1 Taming the market

China and the forces of globalization

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China is no stranger to global interactions. The early Ming dynasty saw China launch grand seafaring ventures that predated those of Columbus and reached all the countries around the Indian Ocean and the China Sea. Neither was the Chinese mind as reclusive as the image of the Great Wall conjures up. Not only did the Chinese civilization lead the world in several historic inventions but it also adopted and adapted Buddhism as its leading religion. And at the time when the Pope was putting Galileo on trial in Rome, Jesuits were preaching the Galilean gospel in Beijing (Boorstin, 1983: 62). From this perspective, China's isolation during the late Mao era was a historical aberration, forced by China's historic confrontation with both the United States and the Soviet Union.[2]

When China again started to reach out to Western markets after bouts of revolutionary self-destruction culminating in the Cultural Revolution, its leaders sought to take advantage of what the global market had to offer but avoid the pitfalls of capitalism. China would export in order to earn the foreign exchange needed to import Western equipment and other necessities. But the Chinese would continue on the socialist road under the leadership of the Communist Party.

Less than a quarter of a century after Mao's death, however, the color of China has changed from red to green. Over this period, China's leaders have gradually overcome their ideological reluctance and steadily liberalized the terms of China's participation in the global marketplace. China today is one of the world's top traders and favorite destinations for foreign direct investment. While the global market has presented challenges for China, it has also offered China's leaders avenues for diffusing social tensions and boosting regime legitimacy.

It is now trite to say that globalization, in terms of increased capital and production mobility across borders, imposes constraints on states. What is interesting is how the constraint operates and how the state copes with these constraints (Cohen 1996). Is China similarly constrained? Has the Chinese state been better able to dictate the terms of engagement than countries with smaller markets? Has the Chinese government been successful in its effort to trade market access for technology in bargaining with multinationals? Will China seek to rewrite the rules of the global system to its liking as its economic might increases? In this chapter, we zero in on China's integration with the world economy and hope to shed light on these questions. Before we proceed further, we should admit that the discussion offered here is highly selective. It is focused on the political and economic aspects of China's integration into the global economy and does not discuss the impact of globalization on the transformation of state–society relations within China. We have also paid little attention to other and especially the cultural aspects of this process, which have recently received much attention in the literature on globalization (e.g. Appadurai, 1996; Watson, 1998).

We begin with an overview of China's integration with the world economy. Then we examine the evolution of China's foreign investment policies in order to assess the constraints on China. Next we examine Chinese government efforts to target foreign investment in specific industries and sectors. Overall, we argue that, as reforms and rapid economic growth increasingly made China an attractive destination for foreign direct investment, China has been able to gain some leverage over multinationals. Nevertheless, that leverage is not one-sided and unconditional and the Chinese government has had to curb its own arbitrary behavior and become more market-friendly. Finally we take a look at China's program to meet its growing energy shortage and find that China has aggressively entered the international oil business. But Chinese behavior in this vital sector is designed to tame an unruly market rather than supplant the market. In conclusion, we find that China has in two decades become one of the most important players in the global economy. This means that Chinese interests are increasingly enmeshed with those of the global economy, making China more willing to take on global responsibilities.

Integrating into the global economy

In some sense China's march into the global market is best viewed from the perspective of the consumer. Most American consumers have experienced first-hand the growing varieties of retail products that are made in China. While in the 1980s most Chinese-made products tended to be low-priced, in recent years more and more Chinese products have appeared with higher price-tags. Some Chinese manufacturers, such as the appliance makers Haier and Kelon, have started to move beyond being simple OEM (original equipment manufacturer) suppliers and have begun selling their products with Chinese brand names in American and European chain stores. In the meantime, the emergence of dominant domestic brands in China means that some foreign manufacturers are now willing to become OEM suppliers to Chinese brands.

