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CHINA'S REGULATORY REGIME AND NEW CAPITALISM

The People's Republic of China launched its Open Door Policy in 1978. More than three decades after the country's reintegration into the global economy, a new model of capitalism has emerged. Market governance and economic engagement today departs from China's Communist past and its East Asian neighbors, which restricted rather than embraced foreign direct investment (FDI). This new capitalism solves as well as creates governance problems as China simultaneously introduces markets and enhances state capacity to industrialize and modernize; and maintain social stability and authoritarian rule.

In an environment of more competition and foreign influence, the Chinese state has taken the lead in erecting market institutions and creating the rules of engagement. Its regulatory state deliberately combines liberal economic and state interventionist mechanisms in sector-specific ways. The restructuring of strategic industries, with significant application for national security, contribution to the national technology base, and the competitiveness of other sectors in the economy, exemplifies how the central state has used administrative streamlining, specifically the various rounds of downsizing of government bodies and personnel, including exercising control when and where it sees fit, to withdraw at the same time that it reasserts its influence in priority areas. In those industrial sectors, the coordination capacity of the Chinese government has increased but it does not regulate as a referee as commonly expected of independent regulators in liberal economies. Rather, the state complements the introduction of competition with the enhancement of bureaucratic coordination up and down the supply chain, and strictly regulates market entry and exit, investment level, and the business scope of and competition between market players. State-owned enterprises (SOEs) and private and foreign companies co-exist; but the state remains a dominant owner and shareholder of infrastructural assets and manages the adoption of foreign technology and initiation and implementation of indigenous technology. This dominant pattern of market governance manifests in strategic industries from telecommunications and banking to energy sectors and automobiles.

In contrast, less concerned about controlling products or services that do not have applications to national security and contribution to the national technology base, the Chinese government introduced competition beginning in the 1980s and decentralized market coordination to local governments and commerce bureaus throughout the 1990s. Empowered with economic decision-making, decentralized actors, government and nonstate alike, play key roles in market coordination and comprise the diversity of property rights. Local governments and commerce bureaus approve market entry, which in many cases are completely liberalized. These decentralized authorities, including sector and business associations, act as economic stakeholders as opposed to dominant owners and managers in a fiercely competitive landscape. Private enterprises, many of which restructured from town and village enterprises or divested from state-owned companies, and foreign-invested ones compete fiercely. The business and politics of these markets are local and companies have to contend with the vagaries of local politics, regulatory arbitrariness, and lack of central will and regulatory capacity in enforcing macroeconomic and economy-wide rules. This dominant pattern of market governance is witnessed in industries ranging from textiles and consumer electronics to foodstuffs and paper.

Various dynamics at different levels of government have emerged in the regulatory transformation entailed in China's bifurcated strategy of market reform. The administrative and ownership restructuring witnessed in different phases of liberalization and reregulation reveal the growing diversity in function and form of government agencies and quasi-state organizations from the center to the locality. In strategic industries, central ministries have a mandate but it does not mean that central bureaucrats always agree on actual policy details. In nonstrategic ones, provincial and local branches of central ministries wrestle for influence in regulatory enforcement and local rulemaking. In these contexts, actual details of regulatory and market restructuring and new and reformulated rules to enhance or relinquish central authority are often products of much protracted bureaucratic conflict or fierce bargaining between relevant political and economic stakeholders. The lists below summarize the sectoral variation in dominant patterns of market governance in China today.[1]

Market Governance in Strategic Industries

- Separation of enterprise from government bureaucracy; corporatization; business restructuring, and/ or creation of SOE groups (and public listing)
- Introduction of competition between SOEs and sometimes the nonstate sector
- Centralized bureaucracies make policy and regulate or delegate implementation to lower levels of government
- Sector-specific rules on ownership, investment level, and market entry (no private entry, domestic sector only, and/or foreign investment through joint ventures), product certification, and technical standards

Market Governance in Nonstrategic Industries

- Divestment of state assets to former managers, corporatization, and/or business restructuring (and public listing)
- Liberalization of market entry
- Vibrant private sector, comprising quasi-state–quasi-private firms and FDI
- Economy-wide rules on market entry, macro-economic policies, and local approval of market entry and licensure of business scope

ECONOMIC, SOCIAL, AND POLITICAL IMPLICATIONS

What are the economic, political, and social implications of China's bifurcated strategy of market governance for the competitive performance of Chinese business and industry? What are the implications for global market competition? Let us consider the telecommunications industry, an industry with high application for national security and significant contribution to the national technology base and the competitiveness of other sectors in the economy. The introduction of market competition has attracted global players from AT&T to Motorola and

[1] Lists adapted from Roselyn Hsueh, *China's Regulatory State: A New Strategy for Globalization* (Cornell University Press, 2011).

MySpace to participate in the largest telecommunications market in the world, exposing Chinese industry to foreign technology and knowhow. The sector-specific reregulation, which quickly followed, has fostered a vibrant Chinese telecommunications industry in which value-added service providers, such as Yahoo and Google compete, even while global operators are shut out of basic services.

