Li Weitao. 2005. "End of the Road for China Unicom?" *China Daily* (January 19)

⁵⁷ "Guanyu Tuijin Guoyou Ziben Tiaozheng he Guoyou Qiye Zhongzu de Zhidao Yijian"

⁵⁸ Zhou GuangXX. 2007. "Development, China's Telecom Industry Melody in 2006," (*Fazhan, 2006 Woguo Dianxinye Zhu Xuanlu*), March 17, <http://it.sohu.com/20060317/n242338200.shtml> (Access: March 24, 2007)

champions. Specifically, SASAC has a plan to organize 80~100 of the large central SOEs, including making 30~50 competitive central SOEs in the international market by 2010.⁵⁹ For this purpose, SASAC reduced the number of central SOEs from 196 in 2003 to 169 in 2006; it has been further reduced to 159 as of 2007.⁶⁰ Four large central telecom carriers, China Telecom, China Netcom, China Mobile, and China Unicom, are inevitably restructured by SASAC. One Chinese scholar in the BUPT asserts that “the market restructuring not by the market forces but by state institution policy cannot be as much effective as planned. These administrative instruments by the SASAC should be abolished; we have to let the market play a role in facilitating the restructuring telecom market.”⁶¹

Control over Budget Management: As the special state institution under the direct leadership of the State Council, the main responsibility of SASAC is to supervise and administer the security and the increase of value of crucial state assets. While the supervision of asset management exerts indirect influence on the actual business operation, the newly established “state capital budget system” (*guoyou zichan yusuan zhi*) gives SASAC considerable authority to control the financial management of central state firms. Under the authority of SASAC, the state capital budget system requires central state firms to remit some portions of after-tax profits and revenues from investment or restructuring to SASAC. And, expenditures for investment in new business projects or the planning of central state firms require approval from SASAC.

⁵⁹ *Ibid.*

⁶⁰ See the official list of China’s central state-owned enterprises in 2007, <http://www.sasac.gov.cn/zyqy/qym/default.htm> (Access: March 27, 2007)

⁶¹ Kan Kaili, <http://it.sohu.com/20060317/n242338200.shtml> (Access: March 24, 2007)

The idea of the state capital budget was initiated by some Chinese scholars when SASAC was set up in 2003.⁶² Moreover, Article 13 of the Interim Regulations on Supervision and Management of State-owned Assets of Enterprises refers to “SASAC may formulate rules and systems on state-owned assets supervision and administration of enterprises,”⁶³ and leaves room for making supplemental rules and regulations. According to this, the new regulations on the budget and investments management of state firms are framed by SASAC. After numerous discussions and negotiations among principal state agencies, a new budget system under the authority of SASAC officially got the office through the approval of the Ministry of Finance (MOF) in 2004, for it is part of the government budget administered by the MOF.⁶⁴ One the one hand, the revenue of a state capital budget includes revenue from state capital management, transferred state capital property rights, and disposed state capital. On the other hand, expenditures of a state capital management budget include expenditures from investment, business management, and loans.⁶⁵ This state capital budget management system allows SASAC to approve the enforcement of budgets and settlements of accounts for central state enterprises, to monitor the procedures of

⁶² *Ibid*

⁶³ Decree of the State Council of the People’s Republic of China, No. 378, “Interim Regulations on Supervision and Management of State-owned Assets of Enterprises” (May 2003), http://www.sasac.gov.cn/eng/eng_zcfg/eng_zcfg_0001.htm (Access: April 2, 2007)

⁶⁴ Barry Naughton, 2006 “Claiming Profit for the State: SASAC and the Capital Management Budget,” *China Leadership Monitor*, No. 18 (Spring), p. 5

⁶⁵ “The SASAC Implements the Authority for Asset Supervision, and Its Budget System will Penetrate Telecom Enterprises,” (*Guozhiwei Luoshi Zichan Jiandu Chuanli Yusanzhi Shenru Dianxin Qiye*), *Telecom Industry Daily (Dianxin Chanye Bao)*, March 21, 2005 (Access: March 25, 2007)

⁶⁵ Naughton (2006: 5)

budget enforcement, and to determine whether the content accords with the development and planning of business management.⁶⁶

The ultimate aim of the state capital budget system is to improve efficiency in managing state capital. By doing so, it not only facilitates the effective distribution of budget and supervisory functions, but also tightens control over state capital. It may eventually lead to accelerating the best allocation of state assets and reform of the state asset management system.⁶⁷ One scholar at the Research Institute of the MOF holds that the state capital budget system also contributes profits from state assets to complement the deficiency of social security funds in China.⁶⁸ However, regardless of these numerous potential benefits, the state capital budget system is clearly a powerful instrument of control over “the largest and most profitable centrally-run corporations.”⁶⁹ This also means that the largest state firms in China’s strategic industries become more susceptible to the voices of SASAC. In effect, SASAC starts to implement the state capital budget system in telecom enterprises, and its intervention steadily penetrates the business operation of telecom enterprises.⁷⁰

As of 2006, SASAC has reconfirmed its absolute control (*juedui kongzhili*) over the telecom industry, including six other key sectors, for they closely relate to

⁶⁶ “The SASAC Implements the Authority for Asset Supervision, and Its Budget System will Penetrate Telecom Enterprises,” (*Guoziwei Luoshi Zichan Jiandu Chuanli Yusan zhi Shenru Dianxin Qiye*), *Telecom Industry Daily* (*Dianxin Chanye Bao*), March 21, 2005 (Access: March 25, 2007)

⁶⁷ Zhao Yunqi, “State Capital Management Budget Would Control Enterprise Lifelines,” *Zhongguo Caijing Bao* (*China Finance Daily*), September 23, 2005, http://www.cfen.cn/loginCt/pageprocess?pageurl=bzbm/2005-09/23/content_166542.jsp (Access: April 2, 2007)

⁶⁸ *Ibid*

⁶⁹ Naughton (2006: 2)

⁷⁰ “Guoziwei Luoshi Zichan Jianguan Quanli Yusan zhi Jiang Shenru Dianxin Qiye,” *Telecom Industry Daily* (March 21, 2005)

the national economy and security.⁷¹ Before the state capital budget system appeared, as an investor (*chuziren*) and the biggest shareholder, SASAC had been exerting great influence on the business of telecom enterprises, particularly when four major telecom carriers attained listings in foreign stock markets.⁷² The new system of a state capital budget allows SASAC to control more details of financial management in telecom corporations. One deputy director of the Research Institute of SASAC argues that the state capital budget system is designed to prevent excessive investment in 3G businesses as well as to encourage the building-up of long-term development and planning in telecom corporations.⁷³ Furthermore, after-tax profits remitted to SASAC can be used for the future development of 3G firms and construct a useful comprehensive financial power. In effect, it indicates the growing power of SASAC over central state firms. Some contend that “this new system gives SASAC new resources and various options for carrying out continuous restructuring of the state sector. In the process, it would make SASAC a much stronger and more influential organization.”⁷⁴

Through a state capital management budget system, SASAC comes to have substantial power to control expenditures and monitor the flows of revenue of state firms. The supervision of enterprises’ budget management is indirect interference in business, for SASAC is not involved in daily business management, such as specific production volume or the development strategy of corporations.

⁷¹ Other six industries include military, electricity, oil and chemistry, coal, civil aviation, shipping. The SASAC “*Guanyu Tuijin Guoyou Ziben Tiaozheng he Guoyou Qiye Zhongzu de Zhidao Yijian*” (December 25, 2006), <http://finance.sina.com.cn/g/20061218/1133173443.shtml> (Access: March 27, 2007)

⁷² Fn. 63

⁷³ Fn. 55

⁷⁴ Naughton (2006: 8)

Personnel (renmian 任免): The control of personnel has been used as a key instrument for political control in China.⁷⁵ SASAC maintains formal authority to appoint and remove top executives of central state-owned enterprises, including the six leading telecom service firms, under coordination with the Department of Organization (*zhongzubu*) of the CCP. In that most top executives of telecom firms are party members, the Party organization *Zhongzubu* takes charge of evaluating and appointing cadres. The Department of Organization delegates the right of personnel selection to SASAC, much of the actual work of managing top leaders of central state-owned telecom enterprises, even though SASAC's administration remains a "rubber stamp" that formally approves the decisions made by the party.

As the *de facto* supervisor of telecom operators, SASAC not only appoints, but also continues to rotate top leaders and senior managers of telecom carriers without pre-consultation or notice. The first extensive rotation occurred in 2004, indicating arbitrary government interference and an ambiguous decision-making process in the management of the telecom business. Starting with the move of Zhang Chunjiang, the former vice-minister of the MII, to the CEO of China Netcom in 2003, SASAC carried out major reappointments in 2004: China Mobile's vice-president, Wang Xiaochu, changed his position to board chair and CEO of China Telecom; the former China Unicom's board chair and president, Wang Jianzhou, was asked to move to the competitor China Mobile; Chang Xiaobing, the vice-president of China Telecom, was appointed as the new board chair of China Unicom.⁷⁶ One general manager working in Putian Telecom, which is not a telecom service carrier but an

⁷⁵ Shirk (1993: 182 – 190); Huang (1996)

⁷⁶ Li (2006: 14)

equipment firm, says that “I was enjoying working in China Telecom, but one day I was reassigned to be senior manager of Putian by the government. Where I work is not my choice, even though I do not want to change the job, because we are working in state-owned enterprises. Our actual boss is the government, not the board of director or the president of enterprises.”⁷⁷ As such, SASAC may control these business elites of the telecom industry through tenure appointments. One faculty member at Beijing University of Post and Telecommunications points out that “the SASAC rotates the top executives of leading telecom firms in order to prevent them from the rent-seeking and growing corruption problems in high level cadres.”⁷⁸ In effect, Minxin Pei holds that China’s telecom industry is “a huge source of rent generation because it employs a large number of employees, invests massive capitals, and collects monopoly rents.”⁷⁹

Continued Strong Hand of the Party

Although the function and influence of the Chinese Communist Party on the business management of telecom enterprises is not clearly specified in public, particularly in foreign stock markets, the Party is still continuing to play a pivotal role in business. Since large central state-owned enterprises have been fully managed by the CCP,⁸⁰ the legacy of party control remains strong. The major channels of control are the

⁷⁷ Interview in Putian Telecom, Beijing (Feb. 2006)

⁷⁸ Interview, BUPT, Beijing (December 2005)

⁷⁹ Pei (2006: 108)

⁸⁰ Dominic Barton and Richard He Huang. 2007. “Governing China’s Boards: An Interview with John Thornton,” *The McKinsey Quarterly*, 1: 99-107.

Department of Organization (*zhongzubu*) of the CCP and the Party Committee (*dangwei*) within the firms.

In fact, the importance of the Department of Organization of the CCP (hereafter the DO) did not arise in interviews in the field with Chinese telecom experts, including government officials, policy-makers, entrepreneur, scholars, and journalists. In the early stage of interviews, without my question, one interviewee voluntarily explained the significant influence of the DO, because the tenure of high level officials of the government (i.e. MII) and senior managers of telecom SOEs are evaluated and nominated by the DO.⁸¹ While SASAC also has the right to appoint top executives and senior managers of state-owned telecom enterprises, substantial evaluations and decisions on either appointment or removal are carried out by the DO, whose main job is to nominate leading cadre (*ganbu renmian*). By creating political incentives, this authority of personnel by the DO constrains the independent function of the MII and keeps maintaining invisible sticky ties between the Party and telecom enterprises.⁸² Moreover, the appointment and removal by the DO is often based not on expertise but on personal relations (*guanxi*) or loyalties to the Party, a practice which is becoming a serious obstacle to future development and reform in the telecom industry.⁸³

While the DO operates as the external mechanism to exert political control (i.e. personnel) over the management of telecom corporations, the party committee (*dangwei*) is placed inside the firms and constitutes the central organization with the board of directors. The party committee in telecom corporations is not the

⁸¹ Interview in BUPT, Beijing (December 2005)

⁸² Interview with Yu Hui in the Institute of Industrial Economy of the CASS, Beijing (January, 2006)

⁸³ Interview in CASS, Beijing (January 2006)

administrative or economic organization (*zuzhi*) but the “political” organization.⁸⁴ Its core task is to ensure that the policies and guidelines of the communist party are well reflected and implemented in business. Its political functions are demonstrated through participation in three ways: 1) all major corporate decisions, 2) management of personnel resources including the control of cadres, and 3) enforcement of supervision.⁸⁵

First, by taking up principal positions in enterprises, the party committee exercises influential power on important corporate decisions. This is significant because most big decisions in enterprises often directly relate to the party’s guidance, directions, and policies. It is believed that the party committee’s central position in state-owned enterprises helps ensure that the business planning and policies of enterprises concord with the directed lines of the party and state. For China’s top leadership, production management and development of telecom corporations particularly count, due to its enormous effect on employment and revenue of the national economy. Second, by holding most of the principal positions in the firms, the party committee can be certain of the actual enforcement of the party’s principles and rules in the firms’ operations. Finally, the party committee is responsible for securing the supervision of the business performance of telecom enterprises and the leading cadres. It mainly monitors whether there are mistakes in the management and reform of large-scale production, and if corruption occurs when the leading cadres of the firms exercise their authority.

⁸⁴ Wang Sanwen. 2002. “*Xiandai Dianxin Qiye Dangwei Shishi Zhengzhi Lingdao de Sikao*”, http://www.chinatelecom.com.cn/sxgz/01/02/t20060116_1679.htm (Access: March 22, 2007). Wang Sanwen serves as deputy secretary of the party committee in Shanghai’s Telecom Corporations as of 2002.

⁸⁵ *Ibid*

Second, with listing major telecom corporations in the Hong Kong and New York stock markets, China's telecom enterprises established boards of directors and actively introduced the Western concept of corporate governance. Yet, the chairmen of the boards of directors in all four major telecom corporations are concurrently serving as the party secretary, which is the head of the party committee; members of the board belong to the party committee at the same time. The party's dominant occupation of key leadership positions is remarkable, and the top executives of telecom firms wear multiple hats at the same time. For example, China's Telecom's CEO (*zongzai*), Wang Xiaochu, serves as the chairperson (*dongshizhang*) of the board of directors and the party secretary (*dangzu shuji*) simultaneously. Likewise, China Mobile's CEO, Wang Jianzhou, is the party secretary and the chair of the board, and China Netcom's CEO, Zhang Chunjiang, is also the party secretary and the chair of the board.

Table 4-3: Three Hats of Telecom Firm Leaders

	China Telecom	China Mobile	China Netcom
CEO (<i>zongzai</i>)	Wang Xiaochu	Wang Jianzhu	Zhang Chunjian
Chairman of the Board of Directors (<i>dongshizhang</i>)	Wang Xiaochu	Wang Jianzhu	Zhang Chunjian
Party Secretary (<i>dang shuji</i>)	Wang Xiaochu	Wang Jianzhu	Zhang Chunjian

Moreover, senior executives and members of the party committee in China's large state-owned enterprises substantially overlap; "all senior executives serve on the party committee except those recruited from abroad and from multinationals operating in China."⁸⁶ Four major telecom corporations exhibit this case exactly; the board of directors is dominated by members of the party committee. The board of directors in China Telecom consists of 14 members; the chairman and 7 executive directors are occupied by members of the party committee.⁸⁷ China Unicom's board of directors is organized with 13 members; 8 executive directors of the board are members of the party committee.⁸⁸ China Mobile's senior management consists of 7 top executives: one president, five vice-presidents, and one chief technology officer. All of them simultaneously serve as members of the party committee.⁸⁹ While China Netcom has a more diverse composition of its board of directors than the other telecom firms, 5 key positions out of 14, the chairman and four executive directors, are still dominated by party members.⁹⁰

This clearly demonstrates how regulatory and corporate reforms in Chinese enterprises actually have been constrained by the party's leadership as long as they remain state-owned. In other words, even though the Chinese government has been actively transforming wholly state-owned enterprises into the form of share-holding corporations with the constitution of a board of directors, these efforts to modernize

⁸⁶ Richard He Huang and Gordon Orr, 2007 "China's State-owned Enterprise: Board Governance and the Communist Party," *The McKinsey Quarterly*, Number 1, p. 110.

⁸⁷ China Telecom official website and the author's data bank, <http://www.chinatelecom-h.com/eng/management/directors.htm>

⁸⁸ China Unicom official website, <http://www.chinaunicom.com.hk/en/aboutus/bods.html>

⁸⁹ China Mobile Annual Report, 2005

⁹⁰ "Investor Relations: Corporate Governance" China Netcom, <http://www.China-netcom.com/english/inv/CorporateGovernance.htm>

the enterprise system are in practice bounded by the party. As indicated earlier, it is because the ultimate key corporate decisions are made by the party secretary, who is both the chairman of the board and the CEO. Zhang Chunjiang certifies the role of the party secretary in state-owned enterprise in one interview, saying that “I am Netcom’s Party Secretary. My responsibility is to ensure that the direction of our Communist Party is upheld within China Netcom.”⁹¹

Paradoxically, China Netcom, under the strong leadership of Zhang Chunjiang, spearheads reforming corporate governance, aiming to be a model for other large state-owned enterprises in China. Zhang emphasizes the importance of introducing a global standard of corporate governance to China Netcom, and the firm launches the management consulting with McKinsey and invites independent directors to the board, such as the former chairman of Goldman Sachs, John Thornton, and the Chinese corporate governance economist, Qian Yingyi.⁹² China Netcom is in effect evaluated as the most energetic in terms of corporate reform by strengthening its board of directors and clarifying the roles of the party committee in business management. However, as China Netcom shows, the reforms in the telecom industry are not necessarily designed to dilute the political power of the party in the business management of telecom corporations in China. Rather the hand of the party remains strong in governing the telecom business.

