CHINA'S LIBERALIZATION TWO-STEP:
A REPONSE TO GLOBALIZATION

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INTRODUCTION

The Chinese government has taken a much more liberal view toward foreign direct investment (FDI) than its East Asian neighbors during an analogous stage of development.[1] Since 1978 when China launched its Open Door Policy, which ended two decades of international isolation, the Chinese government has steadily relaxed restrictions on FDI. Moreover, regulatory reform in China since the mid-1990s has unleashed competition in various sectors, and in its accession protocol to the World Trade Organization (WTO) in 2001, China further committed to liberalizing FDI in previously closed sectors. Today, the magnitude of foreign investment in China dwarfs that of many developing countries; as percentage of GDP, FDI inflows into China outstrip its East Asian neighbors and developing countries of comparable size.[2]

In contrast, the developmental states of Japan, South Korea, and Taiwan integrated into the international economy through policies that restricted FDI to promote the domestic sector through export-oriented industrialization; the state helped domestic companies obtain capital and technology at arm's length through foreign debt or aid and licensing. Moreover, while China's post-Communist counterparts dismantled the Communist state upon the collapse of the Soviet Union and pursued a liberalization program of "shock therapy," the Chinese government has retained state ownership and introduced private and foreign competition in distinct ways across industries to achieve its goals.

The different strategy toward FDI and sequencing of reforms and property rights restructuring pursued by China beg for a closer examination of the Chinese government's relationship with foreign capital and the institutional context under which varying patterns of state-FDI relationships have emerged. Why has China adopted a more open strategy with foreign capital, fundamentally breaking from the developmental state model and from its own Communist past? Why do we see variation in degree of liberalization and reregulation across industries? How do we reconcile extensive liberalization of FDI and decentralization of

[1] See Lardy (2002), Guthrie (1999, 2006), Zweig (2002), Huang (2003), Steinfeld (2004), and Gallagher (2005) for China's openness toward FDI as compared to Japan, Korea, and Taiwan during a similar stage of development.

[2] In 2005, as percentage of GDP, FDI inflows in China is 3.2% as compared to Japan's 0.1%, Korea's 0.9%, Taiwan's 0.5%, and India's 0.8%, Russia's 1.9%, and the U.S.'s 0.8%. In terms of inward FDI stock as percentage of GDP, China stood at 13.7% compared to Japan's 2.2%, Korea's 8.3, and Taiwan's 12.4%. India stood at 5.5%, Russia at 22.1%, and the United States at 12.7%. Source: World Investment Report, United Nations Conference on Trade and Development and International Monetary Fund, 2005.

economic decision-making in certain sectors with the picture of regulatory centralization and enhanced state control? Moreover, how has China managed to retain its political control and capacity and at the same time modernize, industrialize, and transform its economic system in the context of international integration?

The core argument of this paper is that the liberalization of FDI in China is sector-specific. Liberalization is often presented as an uniform process. In contrast, the Chinese state is quite selective in how it reregulates.[3] The Chinese state has pursued a *liberalization two-step* – the Chinese government has broadly liberalized FDI yet compensated for macro liberalization with micro control.[4] The Chinese state has shifted from universal controls of FDI on the aggregate level across all sectors to selective controls at the sectoral level. The state exercises a *bifurcated strategy* to meet its twin goals of complying with WTO commitments and retaining some control. In strategic industries—those important to national security and the promotion of economic and technological development, such as telecommunications,—the government has centralized control and strictly managed the level and direction of FDI. In less strategic sectors, such as textiles, the Chinese government has relinquished control over industry, decentralized decision-making to local authorities, and encouraged private investment and FDI. In other words, China has allowed large-scale FDI to structure foreign competition in ways that allow it to transfer foreign technology, encourage indigenous technology and production capacity, and promote domestic business. Moreover, state control varies across subsectors and time as the domestic sector's competitive position and the organization of government institutions in a given sector also shape the Chinese government's relationship with industry and the methods of state control. These variations and details in turn tell us a lot about the Chinese state's role in the post-WTO era. A purposive relationship has developed between the Chinese government's industrial and FDI policies. The state that emerges resembles neither the development state model of protection nor does it mirror the example of the successor states of the Soviet Union where rapid liberalization and the collapse of the state predate the emergence of a private sector.

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[3] This study uses "regulation" in the literal sense of the state formulating and creating rules to control industry and not in the way commonly used in the developmental state literature to mean the liberal state that only regulates as a referee. See section on disaggregating the state for more on this usage.

[4] Jonah Levy (1999) uses a similar concept, "statist two-step" to describe the parallel processes of associational liberalism, whereby the French state sought to create German-style institutions to coordinate state-market interactions, and the transformed but continued presence of the government in policy areas.

The findings presented in this paper are from a larger study, which uses a comparative case approach to explain and document China's distinctive strategy of integration into the international economy. This comparative case research design, which systematically selected industry, subsector, and company cases, maximizes analytical leverage to examine how state control of FDI varies and rigorously tests alternative expectations of state control of industry. To do so, I bring together original data from over 200 semi-structured interviews with local and central-level government officials, industry representatives, foreign delegations, and domestic and foreign companies, which I conducted during 18 months of field research in the eastern coastal and western interior provinces of China. Data from statistical yearbooks and surveys collected by domestic and foreign sector and business associations further supplemented my analysis.

The rest of this paper is organized as follows. I first introduce a conceptualization of state control that allows us to better understand how state control varies. Following that section, a strategic value framework is proffered to explain why and how state control of FDI varies. Next, I delineate the common forces experienced by all sectors. Scholars have proffered these common forces as explanations for why China has liberalized. I argue, however, they fall short in explaining *why* the Chinese government has liberalized and *how* it has reregulated. Case studies of telecommunications and textiles illustrate how China has liberalized FDI only to reregulate it across industries in vastly different ways to achieve its political and economic goals. I conclude with a discussion of the implications of this bifurcated strategy for China's new regulatory state.

LIBERALIZATION TWO-STEP: UNDERSTANDING STATE CONTROL OF FDI

China's integration into the international economy in the context of multilateral and bilateral pressures to liberalize, market reforms and devolution of economic decision-making which have spanned three decades, and sector-specific challenges, is a story of opening up to foreign capital and retaining control, the methods for which varies across industries and have implications for China's emerging market infrastructure. Recent research on the state's response to economic globalization suggests the utility of problematizing the Chinese "state" and focusing on sectoral variation in China's FDI and industrial economic statecraft policies.[5] In answering whether the state has retreated or somehow transformed or continues to eschew the import of

[5] S. Vogel (1996, 2006), Snyder (1999), and Cammett (2007).

global flows of ideas, capital, goods, and services, scholars have moved to "varieties of capitalism" approaches that stress eclectic mixtures of policies based on historical legacies, institutions, and on resources, opportunities, and costs of global integration. They build on earlier studies which have found that development paths are not inevitable but may be forged through purposive state action and that state institutional structures influence the way the private sector interacts with the state and the structure of the private sector itself.[6] In the face of globalizing changes, state activism has shifted rather than fallen away; state officials have changed their goals and instruments but they have by no means curbed their ambitions.[7] Cross-national studies suggest that countries respond differently to different types of capital flows, trade, and other forces of globalization because of different capitalist arrangements, paths to development, and national identities.[8] Moreover, scholars who study developing countries argue that the state there intervenes in a context of mobile global capital often because of weak regulatory institutions rather than as a strong state eschewing global pressures to liberalize.[9] Finally, intranational and cross-sectoral studies find that the state actively deregulates and decentralizes as much as it intervenes to accomplish state goals and responds to political entrepreneurs, societal actors, and integration in global manufacturing chains to create new institutions for market governance.[10]

Similarly, we find that the unprecedented liberalization of FDI in the Chinese economy is as much about removing barriers to competition as it is about the state actively introducing foreign competition to meet state objectives, face institutional constraints, and confront technological complexity. This finding conforms to Karl Polanyi's 1944 study of the evolution from feudalism to market society in nineteenth century Europe, in which he contends the market system did not spontaneously arise, but governments had to actively create national markets. Studying market reform in advanced industrialized countries in the context of the recent wave of globalization, Steven Vogel (1996, 2006, and 2007) finds the government has to actively create a

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[6] Drawing on the tradition of Alexander Gerschenkron (1952) and Karl Polanyi (1944), John Zysman (1983, 1994) emphasizes variation in institutional mix and the state's response to the imperatives of industrialization to explain national patterns of state-market interactions.
[7] See Levy (2006) for cross-national studies of advanced industrialized countries of how the move to the market in the context of globalization has been at the same time a move and through the state.
[8] See Hall and Soskice (2001), Wilensky (2002), and S. Vogel (2006) on varieties of capitalism, Guillen (2001) on variation in path to development, and Abdelal (2001) on impact of variation in national identity.
[9] Chaudhry (1993 and 1997) and Stoner-Weiss (2001, 2006).
[10] S. Vogel (1996 and 2006), Snyder (1999) and Cammett (2007).

more sophisticated market infrastructure, more regulation to sustain competition, and social regulation to buffer society from negative externalities. This process involves both building institutions and removing constraints, and changes at every level of a political-economic system from government policies to private sector practices to social norms.[11] How governments do so is a function of how ideas and institutions vary across countries.