Foreign equipment makers from Ericsson and Nortel to Qualcomm also enjoy market share thanks in part to the procurement of state-owned carriers, which have embraced foreign technologies, in addition to implementing indigenous ones. Moreover, Chinese companies now sell telecommunications equipment and provide services in global markets, particularly in developing countries such as Iran and Nigeria, with which the Chinese government has strong diplomatic ties. Politically, with complete control of telecommunications infrastructure in government ownership and management of communications networks, top leadership can mandate blackouts of Internet and mobile communications in China proper and Tibet and Inner Mongolia when politically sensitive and socially destabilizing issues arise and events occur.

At the same time, price-cutting is the dominant strategy between the fiercely competing state-owned carriers; this is not a sustainable strategy for the provision of quality services, which will limit the globalization potential of Chinese operators. It remains to be seen whether sector-specific reregulation to control information infrastructure and dissemination will exempt the Chinese Communist Party from the political effects of the global information revolution being witnessed in the Middle East with the Arab Spring. Developments thus far show that it is very possible to have freer markets and more authoritarian control. In the short term, the distinct path-dependent patterns of state control disincentivize bottom-up democratic mobilization and political reform from above.

Moreover, industry insiders and market watchers have questioned the technical quality and marketability of China's indigenous networking technology, TD-SCDMA; they doubt global market adoption will ever occur. Strict regulation of strategic sectors has stifled domestic innovation and market viability of indigenous technologies; and in select Information Technology subsectors, global companies have successfully protested against the enforcement of Chinese standards. Additionally, aside from a few market standouts, such as Huawei and ZTE, most Chinese equipment makers compete in consumer telecommunications equipment and not the high tech, more value-added networking segments.

Among the nonstrategic industries, de facto and formal market liberalization and reregulation encouraged the emergence of domestic industry. Hypercompetition reigns; thus many businesses emerge and quickly fail. Those that survive dominate local markets regulated by local rules and local enforcement of economywide rules. Extensive market liberalization and non-sector-specific economy-wide and macroeconomic rules attract FDI, benefiting the domestic sector through technology and knowledge transfers. Domestic companies have also benefited from subsidies targeted at strategic subsectors in nonstrategic industries, such as technical textiles and geosynthetics, along the supply chain that contribute to the development of infrastructure, that have military applications, and that contribute to the competitiveness of other sectors and the rest of the economy.

In sectors and issue areas in which the central state has relinquished control, the lack of rules and lackluster enforcement of regulations have created economic, social, and political problems that challenge China's political regime. These problems include deficient regulatory capacity to enforce rules concerning human and animal health and safety and the environment. This is prevalent in industrial sectors, such as food production and distribution and energy generation, where the state had previously decentralized regulatory control.

Importantly, as the Chinese government has concentrated its macro- and micro-level measures on promoting industrial development, much of the dividends fall in the area of export growth. Many measures encourage manufactured exports at the expense of the service sector, depressing job growth and cramping spending power when wages are already low, thereby dampening domestic consumption. In the Eleventh Five-Year Plan issued in 2006, the Chinese government switched its focus to promoting indigenous production and domestic consumption, relying on administrative and macroeconomic measures to do so. But to the chagrin of its trade partners, the Chinese government has not increased the value of the renminbi to a satisfactory level. What is more, the central government's efforts to address the unintended consequences of China's development model never stray too far from its bifurcated strategy of reregulation.

For example, during the global economic slowdown, the Chinese government announced in 2008 an economic stimulus plan that allocated nearly USD 600 billion to infrastructure and social programs. Provincial governments followed suit with their own stimulus packages. Central and local stimulus plans, however, were not necessarily conceived in response to the financial crisis. The Eleventh Five-Year Plan (2006-2010) had already included many of the projects, and provincial governments revived previously defunct projects in the hopes difficult financial times would persuade Beijing to fund them. Beijing has paid special attention to strategic sectors, and left the rest of the economy to the localities.

TOWARD A CHINESE MODEL OF DEVELOPMENT

Notwithstanding the divergent patterns of market governance witnessed in China today, the most centrally coordinated sectors in the post-Mao era break from the ideal typical socialist system and the most liberalized depart from a liberal capitalist system. China in 2010 is a one-party dominant state that does not exercise ideologically driven control over its economy. Rather, it bases its control of the economy and markets on a strategic value logic, which varies by industrial sector. Its departure from Marxist-Leninism is exemplified in the de facto distribution of property rights across the political economy. While state-owned national champions in strategic industries receive preferential treatment from state financial and administrative bureaucracies, quasi-private and de facto private companies, including foreign ones, compete with one another in nonstrategic industries. Moreover, while bureaucratic coordination dominated Mao's China, today central bureaucracies preside over less than half of the economy. Decentralized market coordination dominates industries noncritical to national security, the national technology base, and the competitiveness of the rest of the economy.

As for the typical behavior of economic actors, even while some national and local state-owned enterprises enjoy soft budget constraints, many state-owned companies have instituted reforms to operate on a hard budget constraint, especially ones considered strategic by the government. Fierce competition to increase market share characterizes the economy; these are markets not constrained by a central plan. The typical economic phenomena are chaotic and saturated markets, and business cycle fluctuations, not chronic shortages and sellers' markets. Chinese entrepreneurs drive economic growth even while operating within deliberate patterns of market governance; they are eager to stay in business and not agitating for political reform. The most successful businesspeople are invited to serve as representatives of the local and national people's congresses. In the span of thirty years, China has transitioned away from a socialist economic system to a capitalist one, marked by bifurcation in market governance.