⁹¹ Tong Chuan. 2006. “Why is China’s Telecommunications Market So Profitable?” *The Epoch Times* (October 11)

⁹² *Ibid*

Leading Small Group on Informatization

The establishment of the Leading Small Group on Informatization (*xinxihua gongzuo lingdao xiaozu*), directly under the State Council, shows the strategic importance of the telecom industry in China. Its members are made up of “representatives from nearly 20 ministerial and state-level organizations, including Ministry of Electronic Industry (MEI), Ministry of Post and Telecommunications (MPT), and Ministry of Radio, Film and Television (MRFT).”⁹³ It was first organized as a supra-ministerial body in 1996, mainly playing the role of “watchdog” for the effective implementation of government regulations and policies in the telecom market.⁹⁴ Its task also included the drafting of telecom industrial policy, aiming to attenuate the monopolized power of the MPT, but it was not effective. The MPT could continue to make and submit drafts of telecom policies and regulations to the State Council despite the internal check system by the Leading Small Group.

While the Leading Group was temporarily dismantled in 1999, the State Council and the CCP continuously emphasized the importance of state informatization development. In 2001, the National Leading Small Group on Informatization (*guojia xinxihua lingdao xiaozu*) was reconstructed, highlighting the promotion of building up the Information Society in China.⁹⁵ The prime minister serves as the director of the Group, and there are 4 vice-directors: 2 vice-prime ministers, one member of the standing committee of the political bureau, and one

⁹³ Special Report, 1997 “Untangling China’s Datacom Networks,” *The China Business Review*, 24 (5)

⁹⁴ *Ibid*

⁹⁵ “The Leading Group on Informatization of the State Council,” (*guowuyuan xinxihua lingdao*), <http://www.jjzy.cn/bbs/simple/index.php?t5052.html> (Access: March 20, 2007)

member of the political bureau.⁹⁶ Just like the makeup of SASAC, the Group is “a joint venture of the State Council and the Chinese Communist Party,”⁹⁷ with each having 50 % of the seats. Led by this leadership, the Group consists of 25 members who are all minister-level leaders.⁹⁸ This reveals how strongly China’s top leadership has put an emphasis on the strategic development of the telecom industry with other parts of the information industry. The Leading Group takes responsibility for deliberating on a number of issues, such as development strategies of the information industry (i.e. telecom or electronic), macro planning, related rules, the drafting and decision-making of important policies, and the overall coordination of development strategies and industrial policies for state informatization and security.⁹⁹

Most importantly, policies and regulations in Chinese industrial economies require final approval from the State Council. In the telecom service sector, the Leading Small Group directly underneath the State Council plays the key role of top policy decision-maker. China’s influential business magazine, *Caijing*, argues that the State Council’s Leading Small Group can be seen as the “architect” (*shejishi*) designing a new system of regulation to govern the telecom industry.¹⁰⁰ While it was first established to monitor and restrain the power of the monopolized MPT, its supervisory function was shifted to the MII. Greater emphasis on promoting industrial development, rather than enforcing fair rules of competition in the telecom market, shows the pattern of regulation over the telecom industry. It also demonstrates that

⁹⁶ *Ibid*

⁹⁷ Naughton (2003: 8)

⁹⁸ “Guoyuanban Zhao Xiaoping XX Zhongguo Xinxi Ziyuan Kaifa Zai liyong,” January 17, 2007, <http://www.sina.com.cn> (Access: March 22, 2007)

⁹⁹ “Guoyuanban Zhao Xiaoping XX Zhongguo Xinxi Ziyuan Kaifa Zai liyong,” January 17, 2007, <http://www.sina.com.cn> (Access: March 22, 2007)

¹⁰⁰ “Tiaowang: Hou zhe fen shidai” *Caijing* (March 26, 2002)

China's telecom industry is actually regulated by "political authority" rather than by market forces.

Constrained Regulator, the Ministry of Information Industry

The creation of a regulatory institution is one formal benchmark in demonstrating state efforts toward regulatory reform. Throughout the administrative restructuring programs, the Chinese state abolished the bulk of industrial ministries, but the notable exception to this movement is the creation of the telecommunications regulator, the Ministry of Information Industry (MII). As discussed earlier, the main responsibility of the MII is to facilitate and monitor fair competition among telecom service carriers. However, the regulatory oversight of the MII in the telecom market has been considerably constrained, due to the internal governing structure and poor coordination among state institutions resulting from institutional deficiency in balancing and constraining mutual interests.

As for the internal governing structures of China's telecom industry, even though the MII is the formal regulator, above the MII there are the party and two powerful comprehensive state institutions: the NDRC and the SASAC. The MII in China's telecom industry is known as "the regulator (*jianguan jigou*)," but it is a state-designated *administrative* agency in order to meet WTO agreements.¹⁰¹

¹⁰¹ Regulation can be translated into "*jianguan*" or "*guizhi*." They have similar meaning but slightly different usage. The former denotes more like "administrative base, while the latter originated from Japan and is used in legal context. Therefore, *jianguan* is generally accepted when we refer to the regulatory state agency. Interview with Zhang Xinzhu, CASS, Beijing (Feb 2006). According to China's bilateral WTO Agreement with the U.S., "China has agreed to implement the pro-competitive regulatory principles embodied in the Basic Telecommunications Agreement, including independent regulatory authority. "Summary of U.S. – China Bilateral WTO Agreement,"

Therefore, although the MII is mainly responsible for promoting and supervising fair competition in the telecom market, it is not free from government. Unlike the Anglo-American independent regulator model, the regulation of the MII is constrained by these top party-state institutions as long as it remains a “government agency.” Since the MII is institutionally subordinated to the NDRC, most industrial policies and regulations drafted by the MII are reviewed by the NDRC. In particular, the MII has the right to participate in the policy decision-making process of setting telecom service fees, but it should consult with the Price Bureau (*wujia ju*, 物价局) under the NDRC and local governments, because telecom service fees significantly affect the overall local economy. As such, although the MII encourages market competition, service fees are determined not by market competition among firms, but by state institutions in the name of the security of the national economy. However, one Chinese scholar holds that even though the MII does not have the final say on service fees, what counts is that the MII is allowed to participate in the price policy-making process. He said this is why regulatory reform in the telecom industry is evaluated as more successful than other network industries.¹⁰²

The oversight of the MII is also restrained by the rising power of SASAC, which asserts a great influence on the business management of telecom corporations in China. While the MII is mainly in charge of breaking up the monopolized market structure and enhancing fair competition in the telecom market, it does not retain substantial authority to direct the market players, telecom operators. The competition

The White House Office of Public Liason (November 17, 1999),
<http://www.uschina.org/public/991115a.html> (Access: July 20, 2007)

¹⁰² Interview with Zhang Xinzhu, the Research Center for Regulation and Competition of the CASS, Beijing (February 2006)

in the telecom market is heavily structured and controlled by SASAC, the overseer of telecom firms in China.¹⁰³ In other words, the norm of competition is encouraged and enforced by the MII, but the actual competition among telecom service carriers is managed by SASAC. Contrary to the MII's emphasis on competition, SASAC, in effect, ensures its plan to create national champions by merger or acquisition aiming to create 80 ~ 100 globally competitive corporations by 2010.

Thus, SASAC is less interested in breaking up the monopoly in the telecom market. While there are four major companies in China's telecom service sector, only two players, China Telecom and China Mobile, dominate the fixed-line and mobile service. How to structure competition is in the hands of SASAC, not the MII. Moreover, the MII is fettered not only by state institutions but also the party, for senior officials of the MII are nominated by the Department of Organization of the CCP. If regulatory oversight is "structurally" constrained by two top comprehensive state institutions, the party exerts political control over the MII through the powerful means of personnel. A number of interviewees confirm that even though the MII was established to assume independent regulation, there are pressures behind the playing field, and they relate to the political interests of the CCP cadres who occupy the top positions of the MII.¹⁰⁴

A more problematic issue is that personnel decisions are often carried out based not on the expertise of candidates but the personal relations (*guanxi*) and interests of the CCP. One interviewee, who is the Chinese expert in regulatory reform

¹⁰³ Interview with Wang Xiaodong, the CASS, Beijing (February 2006)

¹⁰⁴ Interviews in the Center for Informatization Study of the CASS (January 2006); the Beijing University of Post and Telecommunications (January 2006); the Institute of Industry Economics (January 2006); the Institute of Law of the CASS (February 2006). Some of them assert that the CCP is the most powerful body in China's telecom reform.

of infrastructure industries, clearly indicates that this could be an obstacle to the effective reform and future development of the telecom industry.¹⁰⁵ Also, the continued sticky relations between the MII and the telecom enterprises are identified by the origins of the personnel. Top executives of telecom firms and high level MII officials are often exchanged by order of SASAC. A representative example is the exchange of position between Zhang Chunjiang, who was the vice minister of the MII and now serves on the CEO of China Netcom, and Xi Guohua who was the president of China Netcom but currently holds Zhang's former position at the MII.¹⁰⁶ In many cases, senior officials of the central or local bureau of the MII move to telecom enterprises, and vice versa. For example, Zhao Jibin, who assumed the head of the Zhengzhou Railway Bureau, is currently serving as the chairman of the board of directors in China Railcom.

Effective oversight of the MII is also limited by poor coordination (*xietiao*) with other state institutions involved in policymaking and implementation. Compared with the auto industry, the division of labor is transparent among the top state institutions, but often overlapped responsibilities produce different voices and make regulation of the MII less productive. Although the recent remarkable regulatory reforms in the telecom industry (i.e. the establishment of the MII, the separation China Telecom from the MII, and the entry of new players) have brought about much progress in corporate governance, the lack of an internal system to adjust mutual interests appears to be an obstacle to the effective regulatory function of the MII.

¹⁰⁵ Interview, in the Institute of Industry Economics of the CASS (January 2006)

¹⁰⁶ Pearson (2005: 308)

Bounded Competition: Policies of Price and Market Entry

The Telecom Price (*zifei*) Policy

In China's telecom industry regulation, oversight over the service fee serves to represent the mechanism of state control as well as government – business relations. The supervision of telecom pricing is perceived as critical to the top leadership, because the service fee considerably affects the overall development of the telecom industry, including distribution of resources, consumers, managers, and market competition, as well as trading costs and efficiency in other industries.¹⁰⁷ In examining the telecom price policy, I will first account for the policy-making structure of the telecom service fee in China, and discuss who sets the rules of the game and who is in charge of supervising market competition. Then, the story of the telecom price wars, which reached a peak in 2004, and the government's immediate battle against it present insight into the central state's continued control over telecom service fees, despite growing market-oriented competition among companies. It also paradoxically demonstrates that even though market competition is encouraged, state institutions, including the MII, not only supervise but also control competition among administrative instruments.

Before the 1998 reform, the telecom service fee was set and regulated by the former planning body, the SPC, and the MPT. Within the boundary of regulations from the SPC and the MPT, the provincial price bureau (*wujia ju*) and provincial post and telecommunications administrations managed and monitored the telecom price of

¹⁰⁷ Li Deming, 2006, "Innovation of Regulation Policy in China's Telecom Service Fee," (*Woguo Dianxin Zifei Jianguan Zhengce Chuangxin*), *Telecommunications World (Dianxin Shijie)*, October 26

local telecom enterprises, which were basically subsidiaries of central telecom enterprises.¹⁰⁸ The initial stage of competitive telecom pricing was introduced by placing the market a principal body. The 2000 Telecom Regulations (*tiaoli*), the comprehensive legal regulations governing the telecom industry, however, manifested the government-set and government-led prices as the standard for the telecom service fee in China.

In formulating the level of telecom prices, Article 26 of Telecom Regulations said the government may consider diverse views from associated groups such as telecom service managers or subscribers through public hearings.¹⁰⁹ Responding to increasing competition in the telecom market, Telecom Regulations was issued in 2000 to provide both service providers and users with price setting rules. Its main principles are to facilitate competition and technology advancement.

Confronting a number of changes in the internal market environment and the WTO entry, the MII and the NDRC successively issued a series of legally valid notices (*tongzhi*) on telecom service fees. While the MII has the main responsibility for supervising the price of telecom enterprises, the specific rules are drafted by coordinating with the NDRC. The Ministry of Finance is also involved in both rule-making and overseeing of telecom service fees.¹¹⁰ But enactment is carried out only after the approval of the State Council. In other words, while the MII takes charge of overseeing price setting by telecom companies according to the 2000 Telecom

¹⁰⁸ Chen (1999: 128)

¹⁰⁹ The State Council, *Zhonghua Renmin Gongheguo Dianxin Tiaoli*, (September, 25 2000), <http://www.21ctn.com/principle/zcfg/5.htm> (Access: April 7, 2007)

¹¹⁰ The 2000 “the Notice concerning Adjusting the Structure of Telecom Fees” (*Guanyu Dianxin Zifei Jiegouxing Tiaozheng de Tongzhi*) was co-worked and promulgated by the MII, the SDPC (renamed as NDRC as of 2003), and the Ministry of Finance.

Regulations, both the MII and the NDRC have no final substantial authority to make decisions about telecom pricing; it must be ratified by the State Council.¹¹¹ This is also confirmed by a number of interviewees in Beijing.¹¹²

The story of price wars in basic telecom services shows the Chinese top leadership's strong will to put the telecom service sector under central regulation, even though the importance of competition has been continuously emphasized for better service and technology development. Besides cutting the price rate, companies have made use of a variety of promotional packages to attract consumers. In early 2001, price competition started to emerge and reached a climax in June 2004, which in the end gave rise to immediate government action to control the telecom market.

In fixed-line service, China Railcom kicked off the price competition with China Telecom by setting its service fee at half of the rate China Telecom charged. The most intensive competition occurred in the field of mobile service as the number of mobile service subscribers grew more quickly compared with the fixed-line users. The situation was escalated by the combative price cuts of China Mobile and China Unicom, two major mobile operators. In April 2003, Guangzhou Unicom (subsidiary of China Unicom) and Guangzhou Mobile (subsidiary of China Mobile) adopted a one-way tariff package in Guangzhou, which was contrary to the national two-way charge system.¹¹³ Consumers of Guangzhou Mobile, with a 20 yuan monthly fee, could enjoy free calls from the same network subscribers; Guangzhou Unicom's

¹¹¹ Huang Yunpeng, 2006, "Attacking the Fort of China's Telecom Reform," (*"Zhongguo Dianxin Gaige Gongjian"*) In edited by Liu Shijin and Feng Fei. *Longduan Hangye Gaige Gongjian*, p. 229

¹¹² Interview with scholar in DRC of the State Council, Beijing (February 2006); Research Center for Regulation and Competition of the CASS, Beijing (February 2006); the Academy of Telecom Research of the MII, Beijing (February 2006)

¹¹³ Two-way charge system is that the receiving call is not free.

GSM users paid a 10 yuan monthly fee and received free calls from other Unicom subscribers.¹¹⁴

In addition, the tools of competition were not confined to price cuts, but shifted to the “package promotion” (*taochan*). Telecom operators competitively provided potential consumers with enticing promotions, such as free wireless service, multi-media messaging, and online games and chatting.¹¹⁵ When the central SASAC dispatched a supervising panel to Guangzhou in order to investigate the state of the mobile service price wars in early 2004, Guangzhou Unicom’s profits as of January 2004 had decreased 60 million yuan. The situation of Guangzhou Mobile was similar. One manager of Guangzhou Mobile admitted that profit loss from the price wars in 2003 was 2.4 billion yuan.¹¹⁶ In the business of telecom operators, Guangdong province particularly takes an important position, for it makes up one sixth of the overall profits of telecom operators. As such, the price competition in Guangdong considerably affected the whole country’s telecom fees.¹¹⁷

Another catalyst to the mobile service fee cuts was the emergence of “Little Smart” (*Xiaolingtong*) in 2001.¹¹⁸ It is operated by China Telecom and China Netcom, whose original license is the fixed-line. Founded on fixed-line local network services, Xiaolingtong satisfied the demands of consumers, through one-way service charges, cheap minute rates and monthly fees, better than the official mobile

¹¹⁴ “Telecom Price Cuts Stir Debate,”

<http://www.newsgd.com/english/news/money/200304180995.htm>

¹¹⁵ It is branded “U Park,” mainly targeting young consumers. Chen Xiao, 2004, “Telecom Operators Sharpen Edge,” *China Daily* (May 12, 2004)

¹¹⁶ “*Xinchanbu Niyixing Jiaoting Shouji Zifeizhan Xingzhengce Rujian Zaixian*” *Nanfang Zhoumo* (Southern Weekly), June 24, 2004

¹¹⁷ *Ibid.*

¹¹⁸ Due to low technological value, Xiaolingtong service has been prohibited by the MII in the major cities, such as Beijing and Guangzhou, until April 2003. “Telecom Price Cuts Debate,”

<http://www.newsgd.com/english/news/money/200304180995.htm>

operators, China Mobile and Unicom. Its subscribers rapidly increased: by 2003, China Telecom had more than 20 million users; China Netcom recorded 15 million.¹¹⁹ Xiaolingtong users also occupied 36 % of China Mobile's subscribers.¹²⁰ However, Xiaolingtong's service was blocked in four major cities, Beijing, Shanghai, Tianjin, and Guangzhou, in order to maintain the stock prices of China Mobile and China Unicom.¹²¹

The 2004 telecom price wars immediately caused the MII and the NDRC to issue a new administrative circular (*tongzhi*), which aimed to implement more strict control over telecom service fees than before.¹²² In the enforcement, the circular asks the headquarters of telecom corporations to tighten supervision of the business management of local telecom firms. For price cuts, short-period promotions, and tariff packages, both fixed-line and mobile local subsidiaries, would have to get approval from each headquarters of telecom corporations. The governmental agencies asserted that price cuts from excessive competition in mobile service markets are “vicious competition” (*exing jingzheng*), because they may lead to the loss of crucial state assets. In effect, when the central SASAC dispatched a supervising panel to inspect the circumstances of the price wars between Guangzhou Mobile and Guangzhou Unicom in early 2004, their revenues for January 2004 were considerably decreased. The decline of revenue from mobile telecom service in Guangdong province was considered to be critical, for the profits from Guangdong province

¹¹⁹ Chen (2004)

¹²⁰ Zou Shan, “Telecom Price War Curbs Called into Question,” *China Business Weekly* (July 12, 2004)

¹²¹ Fang Yan, 2003, “*Dianxinye de Yushi Zuijin*,” *Gaige Neichan*, 9, p. 29

¹²² The MII and NDRC, “*Guanyu Jinyibu Jiaqiang Dianxin Zifei Jianguan Gongzuo Youguan Shixiang de Tongzhi*,” July 2004

occupy one sixth of the national telecom operation. However, the meaning of “vicious competition” is ambiguous. Chen Jinqiao, director of the Chinese Academy of Telecom Research under the MII, points out that “fair” and “vicious” competition is not clearly specified. Given that price is a key indicator to manifest the market-based economy, it is called for that the government needs to clarify when price competition is vicious, and how price competition relates to the loss of crucial state assets.