To fully understand why China has extensively liberalize FDI, yet reregulated in ways that relinquish state control in some sectors while redoubling central government control in other sectors, I introduce a multidimensional conceptualization of state control that helps us better understand how patterns of state control vary across industries. I conceptualize state control in a manner that allows us to systematically identify *state goals*, *relationship with industry,* and *methods of control*. To begin with, the *goals of state control* reveal whether the central government takes a laissez-faire or a strategic orientation toward market players, the incumbent or the new entrant. Next, the *government's relationship with industry,* i.e., the level of government that manages industrial development and the extent of state intervention, reveals whether the central government's control enhances or undermines its authority over industry. Last but not least, the *methods of state control* reveal whether central government control emphasizes liberalization (introduction of competition) or reregulation (reformulation and creation of rules), and whether measures of control tend toward primary measures to achieve state goals or corollary measures that facilitate it for functional and political reasons.[12] *Liberalization* is defined as both policy measures and company-level interventions taken by the state to introduce competition and influence and enhance the role of markets. I define *reregulation* as the reformulation of old rules and the creation of new ones to achieve state goals.[13] As a footnote in the Introduction indicates, I use "regulate," "reregulation," and "regulatory" in this study in the literal sense of the state formulating and creating rules to control

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[11] Steven Vogel (2006) argues that "freer markets require more rules." See also S. Vogel (1996). Moreover, Richard Snyder (2001) has observed that to the chagrin of neo-liberal reformers, the introduction of competition in Mexico has led to the formation of new institutions for market governance.

[12] S. Vogel (2006) differentiates between primary measures that enhance competition and corollary measures that facilitate competition for functional or political reasons such as to protect society from negative side-effects and/ or compensate the potential losers from these policies.

[13] See S. Vogel (1996), p. 3.

industry. I do not mean to invoke the developmental state literature's regulatory state usage, which is a liberal state that only regulates as a referee and does not intervene beyond that.[14]

By recognizing that state control varies according to state goals, the resulting government relationship with industry, and methods of control, this multidimensional conceptualization finds the central government can take on a strategic or laissez-faire orientation to introduce competition that can enhance as well as undermine state control. Promoting competition is not just about removing legal controls and then getting out of the way. It requires that state actors consciously design new markets, often with significant rules and regulations, to promote state goals, such as economic efficiency, political authority over industry, and/ or responding to societal demands.

This conceptualization differentiates at least four types of state control that combine to reveal patterns of deliberate state control and incidental state control. In *strategic reregulation*, the central government takes a strategic orientation to introduce competition in a way that ultimately enhances state control to achieve a particular central goal, such as increase in technological know-how. We find this type of state control in high-tech, value-added sectors of both strategic and non-strategic industries. State control of FDI in telecom equipment illustrates this type of state control. In *expansionary reregulation*, the central government takes a strategic orientation to in reformulating old and writing new rules, which enhance state control. In this type of state control, the central government expands its bureaucratic discretion over industry to achieve particular goals, such as the control of information in telecommunication services.

The types of state control that combine to reveal a pattern of incidental state control are the following. The central government takes a laissez-faire orientation to introduce competition, which undermines its control over industry, and decentralizes regulatory enforcement to lower levels of government in *decentralized reregulation*. This type of state control can be found in the state's control of textiles. In *subordinated reregulation*, the central government takes a laissez-faire orientation toward market players to introduce competition but retains state control at the central-level, which enhances state control. This type of control can be found in the state's regulation of more strategic subsectors of less strategic industries, such as textiles trade.

In this understanding of state control, China's transition from a planned economy to one governed by markets, which I follow Vogel to define as a broad range of laws, practices, and

[14] See Johnson (1982).

norms, is a series of government intentions and consequences in that they are based, by design or default, on political principles and choices of how individual resources, rights, aspirations, and possibilities are reconciled with collective ones.[15] The important question becomes, what drives these intentions and consequences?

Figure 1.1 shows how state control varies along the three dimensions of state goals, state-industry relations, and state methods.

FIGURE 1.1 TYPES OF STATE CONTROL

	State goals	State-industry relations	Methods of state control
Expansionary	Strategic	Enhance	Reregulation
Strategic	Strategic	Enhance	Reregulation
Subordinated	Laissez-faire	Retain	Liberalization
Decentralized	Laissez-faire	Undermine	Liberalization

THE STRATEGIC VALUE LOGIC: HOW STATE CONTROL VARIES

In this section, I introduce a strategic value framework, which we will apply to two industries, to understand how what might be seen as contradictory combinations of state goals and state methods are, in fact, reconcilable if we examine exactly how reregulation, which varies by industry, has followed macro-liberalization. Next, I describe the common liberalizing forces, each of which partially explains the nature of state control of FDI, experienced by all sectors in China. These common forces fall short in explaining what we find, which is that FDI liberalization and the reregulation that has followed vary across industrial sectors. Some of these common forces explain state goals, state-industry relations, and state methods in one sector but not another, in one era but not the next, or explain state goals but not state methods. China has reregulated using both liberal and non-liberal methods and strategic value of sector best explains how these methods are applied across the political economy.

Strategic value explains sectoral variation

The *strategic value of a sector* shapes how the central government formulates state goals, who controls FDI policy, and what kinds of measures are employed. In other words, the state's

[15] See Vogel (2006) for definition of an institutionalist definition of markets. Also, as for the intentionality of market building in advanced industrialized and developing countries, see Zysman (1983) and Chaudhry (1993), respectively. Moreover, research on developing countries has found that to defend liberalization, the state has exercised authority to trump industrial interests for protectionism no matter how robust (Haggard and Kaufman 1992).

sector-specific goals and priorities, state-industry relations, and state methods of control are shaped by the strategic value of a sector to explain the poles of greater liberalization and continued state intervention in China's political economy.[16] The degree of strategic value has political and economic dimensions; it is defined on the political dimension by a sector's importance to national security, broadly defined, including political and social stability, environmental security, and foreign relations. Strategic value is defined on the economic dimension by a sector's value input in the country's technological and infrastructural base and the importance and contribution of a given sector to the competitiveness of other sectors and the rest of the economy. In other words, a sector's importance to national security, defined as both internal and external security, and contribution to economic and technological development, measured by a sector's contribution to the competitiveness of other sectors of the economy and a sector's value input into the national technology base, respectively, shape the extent of Chinese government intervention in a given sector.[17]

In practice, how a sector's strategic value translates into state goals, state-industry relations, state methods rests on the substantive essence of a sector. In other words, the core features of a sector (generic features and China-specific features) shape what the state wants to control and how it does so in a given industry and subsector. Generic features of sector include whether production involves complex interactive technology or linear technology and whether the industry is a producer driven commodity chain or a buyer driven commodity chain. The central government is more likely to impart deliberate control and enhance its authority when a service or product entails complex technology and when the purpose of product or service utilization is perceived to be related to a national security imperative.[18] To facilitate network modernization at the same time control information, the government limits telecom carriers to state-owned players and retains discretionary licensing of network technology, but liberalizes equipment and value-added services. To acquire technology, state-owned carriers procure from

[16] Adam Segal (2005) argues that geographic size and security concerns shape greater liberalization and continued state intervention in high technology sectors in China.
[17] Evan Feigenbaum (2003) finds that the Chinese government connects high technology acquisition with national security concerns.
[18] Herbert Kitschelt (1991) finds that properties of technology shape the choice and efficiency of governance structures and industrial innovation strategies in different industrial sectors. He argues that countries predisposed to particular governance structures (centralized, direct public or private governance structures versus decentralized, competitive market relations but little nonprofit research infrastructure) will encounter difficulties in assimiliating new technological trajectories.

foreign equipment vendor but to retain control of technology that runs networks and to shape telecom markets, the state initiates and leads standards setting. In contrast, the central government is more likely to impart incidental control, when the product or service in question involves linear technology and when the purpose of that utilization is not related to a national security imperative, such as in textiles.

