



Disaggregating China, Inc: State Strategies in the Liberal Economic Order with Yeling Tan

This is a written transcription of the podcast 'Disaggregating China, Inc: State Strategies in the Liberal Economic Order with Yeling Tan'.

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Yeling Tan: So, I want to start off our discussion by going back in time, 20 years, when China joined the World Trade Organisation (WTO) in 2001. As you can see from this picture on the slide, the mood was jubilant. There were these very high expectations that this event would usher in a new era of liberalisation in the Chinese economy. And the hopes were that through a common set of global trading rules, and through mutually beneficial economic exchange, WTO entry would peacefully integrate a rising China into the international order.

Over in the United States, we had President Bill Clinton putting his case forward for China's WTO entry and arguing, that under the WTO, some of China's most important decisions for the first time will be subject to the review of international bodies with rules and binding dispute settlement. Treasury Secretary Larry Summers, who was also a strong supporter of China's WTO membership, similarly argued that by learning to play by the rules, China will strengthen the rule of law, which will enable it to become a more reliable partner and a fairer society.

So why were there such high expectations for this critical event? This was in part due to the strength and depth of China's commitments to the WTO as part of its protocol of accession, which you see on the slide there. So as part of this protocol, China promised to let the market, rather than the state, set prices. It promised to liberalise the right to trade to all firms, not just state owned enterprises. It promised to improve the disclosure of information around economic policies. They committed to not intervening in the operation of the market; to not discriminating between domestic and foreign firms. To building a whole set of institutions for the independent regulation of the markets. To strengthening the rule of law and governing the market. In short, commitments that amounted to no less than a Herculean effort to transform China's economy from one rooted in state planning, to one that would operate much more on market forces.

And we fast forward to today however, and this liberal, internationalist promise of integration appears to have been replaced with disappointment and discontent. In 2018, the Trump administration declared that it was a mistake to have allowed China into the World Trade Organisation. And on top of that, recent years have seen the number of dispute cases at the WTO involving China steadily increase. China has clashed with the European Union and the United

States over its status as a non-market economy. The United States and the European Union have shifted their postures to treating China as a strategic competitor. Sanctions on Chinese companies, Huawei and ZTE. There's been a trade war that sees no end and all of these various tensions have raised concerns that the world is headed towards a decoupling of its two largest economies. And importantly, this discontent with China is bipartisan. So the Biden administration's trade representative and commerce secretary are sticking to the use of tariffs, and other tools, against China. And both the Commerce and Trade Representative have reiterated that they're committed to using all tools available to the U.S. government in terms of managing relations with China.

So in contrast to the integrationist expectations of two decades ago, the new conventional wisdom appears to have formed around China in the global trading system. This new conventional wisdom is firstly that the WTO has failed to alter China's economic model. Secondly, China is building a state capitalist model instead. And thirdly, this model is being now exported globally through national state owned champions, and state industrial policy.

Now, this state of affairs, as I've just outlined, poses a real challenge to the promise of liberal internationalism and to the large body of research that attests to the cooperative gains that are supposed to be reaped through membership in the WTO. It also poses a challenge to research that argues that these gains from cooperation should be greater for countries like China, since China had a far more rigorous process of accession compared to other new members, and it also has larger political and economic differences with developed economies that can be reconciled through global rules. So studying and explaining WTO's impact on China is immensely important. In the China case it's a really important one to study, not just for itself, but also for our broader understanding of international trade institutions.

So when it comes to explaining these changes, my own approach is actually to push beyond the success versus failure dichotomy that appears to have sprung up around this question of China in the WTO. And my approach is to do so because it would, to commit to this dichotomy would overlook, I think, what are more important questions which are when did liberalisation actually take place and why? And to also look at timing. When did reforms actually slow down and why? And along the same lines, I also tried to push against categorising China's WTO responses into binary categories that we tend to see in the broader political science literature, protection versus liberalisation. Given that the choices available to states actually are quite wide ranging, they're far from binary, so instead I argue that we have to consider how responses to global rules are mediated by state structure and also by politics within the state. So following on from these premises, I structured the book around two main research questions. The first is to actually establish the range of strategies that Chinese state actors can adopt to engage with WTO rules. And then I move on to the main question of the book, which is why did some parts of the Chinese state adopt more liberalising reforms than others in response to WTO entry?