Responding to the government’s claims on the problem of state asset loss, Zhou Qiren, economist of the China Centre for Economic Research at Beijing University, argues that “if something is overpriced, price cuts will not lead to losses of corporate assets. On the contrary, such cuts may increase corporate revenues as they will boost consumption of the service.”¹²³ Furthermore, one official, who works in the research center for the macro economy in the NDRC, argues the need for more price competition, holding that today, telecom price competition in China’s mobile service is not enough to renovate the overall system of telecom fees; it simply remains the reconstructing of the system.¹²⁴ Some even warn that state institutions’ unnecessary control over telecom pricing can turn into a new type of “administrative monopoly” (*xingzheng longduan*) in dealing with the natural monopoly industry. Administrative monopoly reinforces the absolute power and position of regulatory institutions while obstructing the interests of consumers.¹²⁵

¹²³ “Telecom Price Cuts Stir Debate,”

<http://www.newsgd.com/english/news/money/200304180995.htm> (Access: April 5, 2007)

¹²⁴ “MIH Holds Back the Telecom Price War and Discusses the Establishment of Related Articles,” (*Xinchanbu Jianting Dianxin Zifei Jiagezhan Taolun Zhiding Xiangguan TiaoKuan*) *New Beijing Daily* (*Xinjingbao*), June 25, 2004

¹²⁵ “Regulatory Commission of Telecom Service Fee Policy Can Bring about a Administrative Monopoly?” (*Dianxin Zifei Zhengce Jianguanhui Haidailai Xingzheng Longduan?*), *21shiji Jingji Baodao* (*21-century of Business Herald*), July 6, 2004

To some extent, even though the MII has been making related laws and regulations to build up a legislative means to control (supervise) price competition among telecom operators, they remain only temporary measures. Telecom service fees in China are not based on market demand, but are made by coordination among state institutions. One official of the MII, who does not want to be identified, acknowledges that the manner of regulatory control over telecom pricing is already unsuitable to the growing market. The minister of the MII, Wang Xudong, referred to market-driven telecom operation as the keynote of 2004 MII policies and said that “MII is working on related laws and regulations to build up legislative means to help cut down mobile telecommunications fees.”¹²⁶ Moreover, local telecom operators cannot cut the prices or supply a variety of promotional packages to attract potential customers, because local telecom firms are annually assigned a target revenue and a number of subscribers to attain. Therefore, the underlying driving force of price competition is not to meet market demand, but to meet the central state firms’ planning. The “buyer’s market,” as Dali Yang anticipates, is unlikely to emerge in the telecom market soon.

To summarize, first, the Chinese government encourages and emphasizes the importance of market competition in the basic telecom service sector. Yet, *de facto* competition is continuously controlled by the central authorities. Not the market but the MII and the NDRC set the prices and make the rules of the game for telecom services; the central SASAC sends off supervising panels to major local telecom firms (i.e. Guangzhou, Shanghai, Tianjin) in order to monitor whether a loss of state assets occurs when price competition is heated up.

¹²⁶ *Ibid.*

Second, telecom companies have had limited influence on the industry's price and competition policies. As the mobile service price wars in June 2004 manifest, local telecom companies had more say in setting prices to reflect consumer demand. Rather than respond to growing market forces, however, the government has made strict restrictions on price competition in the name of securing crucial state assets, calling for strengthened supervision of telecom corporations' head offices over local units.

And, third, the governing mechanism of price policy is highly centralized. In the bureaucratic structure, local state institutions, such as the local level NDRC or SASAC, have no substantial right to interfere. Local Telecommunications Administrations oversee the price policies of local telecom companies, but they do not retain the right to make policy decisions, simply enacting the rules from the central government (MII, NDRC, SASAC, and Ministry of Finance). In business, local telecom firms are not allowed to decide their own prices, billing systems, or promotional events. The 2004 circular stipulates that local telecom companies should first submit a "written" document to their head offices of operators and need to receive permission from the head before making any changes in price-related business.

Regulating Market Entry

Market structure is in general organized out of competition, and at the same time competition is the major force in shaping market structure. Therefore, control over market entry can be regarded as control over the structuring of the market. In China's

basic telecom service, the number of operators and forms of investment capital are strictly restrained by the state. Even though there is no official statute, only six companies are allowed to provide basic service.¹²⁷ These are China Telecom, China Netcom, China Railcom, China Mobile, China Unicom, and China Satellite. The central part of control is the areas of service; for example, mobile or international telecom services are very stringently restrained.¹²⁸ It is a path-dependent legacy of a state-run monopoly system that tightly restricted the entry of new telecom companies in order to maintain the monopoly system. Regulatory control over market entry is the exercise of administrative authority in establishing and preserving the relationship of enterprises. Since the 2000 Telecom Regulations Article 9 stipulates that the creation of new telecom enterprises should receive ratification from the State Council, in China's basic telecom service, the State Council takes the main responsibility for deciding on the market entry of new companies into the basic and value-added services.¹²⁹ The break-up and merger of telecom enterprises are also subject to the decision of the State Council. So far there have been two new telecom enterprises established by the ratification of the State Council, China Unicom and China Jitong, which was incorporated into China Netcom in 2001.

Furthermore, the nature of capital entering the basic telecom services is also controlled by the State Council. On the one hand, the entry of domestic private capital to the basic telecom services is restricted, although no clear regulations exist.¹³⁰ On

¹²⁷ The Development of Research Center (DRC) of the State Council, 2005, "*Zhongguo Dianxianye Guizhi Zhengce Xianzhuang he Zhanwang*" *Internal Report*, p. 118

¹²⁸ *Ibid*

¹²⁹ "*Dianxinye de Zhengfu Guanzhi Wenti Yanjiu*," [The Study of State Control in Telecom Industry], *Jingji Yanjiu Cankao* [Economy Research Reference], 2003, (25), p. 6

¹³⁰ DRC Internal Report, p. 118

the other hand, the WTO accession no longer allows the Chinese government to delay the entry of foreign capital into its telecom industry. Responding to these demands, the government, the State Council, and the MII clearly formulated the rules, and the entry and operation of foreign capital is controlled by the government based on these regulations.¹³¹ The Regulation (*guiding*) of Foreign Business Investment in Telecom Enterprise, released in 2001, has three major parts in governing foreign capital.¹³² First, regardless of basic or value-added telecom services, the Regulations Article 2 prohibits the establishment of a foreign company that consists of only foreign capital. Second, according to Article 6, foreign capital that enters China's telecom service areas must organize a joint venture with Chinese capital, and foreign investment in the joint venture cannot exceed 49 % in fixed-line, or 50% in wireless and value-added telecom services. And third, foreign capital is allowed to invest within the confined areas of telecom service, but is not allowed to be an independent actor.

With respect to state control over telecom market entry, we can see some transitions in arguments within China's major government think-tank. As of May 2004, one report from the Institute of Enterprise Research of the DRC under the State Council argues that a licensing system (*xukezhi*) for telecom market entry in China is necessary for a while, because it helps moderate any potential disorder and conflict resulting from the rush of large scale companies into the market.¹³³ At the same time, the nullification of market entry licensing does not always accelerate market

¹³¹ "Dianxinye de Zhengfu Guanzhi Wenti Yanjiu" *Jingji Yanjiu Cankao*, p.8

¹³² The State Council, "Waishang Touzi Dianxin Qiye Guiding," <http://www.gqb.gov.cn/node2/node3/node5/node9/node102/userobject7ai1554.html> (Access: April 10, 2007)

¹³³ Ma Jun, 2004, "Dianxin Shichang Zhunru Zhidu de Gaige, (The Reform a Licensing System of the Telecom Market), *DRC Internal Report*, No. 62, p. 4

competition. For the public interest, the control of market entry may contribute to gradually opening up and putting the market in order. The report also claimed that a controlled market entry would be beneficial to the supply of stable services as well as harmonious development of the industry. Through a licensing system, the governmental agencies can make plans and coordinate technology standards ahead of time, which is conducive to not only facilitating the creation of a unified network but also to promoting a domestic manufacturing industry.¹³⁴ The same research institute presents somewhat contrasting arguments in the report of December 2005, holding that stringent controls over both market entry and types (nature) of capital are actually adverse to the development of the telecom industry and improvement of subscriber interests, by constraining effective market competition.¹³⁵

V. Chapter Conclusion

Highly centralized state regulation for the telecom industry in China is hardly surprising, for its state assets and profits constitute huge resources of revenue in the Chinese economy. However, what is interesting and important is to identify the *pivotal* state institution for exercising substantial control over the business of telecom firms, and to single out the patterns of centralized regulation in the telecom industry. In this chapter, I have explained two major findings: the empowerment of the SASAC and the concept of “centralized *hard* regulation” for China’s telecom industry, and its

¹³⁴ Ma (2004)

¹³⁵ Enterprise Research Institute, the DRC of the State Council, 2005, “*Zhongguo Dianxinye Guizhi Zhengce Xianchuang ge Zhanwang*,” *Zhongguo Xinxi Chanye Zhengce Zichi Tizhi Yanjiu: Ti San Jieduan Baogao*, p. 118

components, such as central state ownership and continued command of the party in both government and enterprises.

First, while the MII appears to be a key state agency in regulating the telecom market, its authority has been considerably constrained by comprehensive state institutions, such as the NDRC and SASAC. Telecom pricing policies have to be coordinated with the NDRC; the structure of market competition is controlled by SASAC. Even though the MII does not agree with state-led market restructuring, rather than by market forces, it cannot avoid it because SASAC has the formal authority to restructure the telecom market by merging firms. Therefore, I propose that the focus should be on SASAC, not the MII. Although both SASAC and the NDRC are comprehensive state institutions, SASAC is a more important key state body than the NDRC in exercising regulatory control over the business of telecom carriers. SASAC as a new operator is increasingly expanding its intervention in the business of telecom firms, from assets management and personnel to budget and investments management. The separation of China Telecom from the MII does not lead to *de facto* separation of government and business, because SASAC, a new comprehensive state institution, replaces the role of operator from the MII and maintains its lever of control over telecom firms. The empowerment of SASAC in the telecom industry is feasible because the six leading telecom service carriers are under central state ownership.

Second, the pattern of regulation in the telecom industry is “centralized hard” regulation. It is *centralized* in that local governments have no binding authority to regulate the business of local telecom firms. Provincial telecommunications

administrations (*tongxin guanli ju*) are the main state agencies to oversee local telecom firms, but they are under the direct leadership of the MII. The staff of provincial telecommunications administrations is recruited and accredited by the MII, and implements the policies and rules from the MII. Local governments may suggest some opinions (*jianyi*), but they do not retain the authoritative power to enforce them on local telecom administrations. In other words, provincial telecom administrations are under a dual-subordination to the MII and provincial governments, but they are the agents of the MII. Telecommunication administrations at county/township levels are administered by provincial telecommunications administrations, not by the MII; provincial telecom administrations direct lower level telecom administrations. As such, the structure of administration in regulating the sector is hierarchically centralized.

In business, since local telecom firms remain the local unit of central firms, they have no right to make final decisions (i.e. price or investment), but simply implement policies and rules from the head office. Particularly, after the price war of 2004, local telecom firms have to receive approval from the head office for any change of telecom service fees or billing systems. These strong central components sharply contrast with the auto industry, where local governments have ownership over local firms; local auto firms, even though most of them are state-owned, have a right to manage the business of their firms.

Moreover, compared with softly centralized regulation in the auto industry, I refer to the patterns of central regulation for the telecom service sector as *hard*. Here I define hard regulation as tight state control over business through formal state

institutions based on rules. Hard regulation in the telecom industry is workable, due to central state ownership and deeply penetrated party organs in both government and enterprises. Since I conceptualize the forms of soft vs. hard regulatory control in terms of government and business relations, even though there are political tensions or struggles among state agencies, this does not necessarily mean that government is not capable of exerting tight control over the firms. For example, there are political tensions between SASAC and the MII, and between the MII and the NDRC in governing the telecom sector. But SASAC as the operator of telecom firms, the so called “*laoban*,” retains supreme power over the telecom firms and can tightly control their business and personnel.

CHAPTER 5

VARIED CENTRAL STATE REGULATION: A CROSS-SECTORAL COMPARISON

I. Introduction

In Chapters 3 and 4, I mapped out the overall features of regulatory mechanisms in the auto and telecom service industries, focusing on demonstrating *how* the patterns of regulatory governance can be divergent across and within a case in China's industrial economy. This chapter compares regulatory patterns of the two sectors in the context of central oversight and seeks to answer the two-fold main puzzles of this dissertation. First, *why*, despite strong components of decentralization, *centralized* regulatory control sits firmly in automobile manufacturing, just as in the telecom service sector, which has a long history of central ownership and control. Second, under the centralized regulatory mechanism, various patterns of regulation still remain. What determines the rise of soft, hard, and mixed forms of central oversight in China's strategic industries? For clarification, my purpose is not to measure the effectiveness of state regulation, rather to attempt to capture the complexities in China's regulatory governance designed by the party-state.

In doing so, I first focus on explaining why centralized regulatory structure commonly arises in China's automobile and telecommunication service industries, which actually disconfirmed my initial assumption before the field research. I

hypothesized that state regulation over the auto industry is likely to be decentralized because of historically strong local components in terms of administration and ownership. As a second step, I further explore important factors that give rise to various patterns of central regulation across the sectors. Through deductive reasoning, I find three key explanatory variables and analyze how each has an effect on making soft, hard, and mixed forms of centralized regulatory oversight. They include: different sectoral characteristics, path-dependent institutional elements, and the role of foreign investors. Path-dependent institutional elements include governing structure and forms of ownership.

In this chapter, I argue that central state regulation, as in the telecom service sector, is employed in China's auto industry to maintain the party-state's vested interests. While there are some other factors that encourage central oversight (i.e., multiplier effects on the national economy), the ultimate purposes of central oversight are to secure the party-state's crucial state assets even though the party does not have an explicit ownership stake, and to create comprehensive state power at the core.

Second, I argue that specific patterns of central control over the sectors are heavily conditioned by pre-existing historical institutional contexts. China's telecom industry has evolved under a vertically centralized governing structure and ownership. As a consequence, the authority of local governments in managing local telecom businesses has been considerably constrained. In contrast, a long history of decentralization policies for the auto industry has allowed local governments to retain the property rights for local auto firms, offering local authorities substantial discretionary measures in managing local auto businesses. Hence, central state control

is inevitably loose due to the lack of formal authority to supervise, and I conceptualize this pattern as centralized *soft* regulation as discussed earlier. At the same time, although the overall sector exhibits strong local components, there are also two centrally-owned auto producers. The form of regulatory controls over central automotive firms shows great similarity to the telecom service firms: tight and direct central oversight of assets and personnel management through formal central state institutions. I call this type centralized *hard* regulation. Drawing on a cross-sectoral comparison, I suggest that such mixed ownership forms in the auto industry contribute to generating divergent regulatory patterns under central control.

After introducing some factors of strategic importance that bring about central regulation in China's automotive and telecom service industries, I explain the underlying political logic that has led the Chinese top leadership to centralize regulatory power. The chapter proceeds to analyze what gives rise to the varied patterns of regulation, and how these forms are different across, as well as within, the sector.

II. Why Are Regulatory Controls Commonly Centralized?

Often, it is taken for granted that the methods of state regulation for the auto and telecom industries are different simply because of inherent distinguishing sectoral characteristics. While automobile manufacturing is inclined to be driven by market-oriented competition, telecom basic service is a natural monopoly that requires a governmental role in order to break up the monopolized market structure and

facilitate competition. Moreover, the long history of a decentralized governing structure in the auto industry makes us readily assume that the mechanisms of state regulation for the auto and telecom sectors are inevitably different, given the highly centralized control and public ownership in the telecom service sector. Yet, as I have pointed out in Chapters 3 and 4, “centralized regulatory control” is concurrently running across the two sectors, despite significant differences in sectoral and surrounding political-economic institutions. Hence, in accounting for why central oversight arises in the automobile manufacturing and telecom service sectors in China, I indicate the strategic importance to the national economy and a desire to create a cohesive state power from the central government.

Strategic Importance

One of the main arguments in explaining the rise of centralized regulatory control across the two cases is their strategic significance in China’s political economy. Li Rongrong, the director of SASAC, points to the telecom industry as the commanding height that needs absolute state control because the sector relates to national security and the economy. The auto industry, as a pillar (*zhizu*) of the national economy, is also highly associated with the development of other sectors; relatively strong state control is also necessary. In effect, the strategic importance of the automotive sector has been increasingly growing since the early 1990s. The auto industry accounted for a 2.2 % share in revenue from the overall sectors in 1990, growing to 4.4 % in 2001,

5.2 % in 2002, and 6.2 % in 2003.¹ As a pillar industry, the position of auto manufacturing, as measured by the share of sales revenue over all industries, is also on a rising trend. It remained number 15 as of 1990, but ascended to 10th in 2000, and rose to 5th in 2003.²

Table 5-1: The Changing Position of the Auto Industry in China, 2000 – 2003³

Position	2000	2001	2002	2003
1	Telecom Electronics	Telecom Electronics	Telecom Electronics	Telecom Electronics
2	Electricity	Electricity	Electricity	Electricity
3	Chemical	Chemical	Chemical	Metal refining
4	Metal Refining	Metal Refining	Metal Refining	Chemical
5	Textile	Textile	Textile	Auto
6	Crude-oil Refining	Electronic Machinery	Electronic Machinery	
7	Electronic Machinery	Crude-oil Refining	Auto	
8	Food- producing	Auto		
9	Construction			
10	Auto			

Sources: Guojia Xinxin Zhongxin Zhongguo Jingji Xinxiwang [National Information Center, Chinese Economy Informatization]. 2003. *Zhongguo Hangye Fazhan Baogao: Qicheye* [China Industry Development Report 2003: The Auto Industry]. Beijing: Zhongguo Jingji Chubanshe, p. 9.