Another core sector feature, the type of commodity chain dominant in an industry, also shapes how methods of government control of FDI vary.[19] On the one hand, because the drivers of producer-driven commodity chains are industrial capital, research and development and production are core competencies, and main network links manifest in investment, we find that the government focuses its resources on promoting domestic telecom equipment makers through initially requiring FDI to enter through joint ventures and then later balancing network procurement among domestic players and foreign players. Moreover, in the post-WTO era, it promoted the development of a homegrown network standard with the assistance but not leadership of foreign equipment makers. On the other hand, because the driver of buyer-driven commodity chains are commercial capital and core competencies are design and marketing and main network links are trade-based, government intervention in textiles manifest in the form of local promotion of apparel design and marketing companies and central-level administered allocation of import and export licenses and quotas and tariff regimes.

Change across time: a phase of reregulation follows a phase of liberalization

How patterns of state control vary is first and foremost a function of the strategic value of these subsectors to the central government. But to understand the full complexity of how patterns of state control vary, we must also take into account the organization of state institutions in a given sector and the competitiveness of the domestic sector. An examination of change across time in each sector reveals a logical link exists between a phase of liberalization and a phase of reregulation of FDI. The state reregulates to compensate for liberalization that resulted in a loss of state control in strategic industries and to more strategically utilize the FDI that has entered a sector as a result of formal or informal relaxation of market entry.

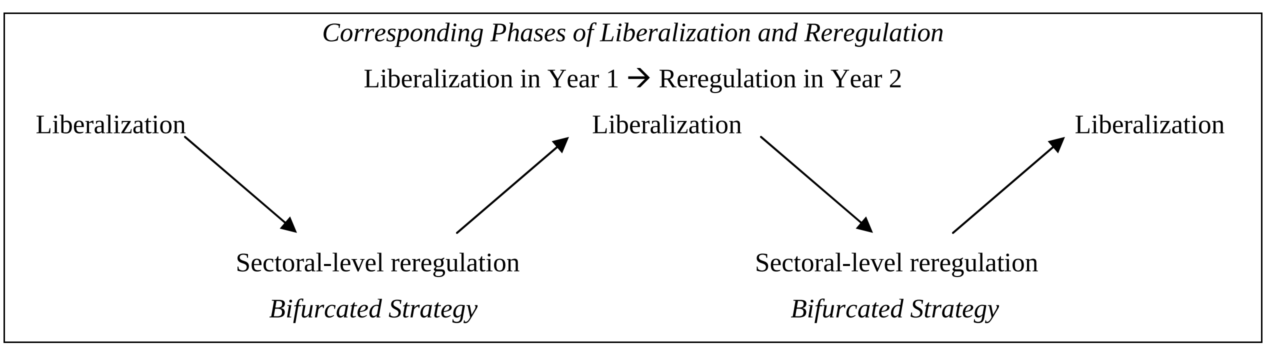
For example, the 1998 to 2001 phase of reregulation in both textiles and telecommunications reveals conscious efforts by the state to correct existing institutions'

[19] See pp. 1618-1612, in Gereffi (2001) for a discussion of the main characteristics of producer-driven and buyer-driven commodity chains.

inability to maximize the benefits and minimize the costs of liberalization, which had taken place in 1993.[20] De facto FDI liberalization, despite legal prohibition, allowed non-incumbent telecom carriers to build third generation networks in partnership with foreign-invested companies but unsettled the government's control of network development and desire for state-owned carriers to retain control of telecom services. In response, the central government consolidated its control of rival equipment and service ministries with the creation of the Ministry of Information Industry and forced the divestment of FDI. In textile manufacturing, the government resurrected the textile bureaucracy despite abolishing it half a decade earlier because the devolution of economic decision-making to local levels resulted in what the government perceived as rampant market overexpansion in the fiber processing sectors of the textile supply chain.

Whether the state relaxes restrictions on assets to serve a strategic purpose or devolves central control because of a sector's less strategic significance (i.e., liberalization of FDI in year 1), reregulation inevitably follows as the state intervenes either to reap the rewards of liberalization or to compensate for administrative and institutional weakness as a result of liberalization (i.e., reregulation of FDI in time 2). Figure 1.2 illustrates the secondary argument that a phase of reregulation follows a phase of liberalization in each sector. Though each sector follows its own pattern, reregulatory efforts roughly coincide with nation-wide administrative restructuring, which has occurred in five-year increments, in 1988, 1993, 1998, 2003, and 2008. Two factors, described in more detail below, explain variation across time.

FIGURE 1.2 CORRESPONDING PHASES OF LIBERALIZATION AND REREGULATION



[20] Chaudhry (1993) argues that interventionist regimes emerge under conditions of institutional and administrative weakness and aborted attempts to create unified national markets, rather than a weak private sector unable to make large investments and respond to market signals.

Domestic sector's competitive position shapes how state control varies across time

That the Chinese textiles industry is globally competitive and the Chinese telecommunications industry is not shape the extent of state intervention and the methods of state control of FDI. The *domestic sector's competitiveness at critical junctures of a country's integration into the international economy* shapes how the state intervenes to manage the direction and scope of FDI across time. The competitiveness of the domestic sector during critical junctures of an industry's exposure to the international economy influences the resources the state devotes to it in order to retain authority to direct the level and scope of FDI and to ensure the domestic sector's dominance of internal markets. In other words, the less competitive a sector, the more likely it is for the state to intervene to maximize technological and knowledge transfers and minimize FDI's dominance in domestic markets. During critical junctures, the state withdraws control in industries where the domestic sector tends to be more competitive, while at the same time reasserts its influence to increase the competitiveness of the domestic sector vis-à-vis global industry in industries where the domestic sector tends to be less competitive. For example, in 1998, the domestic sector's competitive position in part explains the state's decision to resurrect the textile bureaucracy that the government had dismantled half a decade earlier. Right around the time when the Chinese government signed WTO accession protocol agreements with the United States and the European Union, the central government intervened to order competition in natural fiber processing sectors and to promote industrial upgrading in manufacturing and technical sectors. Likewise, at another critical juncture, WTO accession in 2001, because the textile industry was fairly competitive, the state demoted the central bureaucracy to create sector associations. This finding confirms that regulatory and extractive institutions of late developers are constructed in a context of growing economic interdependence marked by highly mobile global capital and technological changes.[21]

Organization of state institutions in a given sector shapes how state control varies across time

Third, the *organization of state institutions in a given sector* also shapes how government officials influence industrial reform and the manner in which government policies are enforced. That preexisting organization of political economic relationships, which are predisposed to solve certain types of technologically complex problems and create political interests, shapes state

[21] See Chaudhry (1993) on effects of capital flows and Zysman and Newman (2006) on effects of technological changes.

control of FDI demonstrates that markets are institutions embedded in society and culture.[22] Administrative realignment, specifically the various rounds of reclassifying government bodies and personnel introduced in 1982, 1988, 1993, 1998, and 2003, has transformed the state's role in governing the economy for its own purposes, including exercising control when and where it sees fit.[23] These reforms not only reduced the number of personnel but also changed the roles and functions of state bureaucracies. This affects the state's capacity, defined by the extent of state authority over industry and the methods available to the state, to organize markets to meet state objectives.

Segmented jurisdiction undermines state control in one subsector even as it enhances control in another. For example, the 1993 dismantling of the Ministry of Textiles undermined state control of textiles manufacturing but because the Ministry of Internal Trade and the Ministry of Foreign Economic Relations continued to manage certain issue areas within internal and external trade and distribution, respectively, the central government retained control of the marketing and distribution of raw materials, critical for upstream fiber processing sectors. The government did not relax central control of the marketing and distribution of domestically produced and imported raw materials until 2001, after WTO accession. Moreover, between 1998 and 2001, the still influential but reassigned textile bureaucrats convinced the central leadership to intervene in cotton processing and industrial textiles even though the state formally liberalized competition in textiles when it dismantled the Ministry of Textile Industry in 1993.