The growing presence of Chinese producers in world markets is reflected in China's rising rank as a global merchandise trader. In 1980, China's foreign trade volume was at 38 billion dollars (US). China ranked as the 28th foreign trader and accounted for less than 1 percent of the world merchandise trade. By 1997, China's merchandise trade volume, not including Hong Kong, had hit 325 billion dollars, ranking it as the world's tenth largest trader. Its share of world merchandise exports had risen to 3.3 percent (WTO, 1998).[3] The depth of China's engagement with the world economy can also be measured by the ratio of trade to GNP. By this measure, China's trade dependency rose nominally from about 10 percent in 1978 to more than 40 percent in 1995, far higher than the average for large economies.[4] Trade has been a major engine of Chinese economic growth. Moreover, exposure to international competition via international trade has had a significant impact on the improvement of productivity of both state-owned and non-state enterprises in China (Perkins, 1996).[5]

As China has traded more with the rest of the world, it has worked hard to attract overseas investors. Initially and through the 1980s, the flow of foreign capital into China was limited as the Chinese economy was caught between plan and market. Rapid growth and liberalization of the Chinese economy in the 1990s have made the Chinese economy a much more attractive investment destination. From 1993 to 1997, China was the second largest recipient of foreign direct investment, behind just the United States. Overall, it appears that the Chinese economy is now substantially more open to foreign investors than China's East Asian neighbors (Japan, Korea and Taiwan) at a comparable stage of development. According to Lardy (1994: 66), China has had "one of the most liberal foreign investment environments in the developing world."

The importance of overseas investment to the Chinese economy cannot be overestimated. In 1997, 145,000 overseas-invested companies employed 17.5 million or 11 percent of China's non-agricultural workforce and produced 14 percent of the industrial output.[6] They also generated over 12 percent of tax revenue and made more than 13 percent of total annual fixed-asset investment. Even more impressively, they accounted for 47 percent (US$152.6 billion) of China's foreign trade volume in 1997, up from 26.43 percent in 1992. Most importantly, the overseas-invested businesses now account for even greater shares of the marginal increases in these indicators as China's state and collective enterprises have had much difficulty in recent years (*JJRB*, 7 January 1998). Investment from overseas now spearheads China's involvement in the world economy.

Indeed, the growing presence of multinational corporations in the Chinese market has marked the globalization that was lacking just a few years earlier (Simon, 1991). According to the State Planning Commission, about 300 of the world's 500 major multinationals have invested in China. As the number of multinationals in China increases, there has been a substantial increase of projects involving 10 million US dollars each (*Xinhua*, 23 January 1998; FBIS-CHI-98-023). Often the leading competitors on the Chinese market are the same ones as in other parts of the world. In cellular communications, for example, Chinese producers must fight for a foothold amid the crossfire of fierce competition among Ericsson, Nokia, Motorola, Siemens, and other companies. Foreign investors thus not only bring in capital, technology, and management skills, but also force Chinese producers to reform or sink. As the *People's Daily* declared in the middle of the Asian financial crisis:

> The use of foreign capital not only has made up for the shortage of funds for domestic construction, enhanced progress in industrial technology and improvement in operation and management as a whole, and promoted economic growth, but also has trained capable personnel, expanded employment, increased revenue from taxes, promoted import and export, increased foreign exchange reserve, and promoted the development at a deeper level of the economic structural reform and the updating of people's ideology and concepts.
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> (*RMRB*, 25 December 1997)

While China has been a top destination for foreign direct investment, its expanding economy and hefty foreign exchange reserves have also meant more Chinese companies are investing overseas. Most of the 6,000-plus Chinese investments overseas are concentrated in OECD countries. With some exceptions such as COSCO, these investments are generally small. Nevertheless, recently, major Chinese manufacturers in motorcycles, televisions and home appliances have started to set up manufacturing operations overseas, generally in developing countries (Southeast Asia, South Africa, Middle East, Latin America and Central Asia), in order to be closer to their product markets (*QB*, 15 November 1997: 24). China's relative economic stability amid the Asian financial turmoil has also given Chinese companies greater elbow room in regional financial markets. For example, in January 1998, the Industrial & Commercial Bank of China and the Hong Kong-based Bank of East Asia Ltd. bought the Asian equities and corporate-finance businesses of NatWest Markets in order to beef up its investment-banking capabilities. The Bank of China was also known to have shown interest in the assets of the collapsed Peregrine Investment Holdings, though it did not work out a deal. Some Chinese scholars have explicitly called for China to take advantage of the depressed asset values in Southeast Asia and South Korea (Huang Weiping and Zhu Wenhui, 1998).