¹ Gui Junsong, “Qicheye Yingzuo Diyi Zhizhu Chanye” *Zhongguo Qiche Bao* (June 17, 2003)

² *China Industry Development Report 2003: The Auto Industry* (*Zhongguo Hangye Fazhan Baogao: Qicheye*), (Beijing: Zhongguo Jingji Chubanshe, 2004), p. 9.

³ *Ibid.*

The central state institutions (i.e., NDRC) have quickly supported the development of the auto industry, for its growth is closely associated with other sectors, such as the chemical, steel, machinery, and service sectors. Due to these strong “multiplier effects” on the national economy, the Central Party Committee and the State Council have attached great importance to auto manufacturing and have several times suggested making the auto sector the pillar of the national economy, a so called “comprehensive industry” (*zonghe hangye*).⁴ One even argues that the development of the automotive industry directly creates more opportunities for 10 auto-related sectors.⁵

At the same time, strategic importance is even more remarkable in the telecom industry. The sector is referred to as “the crown jewel of China’s industries,”⁶ in that the central government has earned enormous profits from mobile service providers, and is hoping for similar profits from fixed carriers. According to a recent report from the National Bureau of Statistics, three out of four telecom service firms are included as the most profitable top ten companies, in terms of state assets, in China.⁷ The report says that “the total assets of these ten companies are valued at 6338,567 billion yuan, which is 769,866 billion yuan more than in 2004.”⁸ Three telecom service providers on the list are: China Telecommunication Corporation (China Telecom),

⁴ Chen Jianguo and Zhang Yuxian, 2004 “China’s Auto Industry Policy and Development Strategy,” (*Woguo Qiche Chanye Zhengce he Fazhan Zhanlue*), *Jingji Lilun yu Jingji Guanli*, 12, p 27

⁵ *Ibid*

⁶ The Economist, “Into the Crucible,” Vol. 361, Issue 8246 (November 3, 2001)

⁷ “China’s Top Ten Richest Company Asset Holders in 2005,” *People’s Daily* (October 11, 2006)

⁸ *Ibid*

China Mobile Communication Corporation, and China Network Communications Corporation (CNC).⁹

Strategic significance is also reflected by the creation of large business groups and controls over the entry of foreign investors, although the degree of regulation is different across the sectors. First, the desire to make gigantic state-owned enterprises in key strategic industries has been indicated as one of the factors in leading the Chinese leadership to (re)centralize regulatory power since the mid 1990s.¹⁰ The emphasis on large state firms was unfolded by the ‘*zhuada fangxiao* policy’ in 1995 and reaffirmed by the CCP 15th Congress in 1997.¹¹ In theory, the *zhuada* policy was designed to rationalize the inefficient structure of state sectors, yet the kernel of strategy for corporatization of state firms is to formulate an oligopoly in the Chinese industrial economy. In practice, “a selected number of large state-owned enterprise groups have been given various preferential policies from the government,” for they are the most profitable and revenue-maximizing businesses in China.¹²

For the auto industry, with its decentralized governing structure and fragmented market, the center has used “merger and acquisition to push the development of the targeted large corporate groups.”¹³ Since the central government has been unsuccessful in preventing local governments from establishing inefficient

⁹ The other firms are: the State Grid Corporation of China, China National Petroleum Corporation, China International Trust and Investment Corporation, China Petrochemical Corporation, China Everbright Group, Ping An Insurance Group, China Southern Power Grid Co., Ltd. Ibid.

¹⁰ Pearson (2005); Chung (2003); Thun (2004); Lin (2006)

¹¹ In restructuring the inefficient state sector, the Chinese leadership promulgated “*zhuada fangxiao*” policy on September 1995, meaning that “grasping large firms while letting go of small one.” See more detail overview, Christopher A. McNally and Peter Nan-Shong Lee, “Is Big Beautiful?: Restructuring China’s State Sector under the *Zhuada* Policy,” *Issues and Studies*, Vol. 34, No. 9 (September 1998), pp. 32-8.

¹² McNally and Lee (1998: 32)

¹³ Thun (2006: 61)

small scale auto firms, the center rather indirectly encourages small local state firms to be merged into large firms. While the central leadership still favors the existing large auto producers (i.e., FAW or SAIC), the winner in China's auto market is more likely to be determined not by the government, but by market-driven competition. For example, the recent rapid growth of Guangzhou Auto Industry Corporations or Beijing Auto Industry Corporations shows that a centralized regulatory power to support some targeted firms is not a necessary condition for China's auto industry.

Emphasis on the creation of enormous conglomerates is also salient in the telecom industry, aiming not only to prepare for incoming competition from global telecom service providers after the WTO entry, but also to promote the value of state assets, which ultimately serves to benefit the central government.¹⁴ Contrary to automobile manufacturing, the telecom service sector was monopolized by a single operator, MPT and China Telecom, until China Unicom emerged in 1993. Through successive market restructuring while new service providers were established, market entry and structure have been strictly controlled by the central state institutions, favoring a limited number of large-scale state-owned firms. Thereby, this state-led "orderly" competition has created an oligopoly where two fixed-line carriers and two mobile service providers dominate. As of 2004, China Mobile constituted 56.18% of market share by revenue; China Telecom was 25.36%; China Unicom was 9.3%; China Netcom was 7.93%; China Railcom was 0.62%; China Satcom was 0.33%.¹⁵ Following the former premier Zhu Rongji's Zhuada policy, the director of SASAC, Li Rongrong, explicitly has emphasized the creation of a handful of large-scale state-

¹⁴ Interview with Zhang Xinzhu in Beijing, Chinese Academy of Social Science (Feb 2006)

¹⁵ Daniel Roseman, "The WTO and Telecommunications Services in China: Three Years on," *The Journal of Policy, Regulation, and Strategy for Telecommunications* Vol. 7, no. 2 (2005), p. 21.

owned enterprises. Central ownership of telecom service firms has virtually made it possible for SASAC to implement decisive and coherent regulation.

The Chinese central government, particularly in strategic industries, has kept close oversight for the entry of foreign investors, in order to maintain the ultimate levers of control over foreign investments. Central oversight has been used as the most powerful source of control since the reform and open policies.¹⁶ During the 1980s, the Chinese central government actively attracted foreign capital, but the business of foreign-invested firms has been circumscribed by the center through various ways, including formal law and regulations, multiple approval procedures, and the rule of the state plan.¹⁷ Daniel Rosen also indicates that when the Chinese central authority issued the “Provisional Regulations for Guiding the Direction of Foreign Investment” in 1995, the government used “vague language” in the restricted category that confined the equity stake of foreign investors, and left room for the exercise of arbitrary power.¹⁸

Automobile manufacturing in China is often perceived as having weak central regulation due to strong local governments, based on local ownership and fragmented foreign investments.¹⁹ Yet it should be noted that the ultimate decision on foreign partners and the scope of their business has always been made at the central level. Unlike cost-cutting investments where the center does not retain much control, the central government is capable of exercising effective control over foreign partners,

¹⁶ Thun (2006: 63)

¹⁷ Margaret M Pearson, *Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment under Socialism* (Princeton: Princeton University Press, 1991)

¹⁸ This regulation divided foreign investment into four types: encouraged, permitted, restricted, and prohibited. For details of regulation, see Appendix A “Catalogue for the Guidance of Foreign Investment Industries,” Daniel H. Rosen, *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace* (Washington, D. C.: Institute for International Economics, 1999), pp. 23; 259-278.

¹⁹ Huang (2003: 261)

for the auto firms have “market-seeking investments that are more vulnerable to host government pressure.”²⁰ Moreover, in organizing automotive joint ventures, the central government has the authority to approve foreign partners, aiming to make all major state auto enterprises have partnerships with at least two foreign companies. By doing so, the center may effectively leverage giant foreign auto firms, making them compete with each other.²¹ By making the best use of the domestic market access to foreign investors, the central government could support a small number of targeted firms to create joint ventures with foreign auto manufacturers.

In the telecom service sector, China’s central control over foreign investments has been very straightforward, as seen in its explicit ban during the 1990s. Sharply contrasting with the state’s active efforts to attract foreign investments in the auto industry, the central government (i.e., MPT) issued two regulations prohibiting foreign investment or joint ventures in the telecommunication service sector.²² More than anything else, the central leadership had strongly contained any type of foreign investment in the telecom infrastructure so as to tightly control and monitor the flow of information to the public, which related to political and security concerns.

Since the WTO agreement, while the market has been gradually opening up to foreign investors, allowing more scope and service, the Chinese government has continued to maintain central regulation for the business of foreign-invested telecom enterprises. Even though the allowed scope of foreign ownership in the telecom

²⁰ Thun (2006: 66)

²¹ Thun (2006: 69)

²² Ministry of Posts and Telecommunications, *Provisional Regulations on the Administration of Examining and Approving Telecommunications Services*, issued on September 11, 1993; *Provisional Regulations on the Administration of the Telecommunications Services* issued on November 10, 1995. Guan (2003: 53)

service is specified in the WTO agreements with the U.S. and the EU, the Chinese central government (i.e., MII) issued a new “Regulations on Foreign-invested Telecom Enterprises” in 2001 with additional detailed provisions concerning the business of foreign-invested firms, such as geographic range or registered capital for business.²³ While the above explanations constitute a significant part of “economic” causes for central oversight, they do not provide sufficient explanation for convergence on the centralized regulatory mechanism in China’s strategic industries. To be sure, there are “political” views for why the Chinese central leadership designs such a system of regulation, and I briefly discuss two key elements that drive to concentrate the regulatory power at the core.

Political Needs for Central Regulation

So far, I have examined some factors that are associated with economic consequences, but there are significant political goals in centralizing regulatory power. Drawing on findings from the field research, I propose that the ultimate purposes of central oversight for strategic industries in China are two-fold: 1) to protect crucial state assets that are tied to the vested interests of the party-state, and 2) to create comprehensive national power at the core, though the manners and sources of sectoral regulation are varied across issue areas. This indicates that, despite the fragmented political and economic authorities and bureaucratic struggles,²⁴ the

²³ State Council (formulated by Ministry Information Industry), *Waishang Touzi Dianxin Qiye Guanli Guiding* (Regulations on Foreign-invested Telecom Enterprises) Issued on December 10, 2001; effective on January 1, 2002

²⁴ Kenneth G. Lieberthal and David M. Lampton eds., *Bureaucracy, Politics, and Decision Making in Post-Mao China* (Berkeley: University of California Press, 1992)

centralized regulatory power over strategic industries mirrors a cohesive political logic emanating from the central government.²⁵

1. Protecting State Assets

Some scholars have argued that market reforms in the socialist system necessarily lead to decentralized decision-making, and as a consequence, the party's capacity to monitor and control the economic activities of society came to be increasingly constrained.²⁶ Susan Shirk has pointed out that economic reform in China has accelerated the fragmentation in political and economic life and led to a major source of conflict, for the reform "redistributed resources and responsibilities from some economic sectors, regions, and bureaucratic organizations to others."²⁷ Shirk claims that this tension was the most outstanding in bureaucratic agencies in Beijing, not the local governments that could gain "increased control over material supplies, fiscal revenues, depreciation funds, and extra-budgetary funds."²⁸ In effect, China's state asset loss has been continuously growing since the 1980s.²⁹ According to the 1998 investigation of the 32 largest state-owned enterprises, 28 firms revealed some problems, accounting for 87.5% of the total number of state firms.³⁰ As a consequence of the price war in the early 2000s, profit loss was remarkable in the

²⁵ I am indebted to Margaret M. Pearson for this insight.

²⁶ Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton: Princeton University Press, 1992); Jan Winiecki, "Obstacles to Economic Reform of Socialism: A Property Rights-Based Approach," *The Annals of the American Academy of Political Science* 507 (January 1990): 65-71.

²⁷ Susan Shirk, "The Politics of Industrial Reform," *The Political Economy of Reform in Post-Mao China* (Cambridge: The Council on East Asian Studies/Harvard University Press, 1985), p. 196.

²⁸ Shirk (1985: 218)

²⁹ X. L. Ding, 2000. "The Illicit Asset Stripping of Chinese State Firms," *The China Journal*, No 43 (January), p. 2.

³⁰ Cao Yifeng, 2003. "Daxing Qiye Jituan Chuziren Jiandu Tizhi Yanjiu" [The Study of Large Enterprise Corporations Investor Supervising System] *Jingji Yanjiu Cankao* [Economic Research References] 17 (1689), p. 32.

telecom service firms. As I indicated in Chapter 4, Guangzhou Mobile in 2003 exhibited 2.4 billion yuan profit loss, and Guangzhou Unicom had 60 million yuan decrease in profits.³¹ In the auto industry, China First Auto Works Group Corporations, a key central state firm, disclosed a net loss of 570 million yuan in the first quarter of 2005.³² FAW-VW was addressed as “the biggest money loser, posted almost 300 million yuan.”³³

For the Chinese party-state, the growing loss of state assets is an imperative issue, for it is directly associated with their vested interests. Moreover, by holding enormous state assets of major state firms in strategic key industries, such as the commanding heights or pillar industries, the party-state can continue to exercise economic control over the national economy, which ultimately becomes the grounds of political power. Some claim that although political change may occur in the future, “the CCP, with its abundant economic strength, would still win in an election.”³⁴ Therefore, the primary concern for the party-state in regulation is to protect crucial state assets through a centralized institutional mechanism.

The party often organizes informal channels to keep control over state assets, for the party does not retain an explicit ownership stake.³⁵ Moreover, since some large-scale major auto producers are locally-owned, the central party-state organizes an invisible supervising group called *xunshizu* in order to monitor the asset management of major local state auto firms, resulting from the party’s lack of formal

³¹ “*Xinchanbu Nyingxing Jiaoting Shouji Zifeizhan Xinzhengce Rujian Zaixian*” *Nanfang Zhoumo* (Southern Weekly), June 24, 2004.

³² “FAW Posts Big Loss, Government Tries to Help,” *China Business Info-Center* (July 11, 2005)

³³ *Ibid.*

³⁴ He (2005)

³⁵ Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge; London: The MIT Press, 2007), p. 317

authority to supervise. The party believes that “its grip on the largest state-owned enterprises, either central or local, is a crucial lever for controlling the economy and bolstering its political power.”³⁶ On the other hand, state assets of telecom service firms are tightly supervised by the central state institutions. Due to strong central ownership in the telecom service sector, local telecom firms are subordinated to the central firms, thereby state assets in both central and local firms are formally supervised by the central state institutions. As such, the underlying logic of centralized regulatory oversight is not simply an economic concern, but rather political, in order to hold on to control over crucial state assets.

In fact, some scholars argue that the capacity of party-state control is increasingly limited because of “a significant gap between rhetoric and practice.”³⁷ The decentralized property rights and ineffective monitoring system have been pointed to as contributing to the rise of a decentralized predatory state in China.³⁸ However, I share the view of scholars such as Andrew Nathan and Maria Edin that the party has a plan and, responding to new challenges, continuously develops and restructures to keep up political and economic controls over economic affairs.³⁹ By doing so, the central party-state may maintain its key control over local entrepreneurs. Although different institutional contexts have led to diverse patterns of regulation

³⁶ Chris Buckley, “In China, Power to the Center: State Firms’ Agency Still Calls the Shots,” *International Herald Tribune* (June 1, 2005)

³⁷ Tony Saich. 2000. “Negotiating the State: The Development of Social Organizations in China,” *The China Quarterly* 161 (March), p. 125; Merle Goldman and Roderick Macfarquhar, “Dynamic Economy, Declining Party-State,” In edited by Merle Goldman and Roderick Macfarquhar. *The Paradox of China’s Post-Mao Reforms* (Cambridge: Harvard University Press, 1999); Pei (2006)

³⁸ Pei (2006)

³⁹ Andrew J. Nathan, “Present at the Stagnation,” *Foreign Affairs* (July/August, 2006): 177-182; Maria Edin, “Remaking the Communist Party-State: The Cadre Responsibility System at the Local Level in China,” *China: An International Journal* Vol. 1, No. 1 (March 2003): 1-15.

even within the Chinese industrial economy, this study evidences that central oversight is commonly employed in the two industries.