Overlapping jurisdiction creates sites of bureaucratic and political contention as bureaucracies vie for control over industrial policy and take actions that contradict official policy. The de facto liberalization of FDI in telecommunication services between 1993 and 1998 allowed practice to diverge from formal rules that prohibit the entry of FDI. During this period, new entrant operators managed by the Ministry of Post and Telecommunications' rival ministries courted FDI without central state intervention. Moreover, the elevation of the abolished textile bureaucracy between 1998 and 2001 to a higher level of government exemplifies how retaining a bureau-level office despite abolishing the ministry in 1993 enabled textile bureaucrats to lobby

[22] In his interpretation of the evolution from feudalism to market society in nineteenth-century Europe, Karl Polanyi (1944) suggests that economic rationality is culturally conditioned and that the market system does not spontaneously arise, but that governments have to actively create national markets. Herbert Kitschelt (1991) argues that certain governance structures are predisposed to foster certain combinations of innovation. Also see Hollingsworth (2001).
[23] Chan and Drewry (2001).

patrons in the State Council to solve overexpansion in upstream sectors through government intervention. Finally, *consolidated jurisdiction* allows the state to smoothly enhance its control and strategically regulate FDI even as it introduces competition. The merger of the electronics and telecommunications ministries to create the Ministry of Information Industry exemplifies managerial consolidation. The organization of state institutions in a given sector interacts with the other two forces of variation to determine whether the methods of state control emphasize liberalization or reregulation and whether methods of state control tend toward primary or corollary measures.

Figure 1.3 shows that the state exercises incidental control in sectors that are less strategic and where the domestic sector tends to be more competitive and deliberate control in sectors that are more strategic and where the domestic sector tends to be less competitive. There are also sectors whereby the state exercises a mix of incidental and deliberate state control, which I survey in the larger study on which this paper is based. The multidimensional conceptualization of state control and the cross-sector and cross-time comparisons of my study allow me to explain why we see a mixed picture in those sectors.

FIGURE 1.3 MAPPING SECTORS TO STATE CONTROL

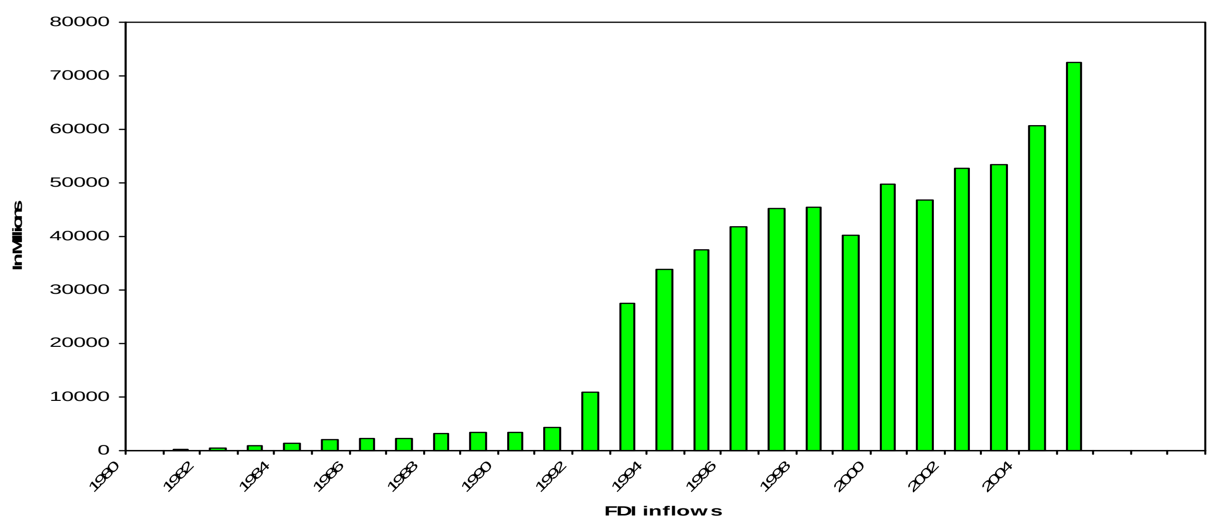
		Domestic sector more competitive	Foreign sector more competitive
Strategic value of sector	High	Food Stuffs MIXED	Telecommunications Financial Services Energy DELIBERATE CONTROL
	Low	Textiles Paper INCIDENTAL CONTROL	Automobiles Consumer Electronics MIXED

Before we systematically apply the strategic value framework to telecoms and textiles, the next section describes the common forces experienced by all industries that have been ascribed as critical to explaining why China has liberalized. In my discussion of each common force, I demonstrate how it falls short in explaining the extent of sectoral liberalization and reregulation.

China's participation in multilateral and bilateral regimes

China entered the international economy at the height of an international ideological movement to export liberal reforms to developing countries.[24] Thus, many scholars link bilateral and multilateral pressures to liberalize to the Chinese government's conduct of sensitive economic and political reforms, including the liberalization of FDI via special trade zones and foreign-invested joint ventures.[25] Indeed, China's participation in multilateral, regional, and bilateral arrangements, such as the World Trade Organization, obligated the Chinese government to liberalize trade and FDI.[26] Inflows of FDI surged into China between 1980 and 2006 (Figure 1.4) and in 2005, China ranks first in FDI inflows as compared to its East Asian neighbors, other developing countries, and the United States (Figure 1.5). Moreover, in terms of trade, according to data collected by the International Monetary Fund, China ranks number three globally in both imports and exports in 2006.

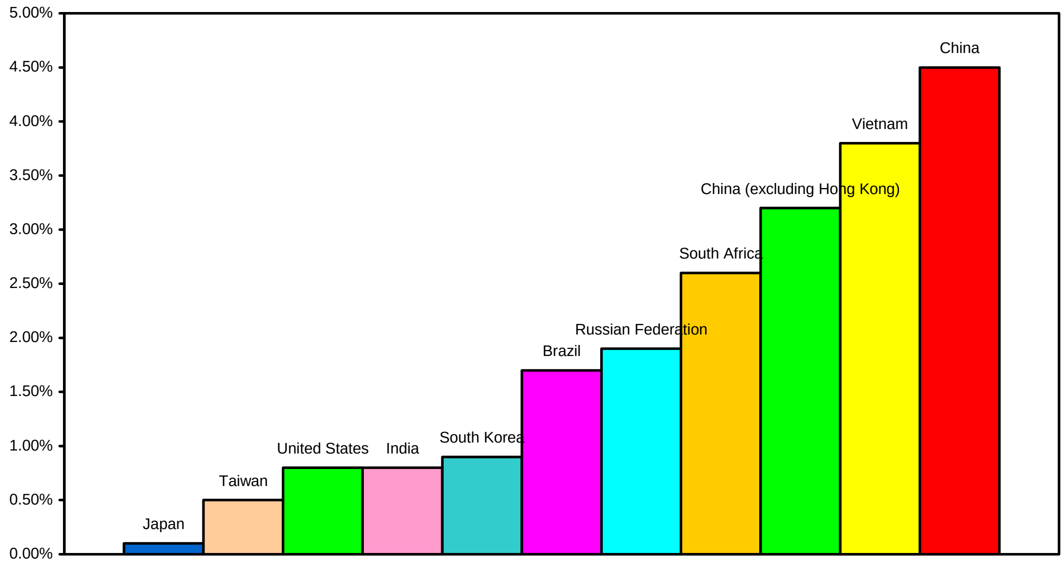
FIGURE 1.4 FDI INFLOWS IN MILLIONS, 1980-2005



Source: UN Conference on Trade and Development; International Monetary Fund

[24] See Stiglitz (2001) for the contours and effects of the export of "Washington Consensus" on developing countries initiated by the International Monetary Fund and the World Bank and Simmons and Elkins (2004) on the spread and adoption of liberal economic ideas and policies across countries as a function of the diffusion of liberal ideas (exported by international institutions and hegemonic countries like the United States).
[25] See Pearson (1999, 2001), Peerenboom (2001), Yang (2004), Jacobson and Oksenberg (1990), and Fewsmith (2001) for the relationship between multilateral and bilateral pressures and economic and political reforms. Early studies on special economic zones and foreign-invested joint ventures include Ho and Huenemann (1984) and Pearson (1991).
[26]See Lardy (2002) and Guthrie (1999, 2006), Zweig (2002), Huang (2003), Steinfeld (2004), and Gallagher (2005) for how China's openness toward FDI contrasts with Japan, Korea, and Taiwan's restrictiveness toward FDI during an analogous stage of development.