The Chinese government finally recognized the trend of growing Chinese investment overseas. Drawing on the findings of the Third Industrial Census, the State Economic and Trade Commission, in consultation with other government agencies, has drawn up a list of products, generally in light industry, machinery and electronics, in respect of which the Chinese government will encourage Chinese investors to move production overseas. To promote export of Chinese capital goods, the

Chinese Eximbank will try to provide loans to machinery and electronic manufacturers setting up factories overseas, or offer financial support to overseas projects contracted by Chinese companies (*FT*, 17 March 1998). Such investment overseas is likely to stimulate more trade flows (Encarnation, 1992).[7]

Channeling foreign investment

A review of changes in China's policies toward foreign investment underscores both the strengths of and constraints on the Chinese state. To begin with foreign capital did not rush into China immediately after China began to open up at the end of the 1970s and early 1980s. Overseas investors hesitated because the Chinese economy was dominated by the state sector and had at best a rudimentary and opaque regulatory framework. Even the special economic zones had trouble attracting foreign capital at first (Crane, 1990). In response, the Chinese government had had to make the Chinese investment environment more attractive by modifying its policies. Even then, through the 1980s most foreign investment into China came from ethnic Chinese living in Hong Kong, Macau, Taiwan and Southeast Asia.[8] Overseas Chinese, building on ethnic networks that provided information and an additional measure of security, have channeled billions of dollars into China and laid the foundations for vibrant export industries (Weidenbaum and Hughes, 1996).

It was not until the first half of the 1990s that investor anxieties about China's investment climate were finally eased. As China's domestic economy became largely market-based, the Chinese government also steadily relaxed its policies for foreign investors by improving the regulatory framework and offering tax benefits (Shirk, 1994). The central government decentralized the power of approval over investment projects to local governments and only watched over large projects (especially those involving capital amounts of more than $30 million). In the meantime, local governments vying for outside investments were caught in a game of competitive liberalization. They offered ever more attractive incentives to investors, including tax benefits, improvement in infrastructure, and easy regulatory policies (Yang, 1996). In response to China's improving investment climate and rapid growth in one of the largest consumer markets, a China fever developed and foreign investment in China jumped as investors from OECD countries feared missing out on a critical market of the future. Up until 1985, about 85 percent of FDI (excluding joint oil exploration) came from Hong Kong, Macau and Taiwan. Since 1992, that proportion has declined to 80 percent in 1992 and 59 percent in 1996.[9] Meanwhile, investments from the United States, Japan and Europe have leaped. As mentioned earlier, China has been the largest FDI recipient among developing countries since 1993. China's current account balance improved dramatically.

While huge influx of foreign investment contributed to China's economic growth and strong export performance, it also engendered much concern about the impact of foreign investment on Chinese industries, especially since consumer product companies such as Coca Cola and Procter & Gamble rapidly gained market share at the expense of Chinese producers and brands. Faced with the onslaught of foreign competition, various affected enterprises, especially less efficient state-owned enterprises, expressed opposition to rapid liberalization and lobbied government officials for restrictions on foreign investors. While the industrial interests in the West may organize their lobbying activities through industrial associations and press legislators for policy change, their Chinese counterparts sought help mainly from government ministries, especially industrial ministries that had assumed the role of guardians of enterprises under their jurisdiction. In consequence, the politics of industry protection versus liberalization became a battle among central government bureaucracies and among regional governments. Led by the *Economic Daily*, the newspaper of the State Council, the Chinese press in 1995–97 fiercely debated on the virtues and harmful consequences of foreign direct investment. Many Chinese policymakers and commentators wondered aloud whether Chinese industry (*minzu gongye*) could survive the competition from multinationals armed with superior management, savvy marketing and mountains of cash, while Chinese companies, especially state-owned enterprises, were financially and managerially weak. Opponents of foreign investment policies, represented by narrowly defined ministries in light, heavy, and machinery industries, complained about preferential tax treatment for foreign investors and attributed their failure in market competition to the government's bias against state-owned enterprises, which not only had to pay a higher tax rate but also had heavy welfare burdens.[10] They called for a correction in the FDI policy, leveling the playing field for all players rather than favoring foreign investors. There was also complaint that some companies exploited the policy to import goods for sale duty-free. Even those who saw the benefits of foreign investment were concerned that China might become overly dependent on foreign technology (Zhong Jingwen, 1997).[11] It was claimed that, without an indigenous ability to develop new technologies, China might be stuck in underdevelopment forever, seriously compromising China's interest in the event of war.