2. Creating Comprehensive National Power

The other impetus to the rise of central regulatory power is the top leadership's desire for making comprehensive regulating oversight at the core. In the existing literature, a number of scholars hold that the Chinese state is becoming fragmented and disjointed.⁴⁰ This fragmented authority in economic decision-making is structurally affected by a bureaucratic bargaining and ranking system, and accelerated by fiscal decentralization.⁴¹ In the early stages of reform, Lieberthal and Prahalad have argued that any major foreign firms in China became influenced by five levels of fragmented bureaucracies, such as "the central planning authorities, the ministerial organization, the local government, the Chinese partner, and the Chinese managers and workers."⁴² They highlighted the importance of understanding the fragmented bureaucratic system for smooth and consistent business in mainland China. In comparing China's

⁴⁰ While there are various literatures focusing on fragmentation and bureaucratic struggles, I will address some representative works. Kenneth G. Lieberthal and David M. Lampton, *Bureaucracy, Politics, and Decision Making in Post-Mao China* (Berkeley: University of California Press, 1992); Jonathan Unger, "The Struggle to Dictate China's Administration: The Conflict of Branches vs. Areas vs. Reform," *The Australian Journal of Chinese Affairs*, No. 18 (July 1987), pp. 15-45; Kenneth G. Lieberthal and Michel Oksenberg, *Policy Making in China* (Princeton: Princeton University Press, 1988); David Lampton eds., *Policy Implementation: Post-Mao China* (Berkeley: University of California Press, 1992); Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993); Carol Lee Hamrin and Suisheng Zhao eds., *Decision-Making in Deng's China: Perspectives from Insiders* (M.E. Sharpe: An East Gate Book, 1995); Jae Ho Chung, "Studies of Central-Provincial Relations in the People's Republic of China: A Mid-Term Appraisal," *The China Quarterly*, No. 142 (June, 1995): 487-508; Yves Chevrier, "Micropolitics and the Factory Director Responsibility System, 1984-1987," In Edited by Deborah Davis and Ezra F. Vogel, eds., *Chinese Society on the Eve of Tiananmen: The Impact of Reform* (Cambridge: Council of East Asia Studies, Harvard University, 1990)

⁴¹ Lieberthal (1992: 9)

⁴² Kenneth Lieberthal and C. K. Prahalad, "Maintaining a Consistent China Strategy: Joint Venture Face Conflicting Expectations at Each Level of Both Chinese and Corporate Bureaucracies" *The China Business Review* (March-April 1989), p. 47

economic governance of the auto industry with South Korea, Yasheng Huang claims that both fragmented central authority and decentralized economic management have considerably confined the regulatory power of the State Planning Commission (SPC) (transformed into the NDRC in 2003).⁴³ As I have discussed in Chapter 3, the former SPC was not independent from other ministries and equally ranked with provincial governments, therefore it did not retain the decisive and comprehensive authority to regulate the industry. Fragmented economic governance is also indicated in state holding corporations. Recognizing the problem of overlapping authority in regulating state firms, Christopher McNally claims that top executives in state sectors could not be effectively monitored, because “the authority was fragmented by a diverse set of party and state agencies, thereby no agency possesses sufficient incentives to monitor.”⁴⁴

Even after the extensive government reforms in 1998 and 2003, fragmented authority and bureaucratic struggles are still a dominant part of the Chinese political system. Yet there are explicit efforts from the top leadership to create comprehensive state power at the core. The automobile and telecom service industries present good relevant examples. As I have pointed out in Chapters 3 and 4, the newly restructured comprehensive commissions, NDRC and SASAC, have tended to gain more integrated and enhanced regulatory capacity than before. Such strengthened oversight is particularly outstanding in the strategic industries of automobile manufacturing and basic telecom service. However, it should be noted that their relative power in central

⁴³ Huang (2002)

⁴⁴ Christopher A. McNally, “China’s State Sector under Reform: Old Wine in a New Bottle?” In Edited by Peter Nan-Shong Lee and Carlos Wing-Hung Lo, *Remaking China’s Public Management* (Westport: Quorum Books, 2001), p. 103

oversight is different across sectors; the NDRC is the key regulatory body for macro-control in the auto industry, while central oversight over the business of the telecom service sector is becoming extensively concentrated on the SASAC. By examining each assigned regulatory function and complementing my observation with numerous interviews in the field, I have learned that their relative power relations are distinguished across the sectors. For example, when I interviewed professionals in the automotive sector, the NDRC was always the most highlighted as the macro regulator. On the other hand, in the telecom service sector, I hardly heard about the role of the NDRC except for the service fee; all emphasis was put on the SASAC.

Often, the capacity of central regulation from the NDRC in the automotive industry has been questioned due to the fragmented market structure as well as to strong local ownership and administration. It is also associated with a relative weak capacity of SASAC in the sector. With a view to strengthening macro-economic regulation, the NDRC in the auto industry has come to retain more authority and scope of regulation, as well as higher bureaucratic rank, than the former regulator, SPC. Thereby, all key projects, such as market entry or foreign investors, strictly require approval from the NDRC. Industrial policies for the sector that set development goals and strategies are also formulated by the NDRC. Indeed, auto industrial development policies still play the important role of navigator for both local state and private auto firms. On the other hand, SASAC holds substantial regulatory power in controlling the business of the telecom service sector and plays the key role of regulator. While the NDRC and the MII are together involved in setting prices and monitoring fair market competition, SASAC as asset owner of telecom firms very

tightly exercises oversight over asset and budget management. SASAC also has the right to appoint top executives of the firms.

III. Explaining Variations in China's Industrial Regulation

Unlike the conventional wisdom, the automobile manufacturing and telecom service sectors in China are under centralized regulatory controls. Yet there are variations in the manner and degree of central oversight across as well as within the sector. As I have detailed in Chapters 3 and 4, the form of central state control over the auto industry is characterized as “soft/invisible” regulation whereas the regulatory regime for the telecom service sector is characterized as “hard” regulation from the central authority. Moreover, since the forms of ownership in the auto sector are mixed with centrally-owned, locally-owned, and private firms, varied patterns of regulation emerge even within the sector.

What gives rise to these variations? How can we explain these complex patterns of regulation in China's strategic industries? While state control over industries across regions and sectors has been widely explored by scholars of China, previous studies have tended to focus on regulation at the *local* level. For example, Susan Whiting has argued that the actions of local officials, which are constrained by a cadre evaluation system and the fiscal system, have played a key role in “determining the dominant forms of industrial ownership in local communities across

China.”⁴⁵ But what has rarely been tackled is how the forms of industrial ownership relate to the actual practice of central regulation. Also, Jean Oi has argued that the regulatory work by local governments on tax and revenues at the local levels has two features: “minimum compliance and protection of local interests.”⁴⁶ According to Blecher and Shue’s findings, diversity in the regulatory structure is identified even in one county. Shulu county exhibits various types of regulation: “centralized and decentralized industrial structure, vertical and horizontal forms of ownership, organization, and administration.”⁴⁷

Given the variations and diversity at the local level, this study explores key variables that create the divergent patterns of central controls: soft, hard, and mixtures of both. As analyzed in Chapters 3 and 4, the decentralized auto industry shows mixed patterns, both soft and hard, while the hard regulation model is identified in China’s telecom service sector. I suggest three important factors that bring about variations: 1) sectoral differences, 2) path-dependent institutions (administration and enterprise ownership), and 3) the role of foreign investors.

Sectoral Differences

One would expect that the forms of regulatory control over the auto and telecom industries are necessarily different due to inherent sectoral characteristics. While the former is a manufacturing industry that shows market-oriented competition, the latter is a typical natural monopoly industry that has been nationalized for security and

⁴⁵ Susan H. Whiting, “Regional Evolution of Ownership Forms: Shareholding Cooperatives and Rural Industry and Wenzhou,” In Edited by Jean C. Oi and Andrew G. Walder, *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999), p. 172.

⁴⁶ Jean C. Oi, *Rural China Takes Off: Institutional Foundations of Economic Reform* (Berkeley: University of California, 1999), p. 141.

⁴⁷ Marc Blecher and Vivienne Shue, *Tethered Deer: Government and Economy in a Chinese County Shulu* (Stanford: Stanford University Press, 1996), p. 207.

public interest reasons since the 1980s. Scholars in the field of Political Economy have emphasized that sectoral characteristics have caused variations in the state's role and its policies. Peter Evans has argued that "sectors are more than just arenas for observing specific kinds of state involvement, because their techniques of production, forms of industrial organization, and *modes of governance* vary systematically."⁴⁸ Therefore, the desired role and degree of involvement of the state in markets are surely varied across sectors. According to Evans, "sectoral characteristics define what roles of the state are likely to work."⁴⁹ Then, the question is why do sectoral characteristics make a difference? D. Michael Shafer has pointed to typical economic organizations embedded in sectors as the main forces for making producers or states respond distinctively. Shafer has argued that "sectoral characteristics influence the defining elements of stateness, absolute capacity, autonomy, and relative capacity."⁵⁰

Drawing on a comparative case study of automobile and information technology industries in China, Thun and Segal have highlighted the importance of sectoral analysis at the sub-national level because different sectors may have different developmental needs and policies.⁵¹ This partly results from the fact that individual firms across sectors have different problems of "coordination and regulation."⁵² According to Segal and Thun, both the information technology and the auto sectors need an active role by the state in the market, but in a different manner and purpose. In the IT sector, they argue that "governments must intervene in new markets in order

⁴⁸ Evans (1995: 81)

⁴⁹ Evans (1995: 94)

⁵⁰ Shafer (1994: 23)

⁵¹ Segal and Thun (2001: 558)

⁵² Segal and Thun (2001: 562)

to provide venture capitals and define property rights.”⁵³ On the other hand, the government in the automotive sector plays an interventionist role in “providing investment capitals and monitoring technology transfer.”

Clearly, the importance of sectoral differences cannot be overlooked in analyzing the varied forms of regulation. Yet these differences are insufficient in explaining the complex systems of China’s industrial regulation due to the following two reasons: First, variations in patterns of regulatory control are found not only across the sectors but also *within* the industry, for individual firms in the sector have different ownership structures and political constraints, state-enterprise relationships, and central-local government relations. As China’s auto industry demonstrates, while the form of soft/invisible regulation rises in the large-scale local state firms, the patterns of regulation for the central state auto firms are very similar to the tight (hard) regulation in the telecom service sector. Hence the auto industry exhibits mixed forms of regulatory governance. Second, sectoral differences are powerful in explaining the rise of different patterns of regulation for the auto and telecom service industries, but they do not provide relevant explanations for why, despite sectoral and institutional differences, centralized regulatory control commonly operates in both sectors.

Importance of Institutional Contexts

In studying Chinese politics, it would be simplistic to characterize general patterns of governance due to “the complex patterns and variations across different parts of

⁵³ Segal and Thun (2001: 564)

China and across different issue areas.”⁵⁴ The question is, other than sectoral differences, what makes these complexities in the Chinese industrial economy? In this section, I point to three key variables as the major sources of variations in the regulatory structure, and explain how each factor contributes to creating diversity within the central regulatory power. These variables are: 1) path-dependent histories; 2) governing structure; 3) forms of ownership. Two indicators are employed to compare and contrast the governing structure: central-local government relations and inter-governmental relations at the center.

1. Path-dependent Histories

One of the major forces in creating various practices of central oversight is the different histories of regulation and ownership. While comparative historical analysis has been employed mainly in cross-national studies, the factor of history also plays an important role in generating the varieties of economic governance *within* a country. In China, while the automobile manufacturing industry has developed under the policies of decentralization and central-local shared forms of public ownership, the telecom service sector has been monopolized by the central government. Hence, heavily influenced by historically evolved institutional contexts, there are more complexities than those captured by a single type of regulatory model.

The importance of history has been particularly emphasized by scholars of historical institutionalism. They argue that “contemporary political decisions are embedded in institutions - whether they be formal rules, policy structures, or norms – and because different historical configurations will lead to different institutional

⁵⁴ Dickson and Chao (2001: 15)

structures, policy change is not easy.”⁵⁵ Highlighting the effects of the self-reinforcing process of history in social science, Paul Pierson argues that “we should turn to history because important aspects of social reality can best be comprehended as temporal processes. It is not the past per se but the unfolding processes over time that theoretically central.”⁵⁶

In part resulting from inherent sectoral characteristics, the central government has adopted distinct developmental strategies in dealing with the auto and telecom industries. This has contributed to creating different historical trajectories in developmental procedures. The two policies that stand out in the automobile manufacturing sector are: decentralized political and economic institutions, and the recent openness to foreign and private capital. By selecting localities having either comparatively advanced machinery and parts production, or strategic significance (i.e., Shanghai and inland Changchun), the central government has delegated substantial discretionary powers and property rights to local governments. The form of ownership is mixed: while two major firms are centrally-owned, most other passenger assemblers are local government firms. The first private auto company emerged in 1998 and for now is rapidly growing.⁵⁷ Under this decentralized regime, the functions of comprehensive state institutions (i.e., NDRC and SASAC) and other central bureaucracies have been limited in regulating local governments unless central approval is required.

⁵⁵ Kathleen Thelen, “Historical Institutionalism in Comparative Politics,” *Annual Review of Political Science*, 2 (1999), p. 382; Recited from Eric Thun, “Keeping up with the Jones: Decentralization, Policy Imitation, and Industrial Development in China,” *World Development*, Vol. 32, no. 8 (2004), p. 1290.

⁵⁶ Paul Pierson. 2000. “Increasing Returns, Path Dependence, and the Study of Politics,” *American Political Science Review*, 94 (2), p. 264

⁵⁷ Shanghai Auto Industry Corporations: The Strategy Committee of the Board of the Directors, *Zhongguo Qiche Gongye Fazhan Yanjiu* (Shanghai: Shanghai Technology Publishing, 2005), p. 66.

In contrast to the auto industry, the telecom service sector has a long history of strong central control and ownership. Before regulatory reform in 1998, China's telecom regime was a state-monopoly system: MPT was regulator and operator. Through the reforms, the operator China Telecom is institutionally separated from the regulator MII, but the market structure, price, and competition are still managed, not by market forces, but by the central state institutions. All telecom service carriers are centrally-owned and tightly supervised by central state institutions. Moreover, provincial and municipal governments reserve no property rights to local telecom companies, which simply remain local units subordinated to the central firms. Private capital is not allowed to enter the basic telecom service market. Centralized ownership has in effect empowered central regulatory institutions, while local governments have had little capacity to manage telecom firms at the local level.

2. The Governing Structure

Given that economic regulation illustrates “an essential mechanism of public control”⁵⁸ over business, reflecting broad state-industry relations, the patterns of regulation would be considerably affected by who has the right to control and supervise the business management of state sectors. The governing structure shows not only power relations among governmental agencies, but also government-enterprise relations. Since power relationships among regulatory institutions in China are varied across issue areas, understanding the governing structure is particularly important. As the case of the automobile and telecom service industries evidence,

⁵⁸ Vogel (1996: 9)

variations in regulatory power relationships is more complicated, for some are dominated by decentralized political and economic authority while others are tightly controlled by the centralized system. In addition, as I have pointed out earlier, the central NDRC is a key regulatory body in the automobile industry while SASAC, not the MII, plays a substantial role in controlling the business of the telecom industry. In other words, they all exhibit the importance of the governing structure marked by issue areas in capturing and understanding the complex forms of regulation. The effects of governing structure on the automobile manufacturing and telecom industries are well demonstrated in the following two dimensions: inter-governmental relations and central-local state relations across the two industries.⁵⁹

A. Inter-governmental (bureaucratic) relations

In governing state sectors, regulatory power among government agencies is dynamic, and these different power relations have contributed to shaping diverse patterns of central oversight in China's industrial regulation. Although comprehensive state commissions (i.e., NDRC or SASAC) at the core hold decisive authority in policy-making for both industries, inter-governmental relations are different. I suggest that *kuai*-based leadership relations among governmental agencies are principal in automobile manufacturing, while a *tiao*-based hierarchical system leads the telecom service sector. The organizational dynamic of the Chinese polity is delineated as the

⁵⁹ Unless specifically addressed, local governments means by provincial and municipal level governments.

matrix of *tiao/kuai* relations: “the vertical bureaucracies are called line (*tiao*), while the horizontal coordinating bodies at various levels are called pieces (*kuai*).”⁶⁰

To begin with, the principal mechanism of regulation in the Chinese auto industry is centered on horizontally distributed power relations among local state institutions, although the key regulatory power lies at the center. This has been conducive to making the mode of central oversight over local auto business soft and invisible compared with controls over centrally-owned auto and telecom service firms. As Andrew Mertha has argued through the study of administrative and financial regulation and commodities management, “*kuai*-based leadership relations help local governments achieve a degree of independence from external influence and facilitate co-ordination between functional departments.”⁶¹ Significantly affected by pre-existing decentralized institutional arrangements, local governments have retained enterprise ownership and the rights to decide the distribution of resources (i.e., land) and to appoint high-level officials and the senior managers of local state firms. In regulating local auto businesses, this allows local governments to enjoy autonomy.⁶² Although the local level Development and Reform Commission (DRC) and SASAC are structurally subordinated to local (provincial and municipal) governments, their functional interagency relations are less hierarchical, and the division of labor is

⁶⁰ Liberthal and Oksenberg (1988); Liberthal (2002: 187)

⁶¹ Mertha (2005: 797)

⁶² The importance of pre-existing institutional structures and systems has been emphasized to understand the path of economic transitions and reforms in the study of China and East Europe. See, David Stark. 1992. “Path Dependence and Privatization Strategies in Eastern Europe,” *Eastern European Politics and Societies*, 6: 17-54; Andrew Walder. 1995. “Local Governments as Industrial Firms: An Organizational Analysis of China’s Transitional Economy,” *American Journal of Sociology*, 101: 263-301; Doug Guthrie. *Dragon in a Three-Piece Suit: The Emergence of Capitalism in China* (Princeton, New Jersey: Princeton University Press, 1999)

horizontally distributed: DRC makes policy-decisions for investment or production, and SASAC supervises the assets management of local auto state firms.

As such, the sector shows that horizontally organized “leadership relations (*lingdao guanxi*)” between local authorities are more emphasized than “professional relations (*yewu guanxi*)” between central and local level comprehensive state institutions.⁶³ Yet this does not imply that there is no vertical bureaucratic structure in governing the auto sector. I argue that the leading regulatory mechanism in the sector is *kuai*-based leadership relations across localities, which has an effect on creating soft/invisible control from the center.

On the other hand, as the following figure shows, the regulatory structure for the telecom service sector is vertically organized in both government and business. Thereby, in governing the telecom business, *tiao*-based interagency relations are dominant. Regulatory oversight for local telecom enterprises is undertaken not by the local regulatory agency, as seen in rural industry,⁶⁴ but by staff directly dispatched by the central regulatory institutions (i.e., MII or SASAC). In regulating the telecom service sector, vertically organized “leadership relations” between the MII and local Telecommunication Administrations, which are local branches of the central MII, are more principal than horizontally organized “professional relations” between local Telecom Administrations and regional governments. In contrast with the auto industry, this demonstrates that local governments in the telecom business may make

⁶³ In China’s political system, most government agencies are simultaneously subordinated to several superior administrative levels. There are two types of political relations: “leadership relations (*lingdao guanxi*)” and “professional relations (*yewu guanxi*).” While the former is governed binding-orders, the latter is consultative based on non-binding orders. See, Liberthal and Oksenberg (1988: 148-149); Mertha (2005: 797)

⁶⁴ Oi (1999)

advising suggestions to local Telecom Administrations, but they are non-binding.