FIGURE 1.5 FDI INFLOWS AS % OF GDP CHINA, OTHER COUNTRIES (2005)



Source: UN Conference on Trade and Development; International Monetary Fund

Scholars argue that China's participation in GATT and then the WTO has allowed China to internalize "free trade norms," and that the shift toward the rule of law has played a decisive role in China's liberal convergence.[27] Moreover, enlightened, liberal-minded reformers bargain with conservative, hardliners to check local protectionism and avoid costly foreign reprisals in pursuit of economic development.[28] This focus on liberal ideas and reform-minded elites, bureaucrats, experts, and the legislature links the state to liberalizing reforms, including FDI.[29] Indeed, a survey of market and administrative reforms promulgated by the Chinese government appears to demonstrate the gradual but progressively liberalizing rules since the Open Door Policy. Table 1.1 lists key economy-wide market reforms, including those measures critical in liberalizing FDI.

[27] Peerenboom (2001) and Yang (2004).
[28] Jacobson and Oksenberg (1990), Shirk (1993), and Fewsmith (2001). On the other hand, Barry Naughton argues that economic reforms in China lack political and intellectual coherence and represent purely adaptive, opportunistic policies of "muddling through." See Naughton (1995) and McMillan and Naughton (1992)
[29] Lieberthal and Okensberg (1988), Lieberthal and Lampton (1992), Shirk (1993), Tanner (1999), and Fewsmith (2001) and Naughton (2002), respectively.

TABLE 1.1 ECONOMY-WIDE MARKET REOFRMS

- **1979-1983**
  - Open Door Policy (1978)
  - Initiating reforms (agricultural reforms)
  - Household responsibility system, *getihu, siye danwei*
  - Joint Venture Law (1979)
  - Creation of Special Economic Zones (1980)
- **1984-1992**
  - Urban industrial reform began (enterprise reforms and experimentations) (1984-1987)
  - Fiscal reforms/ revenue sharing/ tax responsibility system
  - Rise of TVEs and other quasi-private enterprise forms
  - 14 coastal cities and island of Hainan opened to FDI
  - Law of Wholly-Foreign Owned Enterprises (WFOE) (1986)
  - Administrative and state sector restructuring (1988)
  - Law on Sino-foreign Cooperative Joint Venture (1988)
  - Deng Xiaoping's Southern Tour (1992)
- **1993-1997**
  - Coastal development strategy, influx of FDI – beginning 1993
  - Administrative and state sector restructuring (1993)
  - Foreign Trade Law (1994)
  - Company Law (1994) allowed for corporatization and privatization of SOEs.
  - Local municipal governments increased incentives to FDI.
- **1998-2001**
  - Western Development Strategy (1997)
  - Administrative and state sector restructuring (1998)
  - State Council continued to refine its definitions of which sectors can receive foreign investment.
  - Accession protocol agreements committed China to FDI liberalization in many industries and geographical regions (1999).
- **2001-Present**
  - 2001 round of administrative and state sector restructuring
  - 2003 round of administrative and state sector restructuring
  - Steady release of implementation rules on FDI liberalization across industries and issue areas according to agreed upon WTO timetable, including Foreign Trade Law (2004)
  - "Harmonious Society" (2003)
  - Began to allow mergers and acquisitions and divest SOEs to foreign investors (2003).
  - Release of reformulated and new laws including labor contract law, government procurement law, mergers and acquisitions, and bankruptcy.

Economy-wide market reforms can be organized in roughly five periods, with one or two polices in each period particularly key in liberalizing FDI. Between 1978 and 1983, the Open Door Policy and the Joint Venture Law created special economic zones that courted foreign capital and technology. Between 1984 and 1992, the de facto recognition of town and village enterprises and other quasi-private enterprise forms gave rise to a domestic sector, which courted and collaborated with FDI eager to form joint ventures with domestic companies. The opening of FDI in 14 coastal cities and Hainan Island in the mid-1980s and Deng Xiaoping's Southern Tour in 1992, further created fertile ground for FDI to invest in productive capacity. State sector restructuring during this period also launched the strategic utilization of FDI to promote industrial development. Between 1993 and 1997, the Company Law launched the corporatization of state-owned companies and allowed the decoupling of state ownership and ministerial control, which provided further incentives for FDI to form joint ventures with state-owned companies. Moreover, the devolution of economic powers to local governments and lower levels of government empowered localities to court FDI with fiscal and infrastructural incentives. China's WTO accession protocols negotiated between 1998 and 2001 and its entry to the WTO in 2001 committed the Chinese government to liberalizing FDI in many industries and geographical regions. Since 2001, state sector reform and the promulgation of rules and regulations in compliance with WTO accession agreements further eased market entry for foreign competition. Reformulated and new rules promulgated between 2006 and 2008 have sought to equalize the playing field between FDI and the private sector by universalizing income tax, buffer society from negative externalities by making it more difficult to hire and fire workers, and favor the domestic sector vis-à-vis the foreign sector in government procurement, mergers and acquisitions, and bankruptcy.

Ironically, it is this macro-liberalization that has unveiled the state's true intent in liberalizing FDI. The elimination of across-the-board protection provides a full view of how much and exactly how state control varies across sectors. Accounts of liberal convergence do not explain why FDI liberalization began more than a decade before WTO accession and reregulation has happened in some sectors despite WTO commitments. If China is really liberalizing and fulfilling the spirit and letter of WTO commitments, then we would not expect to find variation in degree and nature of reregulation across sectors. Moreover, these accounts cannot explain why even as market reforms were introduced in some sectors, reregulation proceeded in others. Liberal ideas, which were prevalent through the reform era, held by both domestic and international actors might explain the macro-liberalization of FDI but do not adequately address what motivates the state to introduce foreign competition only to follow it with reregulation.

Political fragmentation and federalism, Chinese style

The fragmented and decentralized context underlying China's economic reforms explain in part the nature of state control of FDI. One view focuses on distinct cleavages between the center and local levels and explains bargaining at both lower and higher levels of bureaucracy.[30] In particular, the "fragmented authoritarianism" model argues that "authority below the very peak of the Chinese political system is fragmented and disjointed," growing more "increasingly pronounced under the reforms beginning in the late 1970s."[31] In more recent scholarship, Andrew Mertha builds on the earlier studies to investigate the interaction between vertical hierarchies as an organizational and institutional continuum, which a traditional focus on the central-local divide overlooks. By focusing on institutional arrangements to understand the relationship between international pressures and variation in domestic policy outcomes and subtle changes, Mertha finds that centralizing attempts in the 1990s in response to these pressures have produced "soft centralization," an incomplete form that shifts bargaining from the lower levels to the provincial level without increasing the authority of the center.[32]

How state control varies, however, reveals that fragmentation and decentralization do not explain the full story. In less strategic sectors, whereby the state does not exercise deliberate intervention, some of these consequences occur; but by and large, the State Council has balanced bureaucratic conflicts and retained its authority to manage developments in industries, such as telecommunications, deemed strategic to the state. Moreover, in some cases, incomplete centralization has occurred because the government has deliberately planned it that way. The restructuring of telecommunication services confirms the recognition that the state has used administrative streamlining, specifically the various rounds of downsizing of government bodies and personnel between 1982 and 2008 to transform its role in governing the economy for its own purposes, including exercising control when and where it sees fit.[33] The state withdraws at the same time that it reasserts its influence on priority areas. Administrative reforms not only reduced the number of personnel but also changed the role of state bureaucracies and its functions.