Supporters of foreign investment, represented by researchers at the Ministry of Foreign Trade and Economic Cooperation, were put on the defensive since most industrial ministries appeared to call for greater control over foreign investment. They blamed the shock to Chinese enterprises on their outdated operating mechanism (*CDBW*, 5 October 1997: 1). One report, submitted for limited circulation among top decision-makers, also made explicit comparison of divergent performances between the internationally competitive home electronics industry and backward automobile industry. The morale from this comparison was clear: competition from markets, multinationals in particular, could speed up the process of technological upgrading and rebuild stronger national industries, while protection and exclusion of foreign players would slacken Chinese enterprises' incentives for innovation.[12] Among the provinces, there were also serious policy differences. Until 1996, about 85 percent of FDI flowed into the coastal region, especially Guangdong, Jiangsu, Fujian and Shanghai. Those provinces were especially strong advocates for foreign investment, either to create new jobs or to help reform existing state enterprises. In contrast, the interior regions, which are still dominated by state enterprises, tended to favor more central control over FDI.

Faced with a flood of foreign investment (and thus growing bargaining power vis-à-vis multinationals) and a chorus of domestic critics, the Chinese government chose to tighten control in the mid-1990s; it could afford to be choosier among the large number of overseas investors. Even some local governments in China openly declared that they did not want just any foreign investment. In 1995, the Chinese government issued a set of guidelines on foreign investment that spelt out industries where foreign investment was to be encouraged, permitted, restricted and prohibited. Most significantly, the Chinese government decided to scrap the system that had exempted foreign investors from import tax and value-added tax on capital equipment in April 1996 and thus give domestic equipment producers greater protection.[13] Domestic industrial producers thus won a round against the internationalists represented by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Indeed, some industrial ministries proceeded to issue their own directives. In spring 1997, for example, the National Council of Light Industries decided to tighten macroeconomic control over foreign investment.

The restrictive policies did not immediately lead to a slowdown of FDI into China. Indeed, it produced a "gold rush" effect as many companies rushed into China to beat the April 1 deadline for tariff-free importing, making 1996 one of the best for China in attracting foreign investment. Once the gold rush effect was gone, however, China became much less attractive to foreign investors. International manufacturing companies now faced duties on capital goods imports of up to 40 percent of the equipment. High-tech investments, which China has worked hard to attract, were especially hard hit because they usually required imports of expensive equipment. GM, for example, complained that the cost of its billion-plus auto plant in Shanghai would increase by one-third without the exemptions.

The Chinese government's decision to tighten control over foreign investment coincided with a growing realization among multinationals that making money in the Chinese market was not as easy as anticipated. Indeed, the government policy reversal was seen as a striking evidence of China's meddling bureaucracy.[14] The bureaucratic meddling, together with a patchy legal system, rampant corruption, underdeveloped financial system, technology transfer requirements, slowing economic growth, and overcapacity in most products, made it hard for foreign investors who also had to deal with Chinese partners more interested in skimming a project. While Japan's direct investment in China peaked at 431.9 billion yen in the year ended March 31, 1996, it plunged to 282.8 billion yen the following year following the cancellation of preferential treatment (*WSJ*, 5 February 1998). By late 1997, major investors such as Ameritech, Bristol-Myers Squibb, Caterpillar and Whirlpool would either quit or scale down their involvement in the Chinese market. While these companies represented only a small fraction of the total number of foreign investors, their actions indicated the end of the romantic rush into China. After all, in the age of globalization, there was always another country that was eager to welcome your investment on your terms.

The Asian financial crisis, which made most other Asian countries cheaper to invest in, compounded the impact of Chinese government decisions since three-quarters of China's FDI have come from the rest of Asia.[15] By fall 1997, the Chinese leadership saw the prospect of a precipitous decline in foreign investment: during the first ten months of 1997, pledged foreign investment dropped 35 percent from the year-earlier period. Full-year figures for 1997 were only slightly better. While foreign direct investment grew by 8.5 percent to 45.3 billion, contracts signed still showed a 24 percent decline from 1996 (State Statistical Bureau, 1998).