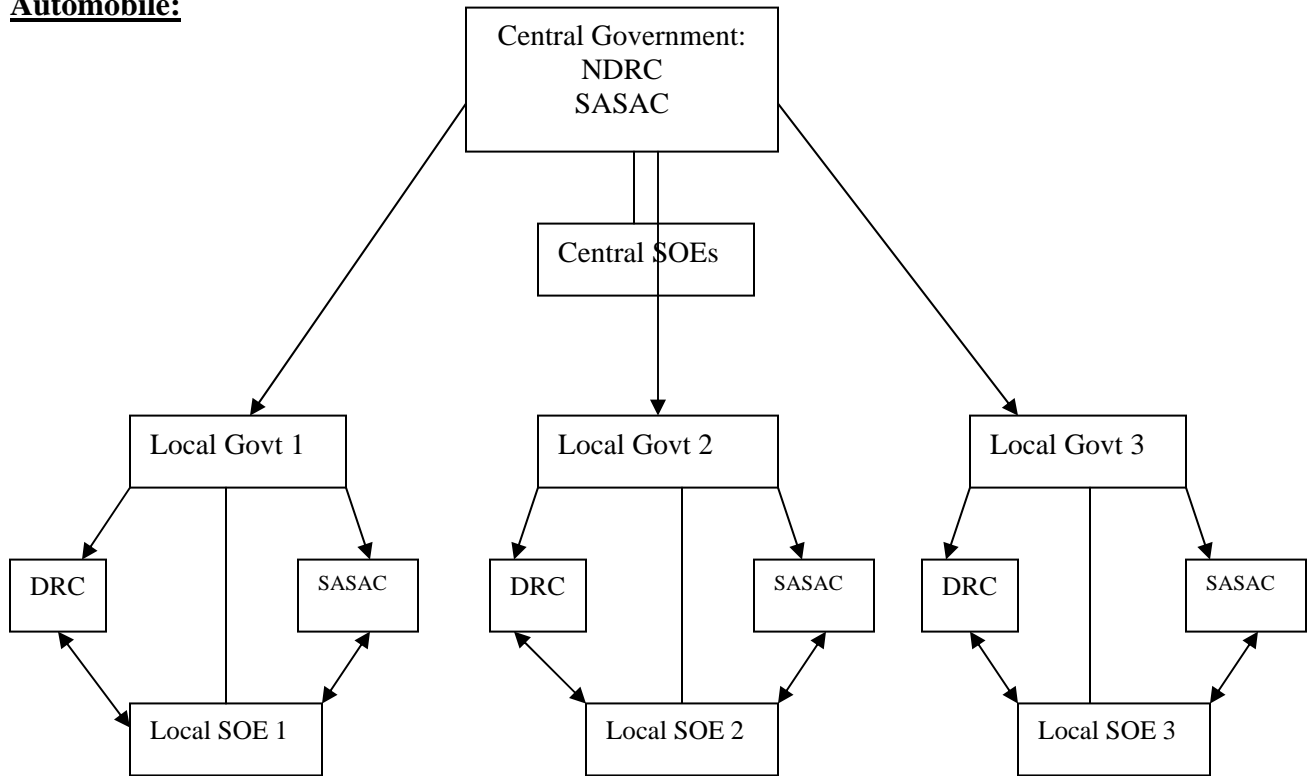
There is also an implicit hierarchy among central regulatory institutions in the sector.

As discussed in Chapter 4, while the MII remains a state-designated special public agency, substantial regulatory power is exercised by SASAC, controlling budgets, assets, investments, and personnel management. Since all telecom service providers are centrally-owned, the central SASAC can tightly and effectively regulate their business management.

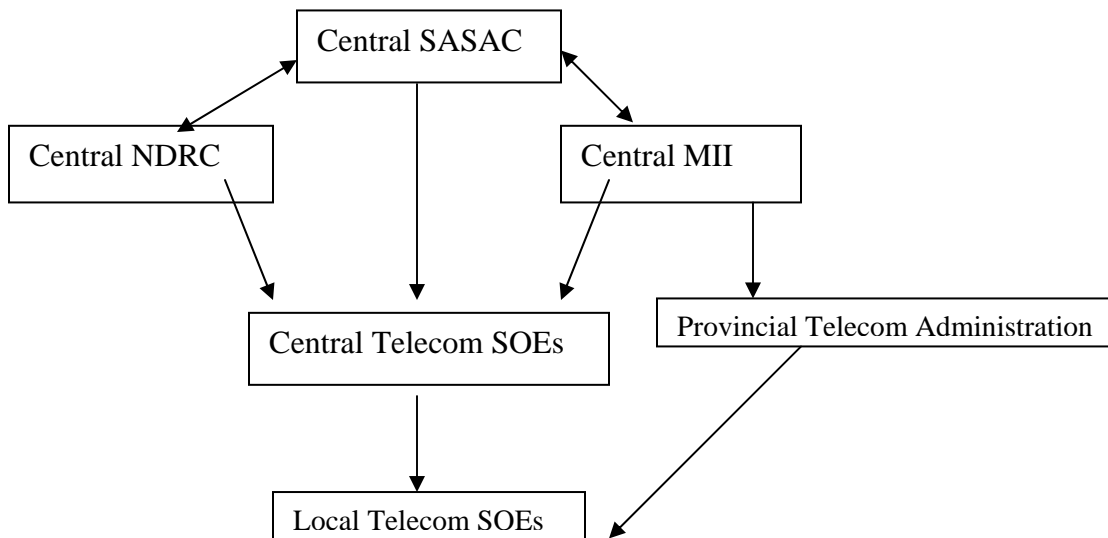
Figure 5-1: Comparing Regulatory Structure in the Auto and Telecom

Industries

Automobile:



Telecom service:



B. Central-Local State Relations: Decision-Making Authority

When decentralization is defined as “the downward transferred decision-making power from some central point to either the production unit or some lower level of regional administration,”⁶⁵ it is manifest that automobile manufacturing is one of the most decentralized industries, while the telecom service sector is highly centralized. Here I discuss how decision-making authority in a decentralized or centralized governing structure has an effect on the variations in the forms of industrial regulation in China.

In the auto industry, local governments retain the right to distribute such resources as budget, tax, and land, as well as to appoint and determine the tenure of presidents of local auto firms and of provincial/municipal leaders.⁶⁶ The power of local governments in the auto sector is further demonstrated in that the local DRC, which plays the role of gatekeeper providing local auto manufacturers with access to the central NDRC, is organized and staffed by local governments. These sources of regulatory power have led provincial/municipal governments to exercise substantial discretionary powers. To promote the development of their own auto companies, local governments often provide them with land at a cheap price.⁶⁷ Senior executives and managers of central auto producers are directly appointed by the central SASAC, while the personnel of local auto companies are in the hands of local governments. In

⁶⁵ Schurmann (1968: 175) In this study, decentralization is defined as “the downward transfer of power and authority to lower-level of government units.” Jae Ho Chung, *Central Control and Local Discretion in China: Leadership and Implementation during the Post-Mao Decollectivization* (Oxford: Oxford University Press, 2000), p. 4.

⁶⁶ SAIC is exceptional, because the center appoints the presidents of the largest three auto companies, such as FAW, Dongfeng, and SAIC.

⁶⁷ Interview in Beijing-Hyundai in Beijing (November 2005); in SAIC-VW in Shanghai (March 2006)

effect, “through decentralization, a wide range of decision authority was transferred from the central government to the provinces and below for the sake of promoting local incentives.”⁶⁸ As such, by examining decision-making authority in the auto industry, we can see how a decentralized governing structure affects the creation of the regulatory pattern. This decentralized economic and political power has allowed local governments to enjoy relatively high discretion, which leads to making the central regulatory oversight loose and invisible compared with the mechanism in the telecom sector.

Policy-making, implementation, and supervision in the telecom service sector are tightly centralized. As a consequence of the strong legacies of the state-led monopoly system, only a limited number of telecom firms have been permitted to enter the market, and they are all centrally-owned state firms. As I pointed out in Chapter 4, such central ownership allows the central regulatory body, SASAC, to effectively control telecom firms’ budget, personnel, investment, and asset management, and its regulation is both expanding and tightening. China’s basic telecom service operates in a government-set price system, not by the market. Since local telecom firms are simply local units of the central telecom companies, they have to acquire approval from the central head office when they attempt to change telecom service fees or billing systems at localities. Local governments can reflect their voices in setting telecom prices through the price bureau, but the ultimate decision is made at the center, the NDRC and MII. Profits of local telecom firms are remitted to the central office, not local governments, and revenue after taxes is managed by the central SASAC. Personnel, ownership, and the distribution of resources are

⁶⁸ Chung (2001: 46)

implemented by the center, which also means that the discretionary power of local governments is very limited. Therefore, the pattern of regulation in the telecom industry is vertically centralized through formal channels.

3. Forms of Ownership

In China's market-oriented reforms, forms of ownership are a key economic institution in generating diversity in state regulation. When ownership is defined as "the right to income and the right to control" of assets and business management, industries where both central and local state ownership co-exist (i.e., the auto sector) inevitably bring about variations in the system of regulatory governance.⁶⁹ In the state sector, central state ownership means that the central government has the right to claim remitted profits, which go directly to the central budget.⁷⁰ On the other hand, locally-owned state firms remit their profits to provincial or municipal governments for the local budget. Ownership composition in the Chinese industrial economy is divided into state-owned, collective (including TVE), private, and foreign-invested.⁷¹ State ownership is again split into centrally-owned and locally-owned firms. Even though the ratio of state-owned enterprises to industrial output has remarkably

⁶⁹ OECD, "OECD Principles of Corporate Governance," (2004) <http://www.oecd.org/dataoecd/32/18/31557724.pdf> More specifically, "ownership refers to a bundle of rights that an agent is empowered to exercise over an asset or piece of property, such as the right to utilize the asset; to possess the fruits of that utilization (return right), and the right to transfer these rights to another agent through gift or sale (alienation right)," Louis Putterman, "The Role of Ownership and Property Rights in China's Economic Transition," *The China Quarterly*, No. 144, Special Issue: China's Transitional Economy (December, 1995), p. 1049.

⁷⁰ Christine P. W. Wong, "Ownership and Control in Chinese Industry: The Maoist Legacy and Prospects for the 1980s," In *China's Economy Looks Toward the Year 2000: Volume I. The Four Modernization*. Selected Papers Submitted to the Joint Economic Committee, Congress of the United States (Washington, D.C.: U.S. Government Printing Office, 1986), p. 585.

⁷¹ Naughton (2007: 300)

declined from 77% in 1978 to 33% in 1996,⁷² public ownership is still pre-dominant in state sectors, accounting for 38% of the whole industrial output in 2004.⁷³

Then, the question is whether and how the forms of ownership affect the patterns of regulation over key state sectors. In this regard, I argue that the level of ownership in the Chinese industrial economy is important, in that it determines who has the right to control and supervise the management of state assets. It also affects who appoints top executives of enterprises and decides the planning of production and investment.⁷⁴ Oi and Walder have argued that “property rights in the Chinese economy have moved decisively away from traditional state ownership”⁷⁵ toward the reformed, contracted, leased public assets, and private firms. Moreover, these forms of enterprise ownership vary across regions and sectors.⁷⁶ Focusing on rural industry, the authors have uncovered two different property regimes marketed by the roles of rural officials: government-centered (corporatist) and entrepreneur-centered (littoral), and variations are further complicated across regions. Whereas rural industrial sectors show great progress toward contracted or privatized assets, Oi and Walder have noted that the “large-scale state sector still is dominated by the reformed public firm model,” where partial rights of control over business management are transferred to managers who are employed and closely monitored by the government.⁷⁷ However, the model fails to explicate the varied forms of ownership *within* the large-scale state sector, either centrally or locally owned, and how they affect the variations in state

⁷² *Ibid*

⁷³ Naughton (2007: 303)

⁷⁴ Oi and Walder (1999: 5)

⁷⁵ Oi and Walder (1999: 22)

⁷⁶ They include: 1) traditional state or collective ownership, 2) the reformed public firm, contracted public firm, leased public firm, and privatization. Oi and Walder (1999: 7-10)

⁷⁷ Oi and Walder (1999: 7)

control. The automobile industry provides an outstanding example: although the reformed state firm, as in the telecom service sector, is dominant, there are also private and foreign-invested firms. In other words, while Oi and Walder have claimed that one type of property in the Chinese economy replaces another through the reform processes, I suggest that various forms of ownership, from traditional state firms to private ones, work together concurrently. This considerably affects the creation of complex patterns of state regulation across and within the sector.

Furthermore, the existing literature on Chinese industry has tended to assume that the notion of state sector or state-run enterprise is likely to have highly centralized organization and administration.⁷⁸ Belcher and Shue, focusing on one county, Shulu, found that “state-run enterprises took several forms, having centralized and decentralized and vertical and horizontal forms of ownership, organization, and administration, thereby not all of which were under tight central control.”⁷⁹ Likewise, at the sectoral level, even though both the automobile and telecom service sectors are strategically significant state sectors and dominated by state firms, they exhibit diversity in the patterns of central oversight: soft/invisible, hard, and a mixture of both.

Since state sectors are “the most compelling national objectives and vested interests,” most of them are centrally-controlled large SOEs. The 1997 *Zhuada* (“grasping the large”) policy evidences the central leadership’s idea that the controls of the central government will be focused on the designated large SOEs.⁸⁰ They

⁷⁸ Blecher and Shue (1996: 94; 207)

⁷⁹ *Ibid*

⁸⁰ Naughton (2007: 297); With respect to the overall public sector reform, see Peter Nan-Shong Lee and Carlos Wing-Hung Lo. 2001. “Remaking China’s Public Management: Problem Areas and

largely consist of the commanding heights and pillar industries, and both automotive and telecom belongs to important state sectors, although there are private and foreign-invested firms in automobile manufacturing. However, what makes regulatory mechanisms in China's industrial economy nebulous are the central and local mixed forms of ownership and continued central control over decentralized state firms. To maintain central state controls over profitable large SOEs, both central and local government regulation apply. Yet due to the lack of ownership of local state firms, central control over local auto state firms is often invisible and looser than in centrally-owned state firms, which I conceptualize as soft/invisible regulation. This echoes what Christine Wong has commented, "Ownership does not necessarily translate into control."⁸¹ As I find, the pattern of soft/invisible central regulation for the large local auto state firms clearly demonstrates the complexities. Moreover, although the ownership of Chinese state firms is separated into centrally-owned and locally-owned, "it would be simplistic to assume that central control extended *only* to centrally owned enterprises" because the central party-state still holds the levers of control via financial (i.e., asset management) and political (i.e., personnel) supervision over locally-owned state enterprises.

Accelerated by the fiscal reform beginning in the 1980s, the policy of decentralization has been a notable feature of economic reform in China. The existing literature on decentralization has largely centered on 1) exploring how the increasing fiscal and managerial incentives for local governments have affected the central state

Analytical Perspectives," In edited by Peter Nan-Shong Lee and Carlos Wing-Hung Lo, *Remaking China's Public Management* (Westport, Connecticut: Quorum Books, 2001)

⁸¹ Wong (1986: 586)

capacity and (re)shaped central-local relations,⁸² or 2) characterizing the role of local governments as corporate states, entrepreneurial states, bureaucratic entrepreneurs, and industrial firms.⁸³ In rural industry, Jean Oi has argued that central regulation conducted by *local* regulators is likely to be conditioned by compatibility with local interests and the degree of supervision from the upper level.⁸⁴ As such, although it is generally accepted that fiscal, administrative, and property decentralization does not necessarily mean the disintegration of central control over economic activities at the local level,⁸⁵ the manner and source of central regulation for the business of decentralized state firms have never been captured and specified. As the case of the auto industry shows, the methods of central control over decentralized state firms are distinguished from the centralized sector (i.e., telecom). Most recently, some scholars have claimed that the central government has been recentralizing its regulatory control over state sectors.⁸⁶ Focusing on the oil and petrochemical industries, Kun-Chin Lin has pointed out the transformation of state regulation, shifting “from decentralized administrator control to centralized corporate shareholder control” so as

⁸² Jean C. Oi, “Fiscal Reform and the Economic Foundation of Local State Corporatism in China,” *World Politics*, Vol. 45, No. 1 (October 1992): 99-126; *Rural China Takes Off: Institutional Foundations of Economic Reform* (Berkeley: University of California Press, 1999); Christine P. W. Wong, “Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China,” *The China Quarterly*, No. 128 (December 1991): 691-715; Michel Oksenberg and James Tong, “The Evolution of Central-Provincial Fiscal Relations in China, 1971-1984: The Formal System,” *The China Quarterly*, No. 125 (March 1991): 1-32; Wang Shaoguang, “Central-Local Fiscal Politics in China,” In edited by Jia Hao and Lin Zhimin, *Changing Central-Local Relations in China: Reform and State Capacity* (Boulder: Westview Press, 1994), pp. 91-112; “The Rise of the Regions: Fiscal Reform and the Decline of Central State Capacity in China,” In edited by Andrew G. Walder, *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary* (Berkeley: University of California Press, 1995), pp. 87-113; Dali L. Yang, “Reform and the Restructuring of Central-Local Relations,” In edited by David S.G. Goodman and Gerald Segal, *China Deconstructs: Politics, Trade and Regionalism* (London: Routledge, 1994)

⁸³ Oi (1992); Duckett (1998); Gore (1998); Walder (1995)

⁸⁴ Oi (1999: 139)

⁸⁵ Oi (1999: 140)

⁸⁶ Chung (2003); Pearson (2005); Lin (2006); Mertha (2005)

to break off the legacies from the planned economy.⁸⁷ Jae Ho Chung has argued that Chinese leadership seeks to leverage central regulation over the public sector by recentralizing fragmented state-owned firms through large business groups.⁸⁸ Yet the abovementioned studies still remain the dichotomous approach to regulation of China's public sectors, either (re)centralized or decentralized control. None of them relevantly explains how the (re)centralized regulatory power is virtually exercised over decentralized state-owned firms, and how the patterns of regulatory oversight are distinguished when compared with highly centralized state industries.