In another view, scholars find that the "market preserving" functions of "Chinese style" federalism explain successful economic growth. Yingyi Qian and his co-authors argue that the quasi-government sector has performed better than the state sector because "appropriate"

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[30] Scholarship that stresses the center-local divide includes Oksenberg and Tong (1991), Shirk (1993), Yang (1994), Walder (1995), and Huang (1996).
[31] Lieberthal in Lieberthal and Lampton (1992). See Barnett (1985), Lampton (1987), Lieberthal and Okensberg (1988), and Lieberthal and Lampton (1992) for more on fragmented authoritarianism.
[32] Mertha (2005a, 2005b).
[33] Chan and Drewry (2001), 553-572.

decentralization of information and state power limits state predation and negative incentives, reduces the soft budget constraint problem, and provides credit commitment.[34] Finally, a third related debate presents two contrasting views of the Chinese state in the context of economic and administrative reforms launched by China's Open Door Policy. One view explains that China has extensively decentralized since economic opening and that the locus of power is at the local level where the local government is either developmental or predatory and that local state-society relations explain variation in local development outcomes.[35] Another view, in contrast to Mertha's soft authoritarianism, argues that the central government has centralized in recent years to increase its regulatory capacity.[36]

These studies on institutional foundations of reform provide snap shots of what I find but do not help us understand the whole story of FDI liberalization and reregulation. Moreover, contrasting pictures of the Chinese political economy have emerged because most of these studies do not disaggregate the state and investigate government control in only one industry or issue area. Instead, my cross-sector comparative case research design enables me to comprehend the political institutional foundations of China's political economy and reconcile the two pictures of the Chinese state. My findings show that even while the state has enhanced state control in strategic sectors to achieve both political and economic goals, the special type of institutionalized decentralization that some scholars praise as instrumental for China's economic growth has also contributed to overproduction, rent seeking behavior, and other externalities as a result of regulatory weakness, which the state has attempted to correct during phases of reregulation.

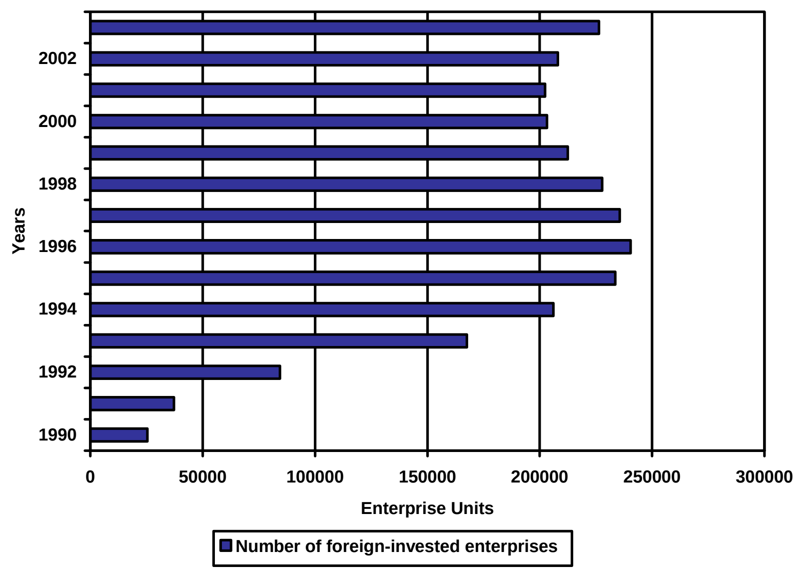
Proliferation of non-state interests

Furthermore, the emergence of China's bifurcated strategy toward FDI occurs in a context of emerging non-state, domestic, and international interests introduced by three decades of economic reforms. Margaret Pearson's 1991 study of joint ventures finds that international pressures compelled the state to accommodate FDI even though initial motivations for reform envisioned a much more conservative strategy of structured development controlled by the state. Moreover, scholars identify participation in international supply chains, which activate the direct involvement of the domestic and foreign sectors and the role of domestic non-state interests as

[34] These studies include Montinola, Qian, and Weingast (1995), Lau, Qian, and Gerard (2000), and Qian, Yingyi, and Weingast (1997).
[35] See Oi (1992) on local state corporatism and Perkins (1986), Nolan and Dong (1989), Parris (1993), Oi (1992, 1999), and Blecher and Shue (1996, 2001) for studies on the local developmental state.
[36] Yang (2004), Naughton and Yang (2004), and Heilmann (2005).

factors shaping policy and institutional change.[37] The steady inflow of FDI in the last decade across all sectors has certainly increased the number of foreign actors in the Chinese economy (Figure 1.6).

FIGURE 1.6 FOREIGN-INVESTED ENTERPRISES IN CHINA, 1990-2003

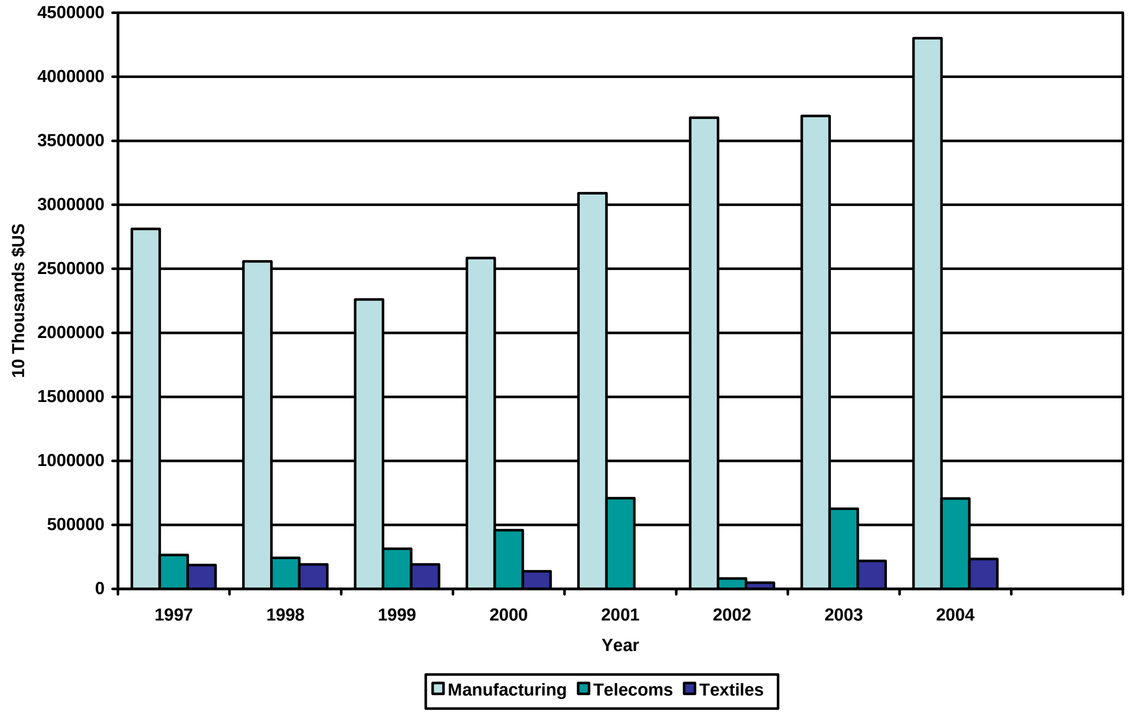


Source: PRC Ministry of Commerce, various years.

In fact, as the state deregulates in textiles and reregulates in telecoms, FDI in electronics surged beyond FDI in textiles. Figure 1.7 shows that between 1997 and 2004, even as the state intervenes in telecoms, FDI continues to surge. During the same period, FDI in textiles remained fairly steady. Moreover, Albert Hu and Gary Jefferson's model with data drawn from the Survey of Large and Medium Size Enterprise that the P.R.C. National Bureau of Statistics conducts each year, finds that in both 1995 and 1999, the electronic industry was significantly more FDI intensive than the textile industry. In 1999, the proportion of FDI receiving firms in electronics was nearly twice that of the textile industry; overall FDI intensity in the electronic industry was nearly three times as large as that of textile industry and the number and proportion of majority foreign-owned firms in the electronic industry also exceeds that of the textile industry.[38] Notably, the increasing number of non-state actors has not prevented the state to reregulate to enhance its control to achieve its sectoral goals. The proliferation of non-state interests falls short in explaining reregulation in strategic sectors, which the state has previously liberalized.

[37] Kennedy (2005), Zweig (2002), and Gallagher (2005).
[38] Hu and Jefferson (2002), p. 1065-1066.