The decline was partly due to comparison with the high 1996 base figure and thus to be expected. Nevertheless, given the importance of foreign investment in China's economy, this precipitous decline in contracted FDI proved to be far more than the Chinese leadership had bargained for and Chinese forecasters suggested that FDI in 1998 could decline by a third to just 30 billion dollars. The Asian financial crisis not only shut off a major source of FDI but also forced even the most successful investors in China to sell key assets in order to support operations at home. For example, the Thai conglomerate Charoen Pokphand, known as Asia's chicken king in Thailand, China and Indonesia, is one of the largest and most successful investors in China, with assets valued at $2 to $4 billion. During the go-go years, CP ventured out of its core feed business into diverse industries ranging from drugs, beer, to petrochemicals and motorcycles. By 1998, however, CP was in retrenchment as its credit lines dried up at home amid the Asian financial crisis. Pressed by banks at home for repayment of about $1 billion in foreign-currency debt, it put many of its Chinese investments up for sale, laid off hundreds of Chinese staff members, and jettisoned some money-losing joint ventures (Kahn, 1998).

Even before the Asian financial crisis erupted like a hurricane, the Chinese leadership had already made some concessions after the cancellation of preferential treatment had provoked an outcry from foreign investors and prompted an intense lobbying effort by multinationals and the Association of Foreign-invested Businesses (Personal interviews, 1997). Foreign governments, such as Japan's Ministry of International Trade and Industry, also lobbied for the restoration of the benefit on behalf of business interests (*WSJ*, 5 February 1998). To soothe investors, the Chinese government allowed foreign-funded projects approved before April 1996 to continue to import capital goods tariff-free until all such equipment had been imported (*RMRBO*, 10 April 1997).

By late 1997, worries about the dominance of foreign investment in the Chinese economy, while still in existence, had become far less pronounced than just a year or two earlier.[16] While multinationals had captured substantial market shares (but still less than majority) in cosmetics, detergents, beer and drinks, there was growing evidence that Chinese manufacturers were ascendant and dominated the consumer appliance and electronics market (televisions, refrigerators, air conditioners, videos, CD players and microwave ovens) (Yang, 1998). In competition some Chinese producers have gained strength. Indeed, for growing numbers of Chinese people, the distinction between foreign and domestic is blurred since multinationals have generated employment and taxes for the local economy and have generally been good corporate citizens in China.[17]

As the international economic environment deteriorated and Chinese economic growth was slowing down, the Chinese government scrambled to keep foreign capital flowing, especially since the Chinese leadership chose not to join in the competitive devaluation sweeping Asia and devalue the Chinese currency. This meant that China had to adopt other measures to accommodate foreign investors and keep up a steady flow of foreign investment. Fortunately, the increasing competitiveness of Chinese firms suggested that China could afford to keep on liberalizing its trade and investment regimes. In October 1997, China announced a reduction of tariffs to an average level of 17 percent from 23 percent. In December 1997, the State Council convened a National Conference on Using Foreign Investment, only the second such conference ever held during the reform era (the first was in 1983), and issued new rules to guide foreign investment. It was decided to resume tax exemptions for imported equipment for projects the government wanted to encourage, thus removing a major complaint of foreign investors. Unlike the blanket exemptions that had existed prior to April 1996, however, the new rules targeted the importation of more advanced technology and equipment as well as the development of the interior regions, while they broadened the scope of investments, promising favorable treatment to 270 of the total 329 industries listed (*WSJ*, 5 January 1998; *Xinhua*, 30 December 1997; FBIS-CHI-97-364). Unlike in the past, the tax exemptions extend to both foreign and domestic companies, thus providing a more level playing field. Key sectors on the list are high and new technology, transportation and telecommunications, electric power generation, aviation, oil and petrochemicals, machinery and electronics. Other sectors include pharmaceuticals, medical equipment, textiles, metals and metallurgy, light industry and agriculture. Investment in the interior is also encouraged. Taxes on some imports are kept to discourage the import of low-technology machinery and equipment that can be built domestically and to protect fledgling domestic industries.