In addition, ownership composition of the auto industry is further complicated by emerging private producers and the number of foreign-invested firms with global auto producers due to the need for the integration of a global value chain. State control, both central and local governments, in private and joint venture auto firms is likely to be attenuated, because the asset and business management of private auto producers are relatively free from state oversight in terms of personnel and asset management. Major auto joint venture firms have to coordinate short and long term business plans as well as daily business with foreign partners. Given that China's passenger car market is still dominated by foreign-invested state auto firms, state regulation in the auto industry is inevitably looser than in the telecom service industry. Therefore, variability in governing strategic industries in China is found not only across the auto and telecom industries, but also within automobile manufacturing, which demonstrates a mixed form of regulatory architecture from the center. In sum, such mixed forms of ownership as central and local state ownership

⁸⁷ Lin (2006)

⁸⁸ Chung (2003)

have considerably contributed to shaping various patterns of regulatory mechanisms under the rein of central oversight.

The Role of Foreign Investors in State Regulation

How does foreign investment have an effect on making regulatory patterns in China? The conventional wisdom is that more foreign-invested firms in state sectors are more likely to corrode the government controls. Focusing on institutional effectiveness, Yasheng Huang argues that the domination of foreign-invested firms has resulted from China's institutional weakness, which turns out highly ineffective market fragmentations.⁸⁹ In terms of managing foreign-invested state firms in the form of joint ventures, this argument would be valid because, as stakeholders, foreign-investors have the right to participate in the decision-making process of business management. But in dealing with foreign investors in the sector, high inflows of foreign investment do not necessarily lead to decreasing state regulation. In particular, where competition among foreign investors is extensive in taking the initiative in the Chinese market, more foreign investment is likely to give the Chinese government more leverage to control foreign investors by encouraging competition.

Drawing on the case of the auto industry, Eric Thun claims that even though foreign-invested joint venture auto firms take a dominant position in China's auto market, this domination results from the government's industrial policies, not from its institutional faults. The central government has always maintained the capacity to control the inflow of foreign investors, such as the rights to approve "the creation of a

⁸⁹ Huang (2002; 2003)

new assembly joint venture, the partner, the terms of the deal, and the model that would be produced.”⁹⁰ This regulatory power surely contributes to raising the leverage of the central government’s control over foreign investors.

From the outset, the central government has taken a contrasting approach to the automotive and telecom service sectors. Auto manufacturing is one of the most progressively open to foreign capital, while foreign capital in the telecom service industry has been strictly prohibited, as seen from the 1993 and 1995 regulations.⁹¹ Upon the WTO entry in 2001, the MII issued new regulations on foreign investment and allowed foreign telecom service providers to participate in China’s telecom service sector in the form of joint ventures.⁹² By expanding cooperation with foreign investors, the central government expected to “reduce cost, promote business volume, and improve service standards and quality of personnel.”⁹³ But foreign-invested joint venture service providers have not appeared yet due to the ambiguous business environment and “numerous hidden regulatory barriers.”⁹⁴

Instead of establishing joint venture telecom service firms with foreign partners, China’s telecom SOEs tend to put more emphasis on promoting corporate governance by inviting experienced foreign professionals to sit on boards of directors. But the regulatory power of foreign board members in state firms significantly differs depending on whether they hold stakes. As part of the auto industry development

⁹⁰ Thun (2006: 67)

⁹¹ MPT, *Interim Arrangements for the Approval and Regulation of the Deregulated Telecommunications Services* (September 14, 1993); *Interim Rules on the Regulation of the Market of Deregulated Telecommunications Services* (November 10, 1995) Recited from Guan (2003: 53)

⁹² Overseas Chinese Affairs Office of the State Council, *Waishang Touzi Dianxin Qiye Guanli Guiding*, <http://www.gqb.gov.cn/node2/node3/node5/node9/node102/userobject7ai1554.html> (Access: April 10, 2007)

⁹³ “China’s Telecom Sector Will Open for Foreign Investment,” *People’s Daily* (September 11, 2001)

⁹⁴ Bing Zhang and Mike W. Peng. 2000. “Telecom Competition Post-WTO Style,” *The China Business Review* (May-June), p. 21

policy, China has been active in attracting foreign investment in order to exchange its enormous market with advanced foreign technology and managerial skills. Hence, the strong need for foreign investment in automobile manufacturing has led state regulation to be less strict and allowed foreign board members to hold stakes. Shareholding foreign investors in the sector retain the right to participate in major business projects. As a result, this has an effect on relaxing regulatory control. This logic is also relevant in accounting for how strict prohibition and its concomitant lack of foreign investment in the telecom service sector have created the pattern of hard regulation in the sector. Yet even though the telecom market entry has been gradually opening up to foreign investors, I argue that it does not necessarily lead to relaxed soft regulation as seen in the automobile firms, because the telecom service is an infrastructure industry intimately tied to political and national security concerns.

For example, FAW-VW, a major JV auto firm, and China Netcom, a major telecom service provider, are both centrally-owned large state firms. While the functions of the boards of directors in both firms are important in business management,⁹⁵ their composition is different, affecting the methods of central state regulation. FAW-VW's board consists of seven Germans out of sixteen members, and the vice chairman of the board is German, while the chairman is the president of FAW Group, Zhu Yanfeng. In addition, there is the board of management (*jingying guanli weiyuanhui*), which is composed of three Chinese and three German executives. As such, foreign investors in FAW-VW as stakeholders have the right to participate in decision-making and business management. This implies that even though FAW-VW is a central state firm, state regulation can be held in check by its

⁹⁵ Interview in FAW-VW, Changchun (March 2006)

foreign partners. According to one senior manager in FAW-VW, “because VW owns 50% of stake, we have to negotiate and cooperate in managing assets and personnel. But, sometimes it is very difficult to make an agreement with German partners regarding technology development or export/import plans, and human resources. They demand more and more autonomy in managing the firm.”⁹⁶ Since FAW is a very important symbol of China’s auto industry, and its good shape is very important to the central government, the relationship between FAW and the central government is fairly intimate.⁹⁷

Conversely, no joint venture telecom service firm has been created, even though the Chinese central government in 2001 issued a regulation allowing foreign investment in telecom service firms. As mentioned earlier, some providers have made an effort to improve corporate governance by inviting senior foreign experts, but their voices remain “advising” as independent non-executive members; they do not have substantial authority in governing the business of the firms. The function of the board of directors becomes more formalized, and Chinese senior executives are willing to learn from Western practices of corporate governance.⁹⁸ But, again, foreign non-executive members have no formal right to participate in policy-making. Through the party committee in state firms, the party-state exercises regulatory control of telecom service providers directly and tightly, for their own interests and without restraint.

⁹⁶ Interview in FAW-VW, Changchun (March 2006)

⁹⁷ Interview with DRC scholar by email (December 2006)

⁹⁸ Barton and Huang, (2007)

IV. Chapter Conclusion

Despite inherent sectoral characteristics, as well as a range of market-oriented restructuring programs, China's regulatory governance of the telecom and automobile industries suggests that strategic state sectors are under central state oversight. However, the patterns of centralized regulation are divergent across the sectors. The factor of ownership is particularly important in that even though the automotive and telecom service industries have evolved under very different historical and institutional environments, central state firms in both sectors show similar patterns of central regulation in order to protect the party-state's crucial state assets. Findings from this comparison confirm my hypotheses in Chapter 1 that pre-existing institutional arrangements significantly affect the creation of diverse forms of regulatory governance. The concepts of centralized soft and hard regulation as specific forms of regulatory governance highlight the complex nature of the Chinese political economy.

CHAPTER 6

CONCLUSIONS

Since the 1990s, the Chinese top leadership has taken a number of steps to *remake* the states' institutional foundation toward a market-oriented economy. This has included a wide range of administrative, corporate, and regulatory reforms as well as entry into the WTO. How do such institutional changes affect economic governance, particularly in strategic industries? Given substantial variation in ownership and governing structure (i.e., central-local state relations), how do regulatory forms vary between sectors?

This research project has investigated the sources and types of complexities in industrial regulation. Taking two strategic industries as crucial cases, I have explored the patterns of economic governance in the automobile manufacturing and telecom service sectors in China. In doing so, I have accounted for the historical development and the structure of government authority of each case. I found that, despite significant differences in sectoral characteristics, both industries have centralized regulatory power. At the same time, the form of central control varies between, as well as within, the sector.

The findings presented in this study make two significant contributions to the study of regulatory politics, particularly in the context of the Chinese political economy. First, the conventional model of regulation needs to expand empirical cases into strategic but decentralized or non-strategic industries in order to better reflect the

overall picture of the system of economic governance. As the two cases in my research strongly demonstrate, there are substantial variations in the forms of ownership and central-local state relations across issue areas. This finding has been overlooked in existing analytic frames.

Second, as the telecom service sector demonstrates, a focus on the independent regulator model, fails to explain who exercises the *de facto* regulatory control over enterprises when its independence is constrained by both government and business. My research suggests that, by relaxing the conventional analytic frames, we discover that the newly *re-organized* and enhanced comprehensive state institutions play a substantial role as the “watchdog” of strategic industries. As their regulatory power has grown, the independence of specialized regulatory bodies tends to become constrained. The case studies presented here demonstrate that the MII in the telecom sector is considerably restricted by the newly emerged comprehensive national power SASAC. The central NDRC oversees the automobile sector through the authority to approve key investment projects, formulate industrial policy, and to oversee its implementation. One study also finds that the regulatory power of State Electricity Regulatory Commission (SERC) in the power industry has triumphed over by the NDRC.¹ The conventional independent regulator model does not adequately explain the empowerment of supra-ministerial bodies (i.e., NDRC or SASAC) as new regulator; nor does it address the political goals of the central leadership. In fact, government restructuring programs and the creation of various regulatory commissions do not lead to limited (*youxian*) or decentralized government. Despite

¹ Chung-min Tsai, “Liberalization without Marketization: The Political Logic of China’s Electricity Reform,” presented at the Annual Meeting of Midwest Political Science Association, Chicago (April 2007)

persistent legacies of fragmented authority and bureaucratic infighting, comprehensive national power *at the core* is newly restructured and strengthened by integrating key policy decisions. Studies of economic governance in China's industrial economy should, therefore, explore the growing regulatory power of comprehensive state bodies, and their impact on the forms of regulation. In doing so, we can identify more relevant mechanisms of regulation and the sources of variations in regulatory practices. The findings of this study present a foundation for such explorations in the future.

Centralized but Soft, Hard, and Mixed Forms of Regulation

This dissertation's central focus concerns the political logic of centralized but varied patterns of regulatory practices in China's two strategic industries, the automobile and telecom service industries. As I have pointed out in Chapter 2, I agree with the scholarly view that China's changing mode of economic governance is characterized as a (re)centralized regulatory state, where the function of government is more oriented to guiding a macro-economic developmental direction than a micro-level intervention.² Yet the forms of central regulation are varied, marked by issue areas due to the differences not only in sectoral characteristics, but also inside institutional environments, such as the level of ownership (central vs. local), the structure of governmental authority, and the role of foreign investors. Hence, rather than relying on the conventional idea of an independent regulator model, I have attempted to disaggregate the concept of a regulatory state that has been treated as unitary in order

² Yang (2004); Mertha (2005)

to better capture the complexities appearing in the varied patterns and sources of regulation in the Chinese industrial economy. The model of soft and hard regulation developed in this dissertation provides a complementary framework to the independent regulator model so as to explicate the mechanism of industrial governance, where the public ownership is still dominant under the reins of the party-state in China.

Before carrying out the field research, I hypothesized that the system of regulation for the auto industry is decentralized due to strong local governmental authority and ownership, while the telecom service sector is under central control. Initially, I planned to investigate why these different patterns of state regulation, centralized versus decentralized, occurred despite similar institutional underpinnings. As the research proceeded, however, it turned out that regulatory power in both industries is centralized, although the pattern and degree of central oversight is different. Then, why is centralized regulation concurrently arising? As I have extensively discussed in Chapter 5, two components are notable: 1) the strategic importance to the national economic welfare, and 2) the political need to protect state assets tied to the vested interests of the party-state and to create a cohesive central power at the core. To begin with, in terms of *economic* concerns, it is clearly stated by the director of SASAC that central regulatory control over such industries is indispensable, for they are associated not only with national security and the economy, but also with the development of other sectors.³ Central regulatory control resulting from strategic significance is also evidenced by the government's efforts to

³ Li Rongrong, "Guoziwei Mingque Dianxin Hangye Wei Guoyou Jingji Yankong Yangye," *Beijing Yuele Xinbao* (December 12, 2006)

foster large state-owned corporations and to rationalize the market by controlling the number of firms and the entry of foreign investors.

In terms of *political* concerns, I have found that the ultimate goal of central oversight is to secure crucial state assets through formally or informally institutionalized channels. Close and tight controls over state assets are imperative for the party-state, for a solid economic foundation serves as the grounds for not only political power, but also continued control of society.⁴ As such, while I did not expect a significant role of the Party in shaping the regulatory regime, it turned out to be a key element giving rise to central oversight. In fact, I had assumed that each industry had one type of regulatory mechanism, prior to the research. While sectoral characteristics were anticipated to have an effect on creating different practices of regulation, it was not expected that varied forms of regulation would be employed within one sector. As my findings have demonstrated, however, not sectoral characteristics alone (i.e., manufacturing or natural monopoly), but the forms of ownership within an economic industry significantly contribute to creating variations in the patterns of regulation, since the levels of public ownership (central or local) influence the manner and sources of central oversight. As hypothesized in Chapter 1, although the varied forms of regulation are facilitated by differences in the historical evolution of industrial development, central-local state and inter-bureaucratic authority relations across industries, the findings reveal that the forms of ownership particularly play a decisive role in making the varied central regulation patterns.

At the same time, while the level of state ownership (central or local) is a significant element, in that it affects who has the right to supervise crucial state assets

⁴ He (2005)

and appoint top executives of major state enterprises, it fails to account for why the centralized system of regulation arises despite such dissimilarities. It is also important to note that the above variables are closely interrelated: the history of industrial evolution has been associated with shaping the governing institutional structure, such as central-local state relations or forms of ownership across localities and issue areas. For example, hierarchical relations among bureaucratic agencies in China's telecom service sector are not irrelevant to historically evolved centralized government authority and regulatory policies. The policy of decentralization in developing automobile manufacturing has led to allowing local governments to exercise discretionary power, which makes central regulation relatively loose compared with the highly centralized telecom service sector.

Given China's rapid integration into the global economy, I also considered the influence of foreign direct investment on shaping the system of regulation. Yet its significance is recognized differently than I expected. I assumed that more foreign direct investments in the leading economic industries would 1) push further to improve corporate governance, conforming to the globally advised type of regulatory regime that emphasizes privatization and transparent governance, and 2) check government controls over business. Findings show that the increase of foreign investments does not simply corrode state regulation. Rather, it evidences the power of central regulatory institutions in strategic economic industries by controlling the entry and partners of foreign investments and requiring the approval of the central government, regardless of the nature of the industrial market and the system of governance. Foreign investments also have an important impact on creating variations

in the patterns of central oversight, which I did not anticipate prior to the research. By holding the rights to state assets as shareholders, foreign investors are allowed to participate in the major business decisions of state firms. Thereby, to some extent, more foreign investments contribute not only to improving corporate governance and maintaining central regulatory power, but also to creating the varied forms of central oversight. Hence, less foreign direct investments, as seen in the telecom service sector, has led the central state institutions to exercise more tight oversight. In sum, soft, hard, and their mixed, variegated forms of central regulation are identified between, as well as, within the sectors. The forms of regulation are diverse not simply because of sectoral differences, but rather because of the mutual interactions of path-dependent history, central-local state relations, forms of ownership, and the role of foreign investment. The findings show that the level of public ownership and the role of foreign investors exert a particularly significant impact on creating variations in governing China's strategic industries.

Recalling the introduction of a model of soft/hard regulation in Chapter 2, soft regulation is one pattern of a *central* regulatory mechanism identified in China's decentralized but strategic industries. Due to strong local components in terms of administration and ownership as well as the important role of foreign investors, I find that the pattern of central regulatory power in China's automobile manufacturing is soft and invisible through informal channels. What is important here is, given that the literature of decentralization has not tackled the fact of soft/invisible central regulation, the case of the auto industry provides an excellent example to show how the central party-state maintains the levers of control over the major large-scale

SOEs. In other words, the policies of decentralization do not necessarily imply the lack of central regulatory power in China's state industries. Moreover, two major central state auto firms, even though local state ownership is dominant, show similar patterns of hard regulation, as in the telecom service sector, in that central state institutions tightly supervise the management of assets and personnel. In spite of the same auto industrial sector, the mechanism of regulation is different depending on the level of ownership. Hence, soft and hard mixed forms of state regulation surface in China's auto industry.

On the other hand, I find that the pattern of regulation in the telecom service sector conforms to hard regulation when compared with automobile manufacturing. Under central state ownership, the business of telecom service firms is tightly supervised and monitored by central regulatory bodies. Unlike in the auto industry, local governments have no binding authority for local telecom firms, which are simply the local unit of central headquarters. Most importantly, substantial regulatory power is exercised not by the MII, which is a formally state-designated regulator, but by SASAC as the owner of crucial state assets. In other words, while the MII plays the role of "regulator" by encouraging and supervising market competition in the sector, as I have pointed out in Chapter 4, its regulatory function is considerably constrained, not only by an ongoing sticky relationship between government and business, but also by the growing power of the comprehensive state commission, SASAC. While some highlight the MII's regulatory function and its separation from business as operator,⁵ the sector is strictly controlled by the rising supra-ministerial regulator SASAC above formally designated regulator MII. As such, if the MII's

⁵ Interview with Zhang Xinzhu by email (July 2007)

independence is constrained, a model of soft/hard regulation then further attempts to uncover exactly who exercises substantial control over the business of telecom service, rather than simply analyzing the case through the conventional frame.