So the focus here is on all of the action within the state. And I do so, I focus on the state, because the content of international rules has really changed from promoting free trade through the reduction of border barriers; to deeper questions of how to govern the economy with increasingly enforceable rules that require what Judy Goldstein calls 'a fundamental, intrusive restructuring of global institutions'. So we need to shift our own analysis beyond the effects and influences of domestic interest groups, and beyond treating the state as a supplier of protectionism, responding to the demands of these interest groups; and focus on the impact of WTO liberalisation on the state itself. And I would argue, despite the fact that China is an authoritarian single party state,

this need to focus on the state is particularly true actually, in the Chinese case, as the main burden of adjustment to WTO entry fell on China's massive state apparatus.

So I quote here from an interview published in a journal with a central party school official who said, back in 2001, "WTO entry is a strategic move for a country's economic development, but also brings along a problem which is how the party, in its decision and policymaking process, can defend China's national interests while fulfilling international norms and WTO rules". And he went on to say, "The biggest shock of the WTO to China is aimed at our government, and we are a government governed by a single party. So in reality, the ones who will feel the shock will be the party and its administrative and leadership methods".

So in terms of looking then at what political science literature tells us about the effects of international rules on the state, a lot of fruitful work has been done in exploring these questions of whether and when state institutions, international institutions, can increase compliance by providing a credible commitment device. And on the WTO itself there's been a very rich research and debate around this question of whether or not WTO rules constrain the policy space of member governments. Now, in response to this existing literature, what I hope to contribute with my book project here, is to push against examining state responses again in these binary terms, as I've just outlined, compliance versus non-compliance, constraint versus non constraint; and instead to look at the range of responses available to a state and how interstate politics affects these responses.

Now, one might argue that since there is single party rule in China, we basically need to just examine and focus on leadership preferences. But the bureaucracy and other political actors within the state and China can also make things difficult or hard for the leadership. So I quote here from Deng Xiaoping himself, who said "once a political line is established, someone must implement it. So depending on who is in charge of implementation, those who support the party lines, those who do not, or those who take the middle of the road position, the result will be different.". So I focus much of the book on the WTO's impact on this tension that Deng Xiaoping was talking about, these intrastate politics in China.

So I want to start by establishing first this range of strategies that China, Chinese state actors, could adopt to engage with WTO rules. And to do this, we have to start with the reform and opening history in China, which was very much a non-linear process involving experimental, incremental approaches to growth. As much literature has documented, new policies were created around the planned economy, rather than an outright replacement, and new agencies were created to lead reforms alongside old ones. And so the result of this very layered approach to change is that older mindsets, older policies, older institutions remained in the governing system, even as China's economy took off, such that there was never an agreement within China's vast party state over this question of how to govern the economy. Instead more and different modes of governance emerged and sat in contestation with each other, as China's economic growth engine revved up and took off from the 80s onwards.

So broadly, I proposed to think of these different disagreements as coalescing around three competing modes of economic governance in China. The first is what I call a 'Directive Strategy', which we can think of as market substituting in nature, in that it relies on administrative guidance and state allocation of resources rooted in China's command economy. So one example would be to set production targets for firms; rather than letting the market drive production outcomes. The second is a 'developmental strategy', which is market shaping in nature in the sense that the

strategy involves the use of state incentives to try to draw firm activity from one sector to another. So, for example, using tax breaks to incentivise firms into strategic high tech sectors. And the third is a 'regulatory strategy', which we can think of as being market enhancing in nature. And here the state acts to set and enforce rules that try to promote the functioning of the market. So for example, in setting standards to enhance inner operability within the economy. And here then market outcomes will depend on firms competing within these rules and so it's the result of firm competition, rather than state incentives, rather than the production targets.

So I argue that these various competing modes of governance are further exacerbated by China's political structure, commonly described in terms of fragmented authoritarianism. Where we have multiple substate actors competing with each other and having the authority to influence economic policy. So not just leaders at the top, but also central, economic agencies, subnational governments and so on. And even within China's authoritarian regime the incentives of these various actors are often misaligned and sometimes even opposed to each other. And that means that China's economic development, which we witness, is often the product of this internal political contestation; rather than the result of a master plan that's coordinated from the top down. And we have to, I would argue, use the same logic to think about the effects of globalisation and WTO entry. The ways in which it's mediated by China's fragmented state structure and its internal bureaucratic politics.