The commitment to boost foreign investment is reflected in the spate of major projects announced in 1998. In February 1998, the central government approved a Royal Dutch/Shell joint-venture project to build a $4.5bn petrochemical complex in southern China. The largest of its kind ever, this is one among a series of petrochemicals projects and goes a long way toward tripling China's ethylene production capacity by 2010 (*FEER*, 11 February 1998). The Royal Dutch/Shell deal was followed shortly by a major investment program by Eastman Kodak (more on this later). Moreover, the Chinese government has promised to continue the gradual liberalization of services and thus attract foreign investment into new sectors.[18] It will also accelerate efforts to phase in national treatment to foreign-funded companies. This will likely lead to the equalization of the fees overseas investors and locals have to pay for utilities and property and of the different tax rates on foreign and domestic financial institutions.

A series of measures have also been adopted to boost China's export competitiveness. The Chinese government promised to continue reforms of the foreign trade system, including accelerating the process of approval for trade rights by enterprises. While trade rights were limited to state enterprises and foreign-invested enterprises, the government has started to offer qualifying private enterprises export rights and thus boost exports (*DJN*, 29 May 1998).

While the number of enterprises enjoying foreign trade rights will continue to expand, the scope of imported goods subject to quotas and licenses will be reduced and the approval for imports simplified. In general, efforts to control imports will be based on general principles, tariffs and technology standards rather than arbitrary and non-tariff barriers.[19] On April 1, 1998, China abolished export quotas and ended export license requirements on twenty-seven types of products covering about 20 percent of China's total exports.

The Chinese government has also repaid overdue export tax rebates to Chinese companies, some of which had been outstanding since 1994. In 1997, China paid out 43.2 billion yuan in tax rebates for exports. The 1997 total, added to the 1996 total of 82.8 billion, has remedied billions of yuan worth of rebates owed to Chinese exporters since 1994 and 1995 (*DJN*, 2 April 1998). In October 1997, the State Administration of Taxation resumed the 9 percent value-added tax rebates for newsprint exporters (*Xinhua*, 8 December 1997). The rebate rates for textiles, China's largest exporter in 1997, was increased from 9 percent to 11 percent of the 17 percent value-added tax in 1998.[20] This was followed by tax rebate increases for exports of a variety of other products, including textile machinery (from 9 to 11 percent), ships (from 9 to 14 percent), steel (from 2 to 11 percent), cement (from 2 to 11 percent), and coal (from 3 to 9 percent) (*CD*, 23 June 1998).[21] Moreover, officials of the State Administration of Taxation have indicated that China is unlikely to annul perferential corporate taxation policies for overseas-funded enterprises before the end of the century (*CDBW*, 4 May 1998: 1).

While export financing dried up in countries that were hard hit by financial crisis, Chinese banks authorized greater lending to exporters to counteract the impact of currency devaluation in the rest of Asia. The Export and Import Bank of China (Eximbank), for example, planned to increase loans to exporters by up to 60 percent to 24.3 billion yuan, with special attention to machinery and electronic products (*FT*, 17 March 1998).

These and other measures as well as China's economic stability, which persuaded some overseas buyers not to switch suppliers for fear of supply problems, have helped China avoid the steep decline in FDI and exports and foreign direct investment that some analysts had forecast.[22] In conclusion, while China's market size has proved attractive to overseas investors, that attraction is not inherent. China could only raise the price of investing in China when the supply of overseas capital was plentiful. But such plenty was short-lived, with the exception of the mid-1990s, and China has had to work very much harder in order to attract overseas investors. In general, as China eagerly sought overseas investment and interacted with investors, it was China that changed to suit foot-loose investors and submit to the rules of global engagement. As the following section suggests, only in certain industrial sectors and under specific conditions has the Chinese state been able to extract important concessions from multinational corporations by combining liberalization and state control.

Bargaining with multinationals: trading market access for technology

The Chinese effort to combine liberalization with state control is noticeable and to some extent successful at the level of industrial sectors. Specifically, the central government delegated the power of investment approval to local governments for relatively small projects (those below $30 million). Because of the intense local government competition for foreign investment, the delegation of authority to local governments has essentially been transformed into deregulation for relatively small foreign investors. Instead, the central government has chosen to focus its limited energy on a relatively small number of major investments in industries ranging from aerospace, automobiles, to petrochemicals and telecommunications. By requiring official approval for major projects in these industries, China has been able to extract better bargains from multinationals than would have been the case had entry into the Chinese market been unfettered. Moreover, the administrative barriers to entry have also provided some limited breathing room for domestic producers who clamor for government protection.

