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Chinese-style Capitalism and Implications of Recent Developments

In the past few decades of China's "reform and opening," conventional wisdom on the institutional foundations of Chinese-style capitalism underscores the impact of liberal reformers and China's participation in international organizations, devolution of economic decision-making and local experimentation, and the proliferation of market actors to explain their origins. More recently, prevailing perspectives of China watchers and political pundits alike contend that the underlying logic of Chinese-style capitalism has transformed in light of anti-trust actions and intellectual property enforcement in favor of Chinese industry and Chinese president Xi Jinping's anti-corruption campaign to consolidate Xi's political power and safeguard the legitimacy of the Chinese Communist Party (CCP). Other explicit state interventions include the devaluation of Chinese currency and sweeping measures to prop up the country's stock market, the ups and downs of which have reverberated globally. The Third Plenum of the 18th National Congress of the Chinese Communist Party in 2013 affirmed China's "opening up" and promised "comprehensively deepening reforms" at the same time identified national security, with emphasis on internal security; social and environmental consequences of reform; and innovation and global competitiveness of state-owned industries as critical issues confronting the country.

These seemingly contradictory practices reflect the *modus operandi* in the last several decades of China's globalization and do not significantly alter the underlying political logic of Chinese-style capitalism. Government actions in both unleashing market forces and protecting state interests date back to Deng Xiaoping's reopening of the country to foreign investment in 1992. Beginning in the early 1990s, after initial market liberalization, Chinese companies started collaborating with foreign partners. Once they benefited from technology and knowledge transfers, however, the government has time and time again restricted the ownership structure and business scope of foreign direct investment (FDI) and intervened to promote indigenous technology, incubate Chinese business in fledging industrial sectors, and ensure their long-term market foothold. My recent *Governance* article ("State Capitalism, Chinese-Style: Strategic Value of Sectors, Sectoral Characteristics, and Globalization") shows that Chinese-style capitalism involves two primary components. First is market coordination, which combines competition with deliberate regulation to achieve industrial modernization and economic and security goals. Second, the CCP works to ensure that industries it sees as particularly valuable—especially in external and internal security, technology, or for overall economic competitiveness—are owned primarily by Chinese businesses, whether state-owned or private.

During a protracted period of political consolidation by Xi and his supporters, the political dimension of market governance is more somberly and intensely experienced. The Third Plenum announced the establishment of the National Security Commission, a rule of law plan, and a leading group to strengthen market forces to achieve stated goals. Moreover, Xi usurped the power of the premiership by creating under his oversight small leading groups, which are not new in the management of markets in strategic industries, when they were traditionally within the premier's portfolio. All the same, state and market combinations of economic governance, which vary by sector, have not changed significantly. Barring pointed failure of Xi's anti-corruption campaign, it remains business as usual in deliberate Chinese state actions toward markets according to a strategic value logic.

The Strategic Value Logic of China's Sectoral Patterns of Market Governance

The institutional foundations of the macro Chinese economy do not have a unitary character. The Chinese state deliberately combines liberal economic and state interventionist mechanisms in sector-specific ways. Sectoral variation in market governance in Chinese-style capitalism reflects first and foremost the Chinese state's priorities and how they are constructed. The *perceived strategic value of a sector*, defined politically and economically, drives state leaders to deliberately combine the use of markets with calibrated state intervention. Beyond that, sectoral structures and economic conditions and existing institutional arrangements influence details within dominant patterns of institutional development.

In industries perceived by the state to possess low strategic value for application for national security, contribution to the national technology base, and the competitiveness of other sectors in the economy, the *decentralized market stakeholder* pattern of devolved market coordination and predominance of quasi-state and private ownership holds. For example, China introduced competition in *textiles* in the 1980s and devolved market coordination to local governments and commerce bureaus by the early 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 aggressively. 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*.

In contrast, in industries perceived to be strategic to the state, those with significant application for national security, contribution to the national technology base, and the competitiveness of other sectors in the economy, 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 coordination and distribution of property rights manifests in strategic industries from *telecommunications* and *banking* to *energy sectors* and *automobiles*.

The *centralized government shareholder* pattern of market governance in *telecommunications*, an industry of high importance to national security and high contribution to the national technology base and the competitiveness of the rest of the economy, enables the Chinese state to achieve its security and developmental goals even while introducing competition and exposing the industry to global economic integration. The actual market governance details vary by subsector and time, in cycles of liberalization cum reregulation, as I delineated in my 2011 book *China's Regulatory State: A New Strategy for Globalization*. Beijing broke up the country's telecommunications monopoly in 1994 and allowed foreign telecommunications service providers and equipment makers to invest in joint ventures and sell in the domestic market, exposing Chinese industry to foreign expertise and knowhow. Later in the decade, foreign investors, including Sprint, Motorola, Deutsche Telekom and France Telecom, teamed with newly formed state-owned telecommunications carriers to build new generation communications networks. Fearful of relinquishing control of the communications infrastructure and during state entrenchment in response to the economic reverberations of the East Asian financial crisis of the late 1990s, the government forced the divestment of FDI, restructured the state-owned operators, and merged the then- separate telecommunications equipment and service ministries.