Soft/hard regulation in China's industrial economy is also identified by the manner of policy implementation and rule-making power. In the regime of hard regulation (i.e., the telecom service and central auto state firms), rule-making authority is monopolized by central state institutions, such as the NDRC and SASAC; the implementation of price, market entry, and industrial policies is strictly monitored by the central authority. On the other hand, rule-making authority in the system of soft regulation (i.e., local auto state corporations), is shared between central and local government bodies, though the ultimate decision is made by the center. By creating this leeway, strong local components contribute to making the implementation of central policies and regulation loose and soft compared with a tight/hard regulatory system. As such, even though key strategic industries are commonly under central oversight, variations in the practice of regulation can be found. This also calls for the importance of understanding the domestic context. Despite vigorous efforts for market liberalization and regulatory and corporate reforms, the strongly lingering legacies of the Communist institutions, party and state ownership, gives rise to distinctive regulatory governance compared with other countries in the world.

Then, are the findings of this study surprising considering how most people think about China? What is astonishing, I suggest, is not the finding of the centralized regulatory mechanism itself, but the unveiling of the manner of how and why the Chinese top leadership exercises central oversight over strategic sectors,

regardless of the nature of the market and governing structure. When compared with the system of regulation in the centralized telecom service sector, central oversight over the business of decentralized state auto corporations is loose and invisible, at least in terms of formalized routes. Furthermore, as the model of soft/hard regulation demonstrates, the mixed forms of central regulation are identified even within one sector, as well as, across industries. This also reflects that while the model of independent regulator portends convergence of economic governance, the creating and practice of regulatory institutions in China is a highly complex process due to “substantially different systems of governance and market characteristics,” which Margaret Pearson calls “a tiered economy.”⁶ Finally, while the telecom service sector in most countries has been nationalized and currently is under centralized regulatory power, what is interesting in the study of China is where the substantial regulatory power comes from. As I have discussed in detail in Chapter 4, I found that the *de facto* regulator is SASAC, not the MII that existing literature has focused on analyzing. This implies that we may better capture complex dynamics by relaxing the conventional analytic frame that centers on a state-designated public agency.

Is the Chinese Regulatory Regime Unique?

This dissertation has identified the diverse patterns and sources of regulation in China’s two very different strategic industries. Comparing the automobile manufacturing and telecom service sectors, this study has demonstrated that, regardless of the differences in market characteristics, the mechanism of regulation in

⁶ Pearson (2005: 322)

China's key strategic industries is *centralized* in order to protect the vested interests of the party-state and create comprehensive national power at the core. It also implies that the wide range of political and economic institutional changes ensuing from administrative and corporate reforms since the 1990s have never led to limited government; rather a cohesive central oversight arises. However, the forms of central regulation are varied. In this regard, I have proposed a model of soft/hard regulation to better characterize the diverse practices of the regulatory power from the center, and to help understand the politics of regulation in China's most strategic industries. Even though central regulatory oversight is commonly operating in the auto and telecom service businesses, the increasing activities of foreign investors and private manufacturers in the auto industry have made the manner and degree of central state control inevitably soft, thereby distinguishing it from the telecom service industry, where property rights are wholly-owned and tightly supervised by the central state. Hence, for the auto sector, I suggest the concept of "soft regulation" when compared with the pattern in the telecom service sector. The model also shows that "diversity" in regulatory patterns is identified not only across industries, but even within a sector, where different systems of administration and forms of ownership are operating. As such, while it is often said that we are living in an era of the regulatory state, we can recognize various practices of regulation marked by issue areas. If so, is China's regulatory practice unique compared with other countries in the world? What makes the Chinese regulatory state distinctive?

Drawing on the findings from the comparative case study of two strategic industries, I argue that China is unique in the following five aspects. First, when we

take a step back and explore who has “substantial” authority to control the commanding heights, China’s telecom service sector demonstrates that the *de facto* regulator does not always coincide with the formally designated public agency in practice. This implies that the independent regulator model that existing literature has relied on to analyze economic regulation may not be the best framework for investigating and understanding how the Chinese central leadership exerts control over strategic state sectors. As the telecom service sector evidences, while the conventional approach has focused on the independence of the formal regulator, the Ministry of Information Industry (MII), I found that the sector is significantly controlled not by the MII, but by the State-owned Asset Supervision and Administration Commission (SASAC).

Second, and related to the first aspect, even though there are official state-designated public agencies, above them, the newly reformulated comprehensive state institutions at the core, such as the NDRC and SASAC, play a key role of “watchdog” as regulator in practice. Given their powerful control over the market place of the commanding heights and pillar industries, which generate much of the government’s revenues, such *re-centralized* state power is never minimal, simply favoring consumers’ interests.

Third, the complex nature of China’s regulatory regime, which is colored by diversity in bureaucratic organizations and state-business relations across industries and localities, shows that no one single model may appropriately capture the overall dynamics of Chinese state regulation. Rather, there is much variation in the patterns of the regulatory system within China’s industrial economy. In other words, while

previous studies have tended to focus on characterizing the national approaches to regulatory reform,⁷ my findings suggest that we need to consider and compare other areas of the economy in order to better understand the whole picture of regulatory governance.

Fourth, despite a global wave of market-oriented regulatory reform coupled with privatization, state ownership continues to be the salient form of economic institution in China. In the U.S., regulation “leaves ownership of industry in private hands,” strongly believing that “the market works well under normal circumstances and should be interfered with only in specific cases of market failure.”⁸ On the other hand, “public ownership of key industries such as gas, electricity, and telecom service, has been the main mode of economic regulation in Europe. It was supposed to give the state the power to impose a planned structure on the economy and to protect the public interest against powerful private interests.”⁹ While regulation through public ownership has been a central feature in Europe, expert agencies are gradually replacing the regulatory functions of “departments of government under the direct control of political executives.”¹⁰

Rather than privatization, China’s central government has been making a great effort to improve corporate governance through transforming the organizational form of state-owned enterprises. According to the Company Law that came into effective in 1994, the traditional form of state firms in China is under transformation into three types of corporate enterprises: limited liability companies, state-owned limited

⁷ Vogel (1996); Majone (1996); Eisner (2000)

⁸ Majone (1996: 10)

⁹ Majone (1996: 11)

¹⁰ Majone (1996: 2)

liability companies, and shareholding limited companies.¹¹ While some argue that “despite repeated denials of the top leadership, the shareholding system reform is a form of privatization in the sense that it provides a channel through which state assets are transferred to private hands,”¹² others perceive that the shareholding company is established as a controlled subsidiary under the direct leadership of the parent SOE.¹³ Since the state in the traditional form of the SOE is the sole owner, the shareholding enterprise system is ultimately designed not to privatize property rights over state assets, but to enhance the value of state assets under *continued* state control. Moreover, the central leadership intends that such corporatization contributes to raising the finances of state firms by allowing non-state investors to own equity. As Donald Clarke has clearly pointed out, the major goals of regulation are not only to enhance pro-competition for the increase of national revenue but also to “reinforce the state’s grip on key economic sectors.”¹⁴ That is, without losing its vested interest, the Chinese party-state has been attempting to harmonize state ownership with market-oriented regulatory reforms and appears to believe that the system of regulation can be enhanced through corporatization, not privatization.¹⁵

Finally, the deeply penetrated Party organizations in both government and business add another distinctive feature to the practices of regulation in the Chinese political economy. As Sebastian Heilmann accurately pointed out, *despite* its significance, “the practice of Communist Party control and the role of secretive Party

¹¹ Donald C. Clarke, “Corporatization, not Privatization,” *China Economic Quarterly* Vol. 7, no. 3 (2003), p. 27

¹² Shu Y. Ma (1998: 380)

¹³ McNally (2002); Clarke (2003)

¹⁴ Clarke (2003: 27)

¹⁵ *Ibid.*

organs in economic regulation”¹⁶ have been the least touched by scholars from both mainland and abroad, in analyzing China’s regulatory reforms. To some extent, the Chinese regulatory regime shows more similarities with the Japanese system than with the European or the American experience, in the sense that the government still is deeply engaged in the business of industries, with strategic goals of growth rather than market efficiency. The Party, as the most powerful political institution, however, plays a key role in making China’s regulatory state distinguished from the Japanese system. Consistent with the global trend of regulatory reform, the Chinese state, in theory, has established independent regulators in key economic sectors and emphasizes the policy of separating government ministries from enterprises (“*zhengqi fenkai*”). At the same time, the personnel of not only regulatory institutions but also regulated state firms are controlled by the Department of Organization of the CCP. Thereby, neither regulatory bodies nor major state firms are free from political control of the Party. This also reveals that despite ongoing programs of market-oriented reform, a sticky triangular relationship among the government, enterprises, and the Party continues to remain central in the newly emerging economic governance.

China’s Construction of a Regulatory State: Implications

Building a regulatory state in China is a gradual and complex process of removing or downsizing the bulk of “old” state institutions and establishing new ones. In order to best secure the political and economic interests of the party-state, some areas of the

¹⁶ Heilmann (2005a: 4)

Chinese economy encourage competition reflecting consumer interests under relaxed state control, while the business of “commanding heights” and “pillar” industries is tightly supervised by central authority favoring state-owned oligopolies. As this study has shown, the regulatory regime over even key strategic sectors is varied due to different levels of public ownership and different roles of foreign investors in such state-owned firms and industries. As Andrew Nathan pointed out, “the American model or Western model has very low appeal in China.” While his remark focused on the political dimension, it also seems to be relevant in viewing economic regulation.¹⁷ More importantly, we should recognize how the Communist Party’s multi-pronged strategy, which entails controlling the management of crucial state assets and personnel decisions in both government and state firms, has been affecting the color of the regulatory state in China. Given the complex nature of the Chinese state and economy, any argument for one single model is incomplete for understanding the new mechanism of market governance that the party-state continuously designs in both formal and informal ways. This study provides the following implications for China’s emerging regulatory system.

First, despite extensive government and corporate reforms since the 1990s, the continued legacies of Communist institutions, such as the party-state and public ownership, have significantly contributed to creating distinct features of China’s regulatory state in governing key industries. As the case studies of the auto and telecom service sectors evidence, the party maintains levers of control over personnel in state firms and government. The dominance of state ownership is particularly

¹⁷ The Carnegie Endowment China Program, “Is Communist Party Rule Sustainable in China?” (October 5, 2006), Unpublished transcript.

remarkable in key strategic sectors where the party's vested interests are closely associated. Moreover, through deep penetration of the party committee in government and state firms, the party can effectively exercise supervisory and rule-making powers over major policy decisions, and control cadre management.

Second, this dissertation shows how/why central regulatory power is employed in a substantially *decentralized* industrial sector in China. Given that existing literature on China's political economy has rarely dealt with the manner and source of central regulation in the decentralization of the economy, this study offers an explanation for central control over decentralized state sectors and argues that strong local components do not necessarily imply a lack of central regulation. Therefore, we need to further study the patterns of central regulation for the decentralized economy.

Third, streamlined government restructuring and state-enterprise separation from administrative and corporate reforms are readily premised to reduce the role of the government in business. Yet this dissertation proves that central regulatory power in China's industrial economy is rather revamped through enhanced comprehensive oversight by formal or informal channels. In other words, institutional rationalization never does lead to a limited modern state. Although corporate reforms have contributed to diversifying the shareholders in state-owned enterprises, the state remains at the core as the dominant owner in state sectors.

Finally, not only to better illustrate and explicate the mechanisms of China's regulation, but also to identify who (which state institution or regulator) exercises substantial regulation, a theoretical framework of regulation is necessary, 1) to

expand empirical cases into non-strategic or strategic but decentralized industries, and 2) to relax the analytic framework that has heavily focused on specialized public agencies and their independent function. By defining regulation as “the use of public authority to set and apply rules and standards,”¹⁸ we can better understand various forms of regulation across as well as within one sector.

¹⁸ Hood et al. (1999: 3)

APPENDICES

Appendix 1: Interview Questions for the Auto Industry

Name:

Date:

Affiliation:

1. What is the role of auto industry policy (AIP) in China? And, what is the goal of the Chinese government to make AIP? Do you think auto industry policy in China is necessary and important? Why and why not?

在中国汽车工业，产业政策的作用是什么？中国政府的目标是什么？您认为在中国汽车产业政策即必须又重要吗？为什么？

2. Do you think the central government have the same approach/strategies in governing industries? (particularly for auto and telecom sectors; 尤其是对于汽车和电讯工业)

你认为中央政府对汽车和电信产业采取同样的政策（方法）吗？

- a. Exactly same: 完全相同
- b. Almost same: 大致相同
- c. Different: 不同
- d. Other (specify): 其它的

- 2-1. If different, why? (explain details)
如果不同，为什么？（详细说明）

3. In China's auto industry, the relationship between the central and local government is different across localities. Then, what does the "national" auto industry policy have meaning, and how does it have an effect on business?

在中国汽车工业，中央政府和各个地方政府的关系不一样，但都很重要。那么，国家汽车工业政策意味着什么？它怎么发挥作用？

3-1 For example, when the national auto industry policy (AIP) conflicts with the interests of local governments (Shanghai, Beijing, Guangzhou, Tainjin), how is it dealt with?

比如说，当国家汽车工业政策和地方政府（上海，北京，广州，天津）的利益发生冲突时怎么办？

4. Which governmental institution does play a key role in regulating China's auto industry?

什么政府部门对管理 (规制或监管) 中国汽车产业发挥主要作用？

5. What are the main functions of the National Development Reform Commission (NDRC) /the State-owned Asset Supervision and Administration Commission (SASAC) in the auto industry?

汽车产业发展政策上国家发展改革委员会与国家资产管理委员会的主要作用是什么？

6. 治理汽车产业上，跟国家发展改革委员会各个地方发改委的关系怎么样？

7. When there is the conflict between the center and local govt. about foreign partner or other auto business affairs, how is it dealt with?

- A. FAW-VW
- B. SAIC-GM:
- C. SAIC-VW::
- D. Beijing-Hyundai:

对于外国投资商谁有最终裁决权？而且对外国伙伴，当中央政府和地方政府发生冲突时怎么办？

8. 中国的政府在经济管理上（特别是在汽车产业）“汽车产业协会”与“汽车企业”的作用是什么？
9. 设立汽车产业发展政策时汽车协会与汽车企业怎么反映它们的建议？
10. 在汽车产业，为了鼓励汽车产业发展政府（中央和地方），主要手段（具体政策）是什么？
11. 汽车工业政策鼓励公平竞争，但国家政府会在一定程度上给大型企业各种支持，这会妨碍市场竞争。如何处理这种矛盾。您如何建议？
12. WTO 规定鼓励民营化和在市场少政府的作用。但是中国政府常常干涉汽车产业，而且鼓励三个大型国家所有汽车公司。您觉得中国汽车产业怎么调和 WTO 和国际体系？
13. What is the most important factor to decide foreign partners?
决定外合资的时候，重要的条件（还有标准）是什么？
14. 为了鼓励大型国家汽车集团公司，中央和地方政府实施什么政策？

Appendix 2: Interview Questions for Telecoms Industry

Name:

Affiliation:

Date/Place:

1. Ministry of Information Industry (MII, 信息产业部) is the key “regulatory” body. What is the prime central body in governing China’s telecom sector? Has there been any conflict or tension between the government agencies?

- A. 国务院 (State Council)
- B. 中国国家发展改革委员会 (National Development Reform Commission)
- C. 信息产业部 (MII)
- D. 国家资产管理委员会
- E. 中组部

下面哪个机构对电信改革的影响最大？

2. For telecom reform, the MII is supposed to be “independent” from both government and enterprises (particularly China Telecom), so called “政企分开”. Do you think MII is ‘independent’ regulatory agency? Why or why not?

对中国的电信改革，信息部应该是独立于政府和企业。您认为在电信改革中信息部真的是一个独立的监管部门吗？为什么？

3. Many Chinese scholars discuss “中国电信产业政策.” What does it exactly mean?

What is your definition of China’s telecom industry policy? And, how is it different from regulation policy?

4. Which government institution (i.e., NDRC, SASAC or MII) is the key government body to make ‘Telecom Industry Policy’? Could you explain the policy-making process?

5. In the telecoms reforms in China, there are several policies, such as industry policy, competition policy, enterprise policy. Which government institution is mainly in charge of what? How is their coordination(协调)?
6. When the government creates telecoms industry policies, is it allowed telecoms enterprises, business associations, or consumers to participate in and reflect their opinions? (public hearing)?
7. How is the relation between government and telecoms enterprise?
 - A. Between 国家资产管理委员会 and 电信企业
 - B. Between 发改委 and 电信企业
 - C. Between 信息产业部 and 电信产业
8. China's telecom sector has been developing and reforming rapidly. What is the major contribution to such rapid development? Government's strategic telecom industry policy (strong state support)? Or the successful business of telecom enterprises (the power of market)?
9. The State Council has the final authority to decide or guide the price in the telecoms market. This may restrain 'market competition,' because the price is set up by the government. How do you think?

国务院有权力决定或指导电信市场中的价格。在某种意义上，这会给竞争强加上一种约束力您怎么认为？
10. Do you think there is the regulatory governance (监管治理) in China's telecoms industry?

If it is, how can you explain/demonstrate?

11. Could you please evaluate China's regulatory reform in telecoms sector?

12. Do you think the central government has similar approach to auto and telecom industries?

你认为中央政府对汽车和电信产业采取同样的政策（方法）吗？

- e. Exactly same: 完全相同
- f. Almost same: 大致相同
- g. Different: 不同
- h. Other (specify): 其它的

If different, why? (Explain in details)

如果不同，为什么？（详细说明）

Thank you.

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