The economic rationale for such limited state intervention is well developed in the literature on strategic trade and indeed has its intellectual lineage in the writings of Frederich List and Alexander Hamilton. Because of economies of scale, latecomers to technology-intensive industries such as automobiles and telecommunications face extremely high barriers to entry and generally have trouble coming up with the high initial investment and huge R&D spending that are needed to break into such industries. Governments may offer some help, such as access to credit and tax breaks for research and development, that may make it possible for indigenous firms in developing economies to overcome entry barriers and become genuine competitors in the marketplace. As economists such as Paul Krugman have been careful to point out, however, there is no guarantee that such state intervention will be successful. Moreover, there is always the danger that indigenous industrial interests will look upon government protection as an entitlement and use their political clout to perpetuate protectionist policies rather than strive for excellence on the marketplace.

In the Chinese case, government officials realized in the 1980s that China could not develop its indigenous industry simply by hiding behind tariff walls. Moreover, the importation of foreign technology, especially in the form of assembly lines and licenses, was of limited help in reducing China's technology gap with developed economies as long as domestic R&D lagged behind. Too often technology imports must be followed by more imports in order to keep up with the technology race. The best way for China would be to attract foreign investors to bring their technology to China and, through partnerships with Chinese firms or gradual diffusion, make China part of the global technology march.

Yet Chinese leaders learned the hard way that it was not easy to persuade foreign investors to bring their technologies to China, especially because China lacked a working legal system as of the early 1980s and generally required foreign investors to export their products. In consequence, as discussed earlier, leading multinationals stayed away from China through much of the 1980s. The political crisis of 1989 dealt a major blow to China's improving international image, prompting the Chinese leadership to be more willing to offer concessions to foreign investors. In the meantime, China's domestic economy had become largely market-oriented by the early 1990s (Naughton, 1995) and Chinese leaders were more willing to adopt market-based policies. The confluence of these two factors resulted in a foreign investment strategy of exchanging market access for foreign investment by multinationals. The Chinese government has promulgated guidelines for foreign investments that target specific industries as well as regions. For foreign investors eyeing the rapidly expanding Chinese market, direct investment in China thus becomes an attractive and often a necessary option.[23] The spectacular negotiations that foreign multinationals such as GM, Ford and others have gone through to secure access to the Chinese automotive market clearly fit this logic.[24] In the rest of this section, we offer surveys of a number of other sectors to illustrate the patterns of interaction China has engaged with multinationals.

Aerospace: monopsony versus oligopoly

The market-for-technology strategy is probably nowhere as prominent as in the airplane industry. As the Chinese passenger travel boomed amid rapid economic growth, the Chinese airline industry, spurred by the rise of regional and local airlines, expanded with abandon, making the Chinese market one of the most coveted for passenger plane makers, especially Boeing and Airbus.[25] By 1998, China's civil aviation sector alone had already spent more than US$18 billion on 387 Boeing and McDonnell Douglas airplanes. Airbus received orders for 92 planes, 47 of which were operational by mid-1998 (*CD*, 15 June 1998; 18 June 1998).

Instead of letting more than two dozen Chinese airlines negotiate separately with the plane makers, the Chinese government has sought to coordinate Chinese purchases, using such purchases as leverage in trade disputes and negotiations with the United States and Europe. For example, in advance of President Jiang Zemin's visit to the United States in the Fall of 1997, Zeng Peiyan, minister in charge of the State Development Planning Commission, led a procurement mission to the United States. The mission signed contracts and agreements valued at US$5 billion, including aircraft purchase contracts worth more than US$3 billion. Using monopsony in one of the largest aircraft markets, China has been able to extract more favorable deals from the world's oligopolistic commercial aircraft manufacturing industry as well as gain some diplomatic mileage out of these deals.