FIGURE 1.7 FDI IN TEXTILES, TELECOMS, AND MANUFACTURING



Source: PRC Bureau of Statistics, Statistical Yearbook of China

Sector-specific requirements and challenges

Finally, industrial sectors differ in technological complexity and capital requirements and plug into distinct global market structures are partial explanations for why state control of FDI varies across industries. Scholars argue that technological complexity and capital intensity require more state intervention; in other words, technological properties of industries shape how governance and industrial trajectories vary.[39] This understanding is insufficient because it falls short in explaining why we find variation across subsectors and time. For example, requiring technologically complex inputs and emergent as viable players during the global telecommunications revolution, the telecommunications industry in China was regulated by two separate ministries before 1997 but only one after 1997. The creation of an overarching industry was not meant to enhance state planning of R&D activities as Herbert Kitschelt (1991) might

[39] Kitschelt (1991). See Segal and Thun (2001), Thun (2006), and Segal (2002) for how regional institutional structures in China explain variation in industrial development outcomes and strategies in automobile and high technology sectors.

predict based on his hypothesis that tightly coupled technological systems require state coordination because of high asset specificity and global learning. Nor was the consolidation of state control an effort to more efficiently and more neutrally regulate market players. Rather, the State Council first introduced foreign competition to impel industrial upgrading and then created a supra-ministry to consolidate its control of network infrastructure and development to achieve national security goals and to minimize the degree of foreign penetration in telecommunication services to promote the competitiveness of domestic industry. The creation of the Ministry of Information Industry occurred in parallel to an increase in China's technology base but the latter outcome is a result of the liberalization of China's equipment sectors, which increased the import and manufacturing of foreign technology. Moreover, despite WTO accession and exposure to global markets, there is more state control, not less, and reregulation efforts have allowed domestic private and state-owned players to increasingly dominant telecommunication markets.

Moreover, Thomas Moore (2002) argues that international market structures forced the Chinese government to subsidize industrial upgrading in textiles; in other words, in response to global competition, the Chinese government intervened to compel its domestic sector to engage in industrial upgrading.[40] Certainly in 1998, shortly prior to WTO accession and during China's bilateral negotiations to extend Chinese quotas beyond the expiration of the Multi-Fiber Agreement, the central government intervened to compel industrial upgrading. All the same, the resuscitation of the dismantled Ministry of Textile Industry lasted only until 2001 and because of prior decentralizing and deregulatory efforts, local authorities in fact engaged in industrial restructuring to achieve local goals, some of which matched central goals but many not.

A concerted commitment to liberalization, external pressures in the form of multilateral memberships and bilateral agreements, intended or unintended consequences of decentralizing reforms and institutional fragmentation, emerging foreign and domestic non-state interests within China, and structural characteristics exogenous to the Chinese political economy are common challenges that the state faces in all industries across the economy as the Chinese government reregulates following macro-level liberalization of FDI. Despite these common forces of change faced by all sectors across time, we find the government has liberalized FDI and reregulated industries with the strategic value logic. The government has liberalized and reregulated FDI in

[40] Gourevitch (1978) and Moore (2002).

the industries that we examine in remarkably different ways to reduce the costs and enhance the benefits of economic liberalization, including openness toward FDI.

The recognition of these common forces and pressures of change help demonstrate the full range and complexity of patterns of state control of FDI in China's integration into the international economy. Figure 1.8 illustrates my basic argument.

FIGURE 1.8 BASIC ARGUMENT IN DIAGRAM FORM

Common Forces		
Marketplace changes	**Multilateral and bilateral pressures**	**Domestic and non-state interests**
• Exert strong pressure to respond • Applies across time • Applies to all sectors	• Exert medium pressure to respond • Applies directly pre- and post-WTO accession • Applies to all sectors (some more than others)	• Exert pressure to respond • Applies across time • Applies to all sectors

⇩

Responses vary by sector
Degree and substantive essence of strategic value of sector affect • how the central government formulates state goals. E.g., do these forces compel the state to exert incidental or deliberate control? • who controls FDI policy. E.g., can lower levels of government approve FDI and engage in state-FDI bargains? • what kinds of measures are employed. E.g., are they sector and/or product specific, industry-wide, or locally-initiated?

Responses vary over time
The domestic sector's competitive position affects • how central government intervenes. E.g., should a central-level bureaucracy manage restructuring? Organization of state institutions in a given sector affects • how government officials try to shape industrial reform. E.g., do bureaucrats try to preserve their authority? • how government policies are enforced? E.g., do practice reconciles with policy when bureaucracies have overlapping jurisdictions?

CHINA'S BIFURCATED STRATEGY: EVIDENCE FROM INDUSTRIES

In this section, I apply the strategic value framework more systematically to our two industry case studies. In 1993, the Chinese government abolished the Ministry of Textile Industry and formally decentralized economic decision-making regarding subsectors of textiles to local governments and lower levels of government. That same year, the central government introduced competition in telecommunications by licensing China Unicom and FDI surged to develop digital telecom networks. Both industries were exposed to greater competition in an environment of economic reform at home and an international economy eager to invest in China both to pursue Chinese markets and make efficiency gains through manufacturing for exports. These two industries provide a good starting point to study the liberalization of FDI and reregulation that has followed because any differences in reform outcomes are likely to reflect differences in how the Chinese government has introduced market reforms across industries despite their similar starting points.

Since 1978, the Chinese government has adopted successive generations of reforms, which range from the restructuring of state-owned enterprises to administrative bureaucracies to liberalizing FDI on the macro-level. Yet what is striking is that these sweeping changes are selectively applied to telecommunications and textiles. Between 1978 and 1993, one overarching sector-specific ministry supervised textile manufacturing and internal market developments across subsectors and FDI was tolerated. Two ministries supervised telecommunications equipment and services, provincial telecom administrations and different ministries operated public and government telecom networks, and FDI was prohibited. Thus, if anything, the governance of textiles was more centralized than telecommunications though the government was ambivalent about FDI in both industries.

In 2008, a very different regulatory picture and extent of state control over industry developments and FDI have emerged in textiles and telecoms. The central government has replaced the textile bureaucracy with quasi-government sector associations and local governments, local branches of the commerce ministry approve market entry, and FDI is completely liberalized. In telecommunications, the Ministry of Information Industry strictly regulates sector developments up and down the supply chain, including level of investment and business scope of FDI, and state-owned national telecom carriers operate telecom networks.

In a context of economic liberalization, the Chinese government has reregulated in ways that disengaged state intervention in textiles and reinforced state authority in telecommunications. This divergence in patterns of state control of FDI cannot be explained by the globalization of liberal ideas, a hegemonic or decentralized state, or market and interest group models that have been attributed to market reforms in China. While China’s exposure to liberal institutions, federalism, Chinese style, and the growing presence of non-state actors certainly are factors that shape its FDI regime, it is the strategic value of a sector that shapes China's bifurcated policy toward FDI and industry. The strategic value logic framework also explains how state control varies across subsectors of these two industries. In the larger study on which this paper is based, I also examine how government control varies in other strategic (financial services, energy, and automobiles) and non-strategic industries (consumer electronics, food stuffs, and paper).

Deliberate reinforcement and telecommunications

Deliberate reinforcement is the overall pattern of state control in telecommunications, a strategic industry. Case studies of subsectors of telecoms and foreign-invested equipment makers and service providers demonstrate an explicit relationship between industrial and FDI strategies, whereby the state adopts a purposive attitude towards market players and enhances state control over industry. The central government has reregulated telecoms to retain deliberate control but has taken a more liberal approach in less strategic subsectors and issue areas. The State Council is determined to modernize China's telecom infrastructure, promote the international competitiveness of its telecom carriers, and control information flows. It has sought to achieve these goals by introducing and managing competition through administrative restructuring, discretionary control of licensing, business scope, and level and type of capital investment, price regulation, technical standards setting, and equipment procurement. By and large, the central government has autonomously introduced competition and enhanced its overall control of industry even though competing non-state industry interests shape the impact of state control on market developments.

The strategic value of telecommunications also applies across subsectors. To upgrade network infrastructure and appease rival ministries that sought to break the telecom monopoly, the state exercises *strategic reregulation* by introducing competition among state-owned carriers in the decade leading up to WTO accession in 2001. Between 1993 and 1998, the central government did not enforce official restrictions of FDI, which rival ministries used to their advantage to develop competing carriers. However, between 1998 and 2001, the state merged the service and equipment ministries to consolidate regulatory control and intervened to regain authority over competing carriers. The central state actors had concluded that the practice of permitting FDI resulted in redundant network infrastructure and undermined the state's authority in preparing the state-owned operators for WTO accession.

The domestic sector's competitive position and the organization of state institutions in telecommunications shape how government control of telecommunications varies across time. Since WTO accession, the liberalization of FDI has lagged WTO commitments as the Ministry of Information Industry exercises *expansionary reregulation* to order competition and restructure price-cutting carriers and to enhance its discretion over network development. It has also enhanced bureaucratic authority to control the dissemination of information in value-added services, the regulation of which the state had *subordinated* to provincial branches of the central ministry prior to WTO accession, and to order competition to promote a more competitive domestic sector vis-à-vis foreign-invested value-added service providers.