So now I want to turn to the main question of the book, which looks at why some parts of the state adopt more liberalising reforms than others in response to WTO entry? And here, the book examines a series of dynamics that plays out across different parts of China's highly complex state structure. First, the first empirical chapter looks at WTO trajectories across administrative levels and China's decentralised hierarchical [00:20:14] state. [0.0s] And then secondly, I move on to examine political responses within the very powerful central state government in China and Beijing in order to explain the rise of state capitalism. And then thirdly, looking across industries to examine how WTO entry affected China's quest to build globally competitive national champions.

So this analysis, as I've just outlined here, is multidimensional, but I try to propose a fairly simple and straightforward theory to try to explain the various policy trajectories emerging from China. And I start by proposing that WTO entry brings about two sets of new conditions that actors within the state have to respond to. The first is open competition brought about by economic liberalisation; and the second are new bureaucratic rules that stipulate how the state should govern the economy. And these new conditions have a really profound impact in shifting the incentives of actors within the state, which are very competitive internally within China's authoritarian state structure.

So I propose that the ways in which these various substate actors respond to these new conditions depend very broadly on the probability of being sanctioned for deviating from WTO rules, and the prospects for their internal political advancement within the CCP system. And with this cost-benefit framework right, which is fairly simple and stylised, I show that the channels for sanction and advancement actually vary depending on where an actor sits in China's state structure, to then effect where their policy responses are directed, whether they're developmental or whether they're regulatory.

Now, one main challenge I faced in putting this book together was this question of how to capture the use of these different state strategies over different parts of the state, and across time. So what I did was to collect an original data set of economic policies, that I scraped from the Chinese

web, and this corpus of documents contains laws and regulations issued by different arms of China's central and subnational governments covering over one hundred and twenty manufacturing sectors, which gave me a corpus of over 43,000 documents. And what I did using this corpus, which basically we can think of as containing the ordinary language of China's economic bureaucracy, I then used machine learning techniques to try to uncover the topics that are latent in these documents, to then identify the changing prevalence of these different types of state strategies issued by the bureaucracy over space and over time. And then I combine that with fieldwork, interviews from fieldwork in China, leader speeches and party documents and so on...to try to piece together this puzzle. And so I'm just going to quickly outline the main findings from the book in my remaining time, starting with these hierarchical politics of WTO entry.

So what we see here, and my argument here is that we need to think about, firstly, how accountable each authority is to the WTO and secondly, whether the industrial diversity of each unit meant that WTO entry either increased opportunities for export, or alternatively raised the threat of import competition. So what I find, firstly, is that the central government responded to WTO entry with a surge in market enhancing liberalising policies. And so what you see here is the prevalence of liberalising, regulatory language in the China central, provincial and local governments, local meaning sub-provincial, over time. And what you see is that there isn't a real trend prior to WTO entry, which is marked by that vertical line there. After WTO entry, however, we see this divergence and there's a real increase in market enhancing content from the central government much more so than provincial governments, much more so than local government policies. So what's going on here? What's driving this divergence in the types of liberalising responses that we see from the Chinese government?

Well, much of this liberalising response from the central government derives from its high degree of accountability to the WTO, where, unlike provinces and townships, it's Beijing that plays this role of sovereign representative to China at the WTO in Geneva. So it has to account for its policies to other WTO member governments. And so in the years immediately following WTO entry, what we see is the central government engaging in a legislative overhaul to strengthen market institutions in China. Reforming numerous laws, reviewing tens of thousands of technical standards, and even launching a national campaign to raise WTO awareness, not just amongst the public, but also within its national bureaucracy. Yeah, but that's just what was going on in the central government, what we see happening in subnational governments, however, were very different responses, as I'll show you,.