China became a member of the World Trade Organization in 2001, making a series of liberalizing commitments in its accession protocol. Yet today, 15 years later, the government owns basic telecommunications services and only permits competition in value-added services (VAS) among domestic companies, such as Alibaba, whose initial public offering (IPO) in the New York Stock Exchange in fall 2014 received more investment than did Facebook, Google, and all previous Internet IPOs. In the fiercely competitive VAS markets, the leaders are Alibaba and other domestic companies with ownership structures and corporate governance connected to Chinese elites. In 2010, China forced Yahoo to divest itself of Alipay, Alibaba's e-payment subsidiary, in which it had invested as a major investor. As I documented in *Review of Policy Research* ("Nations or Sectors in the Age of Globalization: China's Policy Toward Foreign Direct Investment in Telecommunications"), this represents China's open-door-close-door approach toward foreign investment, allowing Chinese companies to take advantage of foreign investment to upgrade Internet services, and then constraining the market scope of FDI.

Today Yahoo, Google, and other foreign companies are limited to minority shares in service segments, like online advertising, that are less important to security and less financially lucrative. Moreover, all telecommunications service providers are expected to follow censorship laws and self-police their content, and to operate on the networks owned and managed by the government. These methods allow the government to consolidate its control over the business of the Internet, including profits and the dissemination of information, to enhance the national technology base, maintain political stability and ensure national security. The new national security law and proposed laws on cybersecurity and counterterrorism fall along the same lines.

Inviting and then restricting the ownership structure and business scope of foreign investment is half of the use of markets. China also takes a more aggressive role in governing the market in a way that gives Chinese-owned companies an advantage and ensures the country's hold on critical technologies. In telecommunications equipment, the government postponed the licensing of foreign technologies for nearly a decade when technical difficulties delayed the release of China's homegrown third-generation networking standard. It then restructured the state-owned carriers to ensure the smooth implementation of TD-SCDMA, the research and development of which involved collaboration between Chinese state-owned companies and foreign ones. The competitive state-owned operators vacillate between competing fiercely with price-cutting strategies and working together to share network infrastructure and technology, in line with the strategic orientation of state coordination of market developments in response to goals of technological development and national security and structural sectoral and economic conditions.

The *centralized government shareholder* pattern of market governance holds in other industries, which score high on the economic and political measures of strategic value. For example, to maintain central control of the national money supply, exchange rate, and other macroeconomic tools, the state centralizes supervision of financial services along subsector lines due to competing bureaucratic interests; retains ownership and management of the Big Four banks; and restricts FDI to minority foreign equity investment. Moreover, parallel to the less restrictive regulation of telecommunications VAS, the state permits private and foreign market entry in select subsectors of financial services, using public-private joint venture arrangements to develop indigenous capacity and retain supervision of financial and human resources. In the last couple of years, Beijing has brought anti-trust actions against foreign automakers and auto parts manufacturers, including Daimler and Volkswagen, and high technology companies, such as Qualcomm and Microsoft, accusing them of overcharging, price manipulation and abusing their market position. Legal decisions ruled in favor of Chinese companies in intellectual property disputes, such as the case involving American company Vringo and ZTE, a Chinese state-owned telecommunications equipment maker, further reveal how China governs markets to enhance the national technology base.

Chinese-style Capitalism Going Forward

The anti-corruption campaign since 2013 has intensified party guidance and supervision of SOE executives and increased inspection and auditing of SOEs. The 26 SOEs targeted by the Central Committee of Discipline Inspection for investigation are from a range of industries, including, construction, electricity, finance, mining, nuclear, petroleum, steel, telecommunications, and transportation. Private entrepreneurs have also been taken custody. These developments do not alter the reality of the party-state deliberately and actively engaging in market coordination and asset shareholding according to a strategic value logic.

The 13th Five-Year Plan, approved in late 2015, also does not change the direction of Chinese-style capitalism. The plan seeks to modernize infrastructure, guarantee national security, and ensure social and political stability. It aims to boost economic growth during a period of slowed growth and sustain China's increasing per capita income. This will be achieved through competition and deliberate regulation (of market entry, business scope, investment, ownership, capital markets, and standards setting), employing new and time tried methods, to support industrial upgrading and indigenous innovation in agriculture and emerging industries, such as those in renewable energy and civil-military integration, and including service sectors, such as healthcare and information communications technology. Likewise, the "Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening State-Owned Enterprise Reform" released in mid-2015 reiterates the party's central role in the internal supervision of SOEs, acknowledges the state's dual role in market coordination and ownership, differentiates between "public" vs. "commercial" SOEs, which operate on political vs. market logics, respectively, and underscores the state's controlling interest in strategic sectors even as private shareholding is permitted.