The state's governance of FDI in equipment varies from that of service providers. In the pre-WTO era, the state introduced competition to encourage technology transfers and Sino-foreign joint ventures in equipment manufacturing but did not strictly regulate the enterprise structure of foreign equipment makers. In the post-WTO era, parallel with the complete liberalization of FDI in equipment, a more powerful sector-specific ministry exercises *strategic reregulation* to enhance its control of technology. Through initiating and managing technical standard setting, the government attempts to increase the market share of domestic equipment makers. The less than successful integration of domestic and foreign technologies, however, has delayed the implementation of third generation telecom networks in China.

Decentralized engagement and textiles

Because the textile industry is lower in strategic value than telecommunications, the central state governs textiles with *decentralized engagement*. The central state has reregulated textile manufacturing with *decentralized reregulation*, whereby decentralization has empowered quasi-government and local stakeholders to enforce commercial rules and create industry-specific rules to favor local stakeholders and powerful interests. The central government exercises incidental control to diffuse local battles and employs macro-economic levers, and local governments, empowered by decentralization, court FDI with local level incentives. Moreover, that the state considers textiles as less strategic than telecoms is reflected in the Chinese government's WTO accession protocol agreement with the United States. The state traded more years of bilateral management of textile exports for a lower ceiling on foreign equity investment in telecom services.

The strategic value logic also applies to subsectors of textiles. Central and local stakeholders promote domestic industry in an attempt to achieve industrial upgrading in subsectors, such as chemical fiber processing, geosynthetics and construction textiles, designated as critical for infrastructural development, and other technical textiles critical for military and space applications, such as the production of body armor, military parachutes, and aviation textiles. They impose tariff and non-tariff measures to control production capacity and levels of technology, FDI, and local content. The state also exercises *subordinated reregulation* to manage the internal and external retail and distribution of textile. Local branches of the commerce ministry manage export quotas because of the strategic value of these exports to foreign economic relations. A discretionary regime allocates tariff rate quotas for raw material imports, such as cotton, other fibers and petrochemical. That the central government retained central-level control of the textile supply chain for raw materials until 2001, even as the state downgraded specialized ministries for less strategic industries during the decade earlier, also reflects the strategic value of raw material inputs of non-strategic industries, such as textiles. Furthermore, although the central government has introduced foreign competition in internal trade in compliance with its WTO accession agreement, the devolution of economic decision-making to local governments means that localities have the discretion to reformulate old rules and write new ones to favor local interests, whether they are to increase local employment, promote local companies, or maximize FDI.

The textile industry's competitive position and organization of institutions shape the extent of government intervention across subsectors and time. Because particular subsectors of textiles remained uncompetitive and local state entrepreneurialism and arbitrary discretion have resulted in what the central government deems as "rampant market overexpansion and irrational investments," the central government intervened to quell these "excesses" and force industrial upgrading immediately before WTO accession. The state has refrained, however, from similar intervention since the creation of sector associations in 2001 eliminated formal central government control of textile manufacturing sectors.

Table 1.2 provides a map of how state control varies across telecommunications and textiles.

TABLE 1.2 BIFURCATED STRATEGY OF MARKET GOVERNANCE

	Telecommunications	Textiles
Dominant pattern of state control	Strategic reinforcement	Decentralized engagement
State goals	• Modernization of networks • Control of information • Control of technology	• Local goals: maximization of employment, FDI, tax revenue • Foreign economic relations
State-industry relations	• Enhance central government control	• Undermine central government control
State methods	• Sector-specific rules and regulations, and technical standards that impede market entry	• Macro-economic policies • Local rules and regulations that impede local market access

CHINA'S NEW REGULATORY STATE

The case studies of telecommunications and textiles presented in this paper allow us to evaluate whether international economic integration and China's strong linkages to the global economy suggest a liberal policy convergence in China. China has not become a liberal market economy. Rather, China has extensively liberalized FDI on the aggregate level but restricts the business scope of FDI in select sectors with market and non-market mechanisms. Administrative restructuring, regulatory reinforcement, and *de jure* and *de facto* restrictions on the business scope and property structure of FDI in the context of the liberalization of FDI entry confirm that, at least in the short term, international economic integration and China's strong linkages to the global economy will not lead to a liberal policy convergence. Do not expect China to act like a liberal state just because it joined the World Trade Organization and liberalized at the aggregate level. You have to disaggregate the Chinese state – China is not one unified state. Goals, state-industry relations, and state methods vary by sector.

The Chinese state is not just one monolithic system; yet, it is also not a weak state. Rather, different dynamics at different levels of government have emerged and in some sectors and areas, reregulation has enhanced government control. To begin with, the administrative restructuring witnessed in the different phases of liberalization and reregulation in telecommunications and textiles reveals the growing diversity of government agencies and offices from the center to the local level that makes up government control and regulates the economy. In some sectors, central ministries have mandate; in other sectors, provincial and local branches of these ministries not only have decision-making and implementation authority but also make policy, and in yet other sectors, local governments approve business scope and reformulate and write new rules to regulate local market developments. Moreover, in strategic sectors, due to their importance to national security and contribution to the national technology base and the growth of the rest of the economy, the central government has enhanced its authority to not only regulate industry but also retain its control of infrastructure, which in the case of telecommunications, for example, also serve political purposes, such as the control of information.

The findings presented here cut at the heart of the scholarly debate in the study of comparative and international political economy concerning the relative strength and weakness of the state and the role of the state in development as a country integrates into the international economy. Scholars have found that countries undergoing development battle being captured by foreign capital and that outside the developmental states of East Asia, developing countries have had difficulty structuring liberalization and the non-state, domestic and international interests that proliferate as a consequence reduce the capacity of the state to control FDI. By studying how the state controls foreign companies to meet central-level prerogatives, my study provides insights into the relative power of the Chinese state vis-à-vis global forces. Without doubt, although China has been much more open toward FDI and foreign trade than its developing world counterparts and the developmental states of East Asia during an analogous stage of economic development, the behavior of multinational corporations will in part be in response to what is happening in their home countries. Telecommunications equipment maker Ericsson may respond to the slowdown in Europe by not expanding its business in China. What is more, Liz Claiborne might not increase its orders because demand is falling in the United States. All the same, evidence suggests that developments within China matter too. The nature of political, economic, and social institutions and the ideas that shape how these institutions emerge affect a country's economic growth and foreign companies operating within that country, and in turn, the nature and direction of the international economy.

A natural question arises, the Chinese state and foreign capital, who controls whom? China appears to have gained the upper hand. If China were simply a market economy, there would not be a point to reregulate. If it were a developmental state, then it would restrict the entry of FDI. Rather, China wants to have it both ways. And what is more, China manages to both control and reap the benefits of its exposure and integration into the international economy. China has managed to foster domestic champions even in a more liberal environment. What has emerged is China's new regulatory state, which exercises a bifurcated strategy in government-business relations, and the capacity for which has increased, rather than decreased, in the face of globalization.

China will not be captured by foreign capital because it is reasserting control where it needs it most. While scholars of Latin America have observed the "mutual indispensability" of the bureaucratic authoritarian state and international capital, state control of FDI across sectors and time reveal that the Chinese state is not dependent on foreign capital for dynamic growth and human development.[41] Rather, the liberalization and reregulation that vary across strategic and less strategic industries have been enough to help the Chinese obtain technological know-how, foster national champions, and retain an upper hand over foreign forces at play within China.

China's authoritarian government has facilitated this exercise of a bifurcated strategy toward government-business relations. Insulated from domestic political pressures, the Chinese government is able to liberalize foreign competition without upsetting an electoral constituency. It is also able to intervene in strategic sectors and issue areas when it sees fit without having to face political retaliation or opposition. Questions for future research include, would a democratic country produce this clear pattern of variation between strategic and non-strategic industries? Would we see more idiosyncratic patterns reflecting domestic political pressures? How does China's approach toward FDI compare to that of India, a developing economy with a large domestic market and growing capabilities in high-tech services, and Russia, which has undergone substantial political centralization in recent years? Importantly, how do these varying strategies toward FDI translate into effective development models in the 21st century?

[41] See O'Donnell (1979, 302).