So here, this figure shows as a surge in developmental policies by provincial governments and local governments, strengthening instead their market replacing, market substituting directive policies. So what's driving these sets of governments to respond so differently? Well, on the one hand, subnational governments are shielded from direct accountability to the WTO. So the city of Dalian, for example, is it enacts a WTO inconsistent policy. It's not going to be directly held to account in the WTO. It can sort of shift that responsibility to the central government. On the other hand, the subnational leaders are directly exposed to the economic effects of WTO led competition, and that's going to affect their promotion prospects. And so those leaders who found that they could compete to expand their exports, such as Anhui province, could be seen issuing industrial policies to spur provincial exports in order to chase political advancement, right, to defend their growth rates. Those who are not as competitive, such as many of China's smaller, rural inland prefectures, who did not have as rich of an industrial mix right, instead had to resort to directive policies to forcibly restructure their industries, consolidate different firms into larger entities, eliminate inefficient firms. So engage in market substituting directive policies to respond to import

competition. Therefore, what we see is that there was no monolithic response to WTO entry. While, there were initial sweeping efforts to institute market enhancing policies, and build market friendly institutions in China, these were by and large led by the central government. Subnational governments adopted contradictory strategies leading to this internal divergence in China's WTO policy trajectories.

So then the next chapter of the book turns to politics within China's powerful central government, to explain the rise of what has come to be called 'state capitalism'. So while the central government responded to WTO entry, as I've just shown you, with this initial surge of market enhancing reform, what happened over time is a loss of momentum in these market enhancing policies. Instead, analysts started to point to this phenomenon of the state advancing; while the private sector retreats. So what explains the shift? And what explains the timing of this shift in central government trajectories?

Now, the dominant explanation that one tends to see regarding this question are, firstly, that it was the 2008 global financial crisis that sparked China's turn towards statism, and secondly that it was the new leadership in the Hu Jintao-Wen Jiabao era who had more statist preferences than their predecessors. And in the book, I discuss why both of these explanations fall short. As I will show shortly, this turn towards state capitalism actually preceded the financial crisis. And explanations that focus instead on new leadership preferences, I argue, assumes that the central bureaucracy will always act as faithful agents of the leadership and over emphasises ideological differences between the leaders of the two periods of time. And more importantly, it doesn't explain the exact timing of this shift towards statism. Instead, I argue the shift was driven by a combination of domestic and international factors.

So domestically, I think we have to consider the accountability relations between the party leadership and the central government. Whether or not this leadership can discipline the bureaucracy and deploy the central government as a faithful agent. Internationally, we have to consider the degree to which reform-minded, technocratic agencies within Beijing could use WTO rules as external leverage to gain influence over rival industrial policy agencies who were opposed to liberalisation. And what I find is that during the initial years under Jiang Zemin and Zhu Rongji, what we had was a leadership that could very effectively discipline its central bureaucracy. So the state acted as a faithful agent of the leadership during this period. In part because their support networks of these two leaders were located outside of Beijing in places such as Shanghai, so leaders could discipline central officials without necessarily hurting members of their network. And so what we witnessed during these Jiang Zemin-Zhu Rongji era's were reforms that were directly opposed to central bureaucratic interests.

So one example was Premier Zhu Rongji's campaign to reform China's State-Owned Enterprises, which led to a massive consolidation and fall in the number of SOE's in the economy. Another example was the 1998 administrative restructuring, where Premier Zhu halved the number of civil servants and cut the number of ministries from 40 down to 29. And I would argue the third example would be WTO entry itself, which was met by a really strong bureaucratic resistance by central bureaucratic agencies that did not want external scrutiny over their domestic policy making. At the same time, the initial years of China's WTO period were marked by strong external leverage, and in fact, it was this external leverage that enabled Zhu Rongji himself to push for WTO entry as his own support within the government for liberalisation was actually quite weak.

China had also committed to a clear timetable for implementing many of its commitments, such that after WTO accession, technocratic reform minded agencies, who were relatively marginalised in the bureaucracy, could use that external leverage to keep the reform efforts going. And this was also aided by the status of international law and China's legal system, which translate international commitments directly into domestic laws. And you don't need to enact a new set of commitments in order for international commitments to have domestic spending.

So that was what was driving this surge of market enhancing policies that I showed in the previous slides. As the years passed, however, both of these variables started to shift. Both party state accountability and WTO leverage started to change, such that the Hu-Wen leadership was different from the Jiang Zemin-Rhu Rongji years, in their ability to discipline the central bureaucracy was actually relatively weak. Instead, these leaders had to rely on the central state as a key political constituency, rather than deploying the central bureaucracy as a faithful agent. This was true in particular for Premier Wen, who spent a lot of his career rising up through the central bureaucracy. So he needed to work through central agencies. That's where his support network was based. And so what we see is, during these different leadership years, right, a style of policymaking that was marked by a reliance on the state and an expansion of the central bureaucracies influence.

We see this in the Premier Wen's failed efforts to restructure the central bureaucracy time and time again. In 2003 we had early reports that there will be several ministries eliminated in this round. Instead, only one ministry was cut. In 2008, there were efforts to create an energy super ministry. Those were derailed due to domestic opposition. What we witnessed instead, during these years, was the rise of really powerful industrial policy agencies such as the National Development and Reform Commission, an agency called SASAC to oversee State-Owned Enterprise assets, and after the 2008 administrative restructuring, the Ministry of Industry and Information Technology. So the rise of these various industrial policy agencies. At the same time, WTO leverage started to shift after 2008 and weakened quite a substantial degree and so as many of these commitments that China agreed to were met, this led to a loss of momentum within the bureaucracy, and instead, many of China's international obligations started to fade and started to be ignored by different agencies inside China's bureaucratic state.

So at the same time, China had committed to so many commitments as part of its protocol of accession that it generated a lot of resentment amongst industrial policy agencies, and that led to an accumulation of opposition to reform. China's chief negotiator was even accused of being a traitor who had sold out the country. And so as WTO leverage weakens this meant that industrial policy agencies were able to gain influence under a new leadership that relied on them as a key constituency, while technocratic agencies lost ground in relative terms.

So this figure that I'm showing you here shows the number of industrial policy regulations issued by these initial policy agencies over time. And we see this big increase around 2005 onwards, a dramatic increase in policy activism by the NRDC. After the 2008 administrative restructuring, a big surge in policies by MIIT. So this is China entering this age of industrial policy here. And this shift in trajectory we can see in a number of very important policy changes of the 11th Five-Year Plan with its focus on indigenous innovation. Another plan that advocated the reduction of reliance on foreign technology. Announcements reinforcing the role of China's State-Owned Enterprises and strategic industries. Regulations giving procurement priority to Chinese made products. Now, these policies have had a real impact on business sentiments and on the business environment.

So this figure here shows us the changes in business sentiment in the American Chamber of Commerce's annual survey of its firms in China. What we see is that in the initial years after WTO entry, we see a large majority of firms saying that they have benefited either to a great extent, or to a very great extent, from China's economic policies. And this number falls dramatically from 2005-2006 onwards. And you can note here that these sentiments are even more negative in 2005, 2006, 2007, prior to the onset of the global financial crisis. So counter to popular perceptions, the rise of Chinese state capitalism predated the financial crisis. This is not to say that the financial crisis had no impact. It had a very big impact. But what it did do was to deepen and further entrench a shift that had already started to occur towards developmental statism. More importantly, this change in trajectory was not necessarily a premeditated plan. It wasn't the result of a coordinated master plan, but the product of a shift domestically, both in party state accountability and internationally in terms of the loss of external leverage.

So then turning to the third chapter, I then explore what the implications are of these shifts for Chinese industrial policy. So looking at China's quest for national champions, I ask whether this turn towards state capitalism brought about greater coherence to China's industrial policy in strategic sectors. What I argue in the book is that rather than disciplining the state, WTO liberalisation generated greater policy conflict between China central and subnational states. And this conflict was specifically widened through an FDI, Foreign Direct Investment, channel because we also have to take into account the surge of foreign capital into China with its entry into the World Trade Organisation. And this is important because while both central and subnational governments seek to attract FDI, each deploys FDI towards a different political purpose.

So the two key factors worth considering here are firstly, what the goal of FDI is, on the right hand side here, is it to maximise capital, or is it to maximise access to technology? And secondly, who has the contracting authority for FDI? Is it the central government or the subnational government? Now, the goal of FDI matters because growth is a political target, and it serves different political purposes for different actors within the state. For the central state, it seeks economic growth for regime promotion purposes, and so WTO entry represents an opportunity to strengthen the Chinese regime through accessing foreign technology to upgrade the industrial structure. Subnational states, in contrast, seek economic growth for rank promotion purposes. What these subnational leaders are chasing, in terms of political advancement, by and large is to advance up the CCP hierarchy. So for them, what they're looking for is opportunities to maximise the attraction of foreign capital to spur growth in the short term, in their jurisdiction.

Therefore, it matters whether the authority for contracting FDI is centralised or delegated to subnational governments, because it then affects whether it's the technology component or the capital component of FDI that's being privileged in any given strategic industry. In the book, I explore these effects of FDI in two comparative case studies, looking at two strategic industries: the automotive sector, and the semiconductor sector.

So in automotive, we have FDI being relatively centralised, with foreign investment controlled by a very strict joint venture rules quite consistently from the 1980s onwards. In the semiconductor sector, in contrast, we had far greater swings in China's FDI policy. So just elaborating a little on China's semiconductor industrial policy, what we have in the initial years, is a joint venture model similar to the automotive industry. In the 2000s, there was a great liberalisation of FDI, and so the contracting authority got decentralised down to localities. And that led to a big surge in foreign investment as the joint venture rule was lifted. This type of FDI however, was largely focussed on assembly and testing, and very little R&D content, very little higher value added content. And this

type of investment was great because it served the short term rank promotion incentives of subnational governments, but did not serve the technology upgrading regime promotion goals of the central government. In fact, Chinese firms that were located in places that had heavy FDI semiconductor presence actually found it difficult to break into these foreign enclaves. And innovation in semiconductor technology was actually weaker in places with stronger FDI presence.

And so what we saw was the central government then responding in the 2010s onwards to reassert central control, to set up a central investment fund, and issuing new policies to support Chinese semiconductor firms; and that then led foreign firms to be relatively more marginalised and these foreign firms found that they increasingly needed to partner with Chinese firms in order to access any central government funding. Effectively, a swing back to the joint venture models of the 1980s. So far greater swings and more, much more incoherence in semiconductor industrial politics.

So in short, what we see is that globalisation weakened rather than strengthened industrial policy through this FDI channel. Foreign capital, in fact, provided resources to subnational governments to bypass central industrial policy. And what we see is that Beijing's high tech ambitions end up being hobbled by the subnational government's quantitative rather than qualitative approach to growth.

So to sum up quickly, I hope that the findings that are presented today allows us to revisit this new conventional wisdom about China and the global trading system. Rather than asserting that China has failed to alter, sorry that the WTO has failed to alter China's economic model. I've shown that different parts of China's vast state apparatus, in fact, responded very differently to WTO entry. We had a lot of liberalisation pushed forward by the central government, but subnational governments adopting divergent trajectories. To the fears that China has been building a state capitalist model, I hope to have shown you and persuaded you that this state capitalism was not the product of a premeditated strategy as part of the coordinated China Inc. Rather, it was the product of domestic and international policies. Domestically, a shift in state accountability relationships; and internationally a decline in the amount of WTO leverage available to technocratic agencies. Finally, to the charge that China's state capitalist model is being exported globally through state owned champions, I suggest that globalisation has in fact supercharged China's fragmented politics, weakening the overall coherence of industrial policy.

So to conclude, while China is no doubt an authoritarian one party system, its engagement with the international economy is far from monolithic. Instead, there's active contestation within the state, between different modes of economic governance, and so that extends beyond these binaries, right? Not just defiance versus compliance; protection versus liberalisation. There's a broader range of state responses and we can see multiple responses emerging. So I hope that this research shows the importance of recentering bureaucratic politics and literature on the political economy of trade. And this is important because the impact of WTO membership varies across different dimensions of the state. It can diverge hierarchically, triggering different responses between federal and subnational authorities. It further alters the distribution of power between substate actors. So WTO entry can empower some agencies over others creating not economic winners and losers, but bureaucratic winners and losers. And also, we have to consider the uneven impact of WTO rules. Trade is highly regulated, investment is not. And so trade liberalisation can end up providing resources for some subnational actors to bypass national policies, further complicating the industrial policymaking process. So with that, I thank you very much for your patience and listening to this talk, and I look forward to your questions. Thank you so very much.

Nicholas Jepson Well, thank you very much for that fascinating talk. I think you get a really good picture of sort of the dynamics and nuances of the story that really is missed a lot, I think, in a lot of, well certainly sort of English language media coverage, but English language scholarship too as well. And I think this really adds to our understanding of many of these dynamics.