Yet China is not content to be just an aircraft consumer, especially as China's own aircraft manufacturers, which used to serve the military, have been desperately chasing civilian purchases. Thus it is not surprising that the Chinese government has sought to tie parts manufacturing and assembly with purchases. Such work not only lowers costs for manufacturers but also provides China with high-paying jobs and helps China upgrade its manufacturing capability. Under one package, the Shanghai Aviation Industrial Corp and McDonnell Douglas (which merged with Boeing) jointly assembled 35 MD-82 aircraft in Shanghai (*CD*, 18 June 1998). Similarly, as part of its strategy to fend off competition from Airbus, Boeing has contracted with Chinese enterprises to make the tail section for its 737 aircraft and certain types of cockpits.

Engine-makers have also become involved in various ventures to cement their relationships with China. Rolls-Royce, which has supplied aero engines to China for more than 30 years, has set up three ventures in China. Its engine joint venture with the Xi'an Aero Engine Corp delivered its first components, including low pressure nozzle guide vanes and low pressure turbine blades for Rolls-Royce Tay engines, in 1988 (*CD*, 8 May 1998; 22 May 1998). Pratt & Whitney Canada, a subsidiary of United Technologies, and China National South Aero-Engine formed the Southern Pratt & Whitney Aero-Engine Company Ltd in 1998 to manufacture gas turbine engine components for Pratt & Whitney Canada (*CD*, 3 March 1998).

Over the long term, China also harbors ambitions of becoming a competitive manufacturer in some segments of the commercial aircraft market. It already exports small passenger planes whose traditional makers in the West are driven out of production by liability claims. The Harbin Aircraft Manufacturing Corp (HAMC) had exported more than eighty of its 19-seat Y-12 light general purpose aircraft to eighteen countries by 1998. In 1998, HAMC clinched a deal with the Canadian Aerospace Group to supply up to 200 Y-12IV planes over a ten-year period (*CD*, 8 April 1998). It is also known that China wants to break into the regional jet airliner market by setting up a multinational venture to produce planes with about 100 seats. It is an indication of China's market clout that, when reports of such a plan surfaced, the world's major aircraft makers jostled to become joint venture partners.[26] In effect, China is offering access to its domestic market in exchange for state-of-the-art manufacturing and design know-how.[27]

Telecommunications: market competition as leverage

Developments in the telecommunications industry show patterns that are similar to aircraft manufacturing: dramatic growth in newly installed telephones and wireless telephony and thus the need for state-of-the-art equipment, particularly digital exchanges and wireless infrastructure that China was hard pressed to produce. Most telecommunications projects are large and need the approval of the Chinese bureaucracy, including the Ministry of Posts and Telecommunications (MPT) and State Planning Commission.[28] In contrast, even though the multinational corporations are each quite large, they come from different countries including the US, Canada, Japan, Sweden, Belgium, Germany and Finland and have not been able to present a unified negotiating stance vis-à-vis the Chinese government but instead have competed among themselves for slices of the Chinese market. Each of them thus has had strong incentives to ingratiate themselves with the Chinese government in order to secure market access even though none of them wants to part with key technologies to the Chinese side. In consequence, the Chinese government has been able to secure joint-venture manufacturing arrangements with some of the world's leading telecom equipment producers. Lucent Technologies, for example, had invested more than 100 million US dollars in China by early 1998, setting up six joint ventures and two solely-owned corporations that together employed 20,000 workers. It introduced the 0.9-micron chip processing technology as well as key know-how in telephone switches into the Chinese market. Moreover, Bell Laboratories, the R&D arm of Lucent Technologies, set up two branches in Beijing and Shanghai in 1997(*Xinhua*, 19 January 1998; FBIS-CHI-98-019). Another major case is Motorola, which has been a leading player in China's pager and cellular phone market. While Motorola certainly has corporate reasons for investing US$1.2 billion in China, it is also widely known that the Chinese government has repeatedly urged Motorola to be a good corporate citizen and fully embrace the Chinese market. Partly to placate the Chinese government, which has regulatory power over Motorola's major products in China, Motorola has built a chip plant as well as beefed up manager training in China. More recently, Motorola has joined hands with Datang, a Chinese firm, to develop equipment based on its CDMA standard in an effort to trade technology for more equipment sales (*Economist*, 27 June 1998: 65).

Because the barriers to entry are lower in telecom equipment than in aircraft manufacturing, the Chinese government has given strong support to domestic producers, calling on telecom operators to give priority to domestically produced equipment (*RMRB*, 3 November 1998). Support for domestic producers has not only translated into lower prices for procurement but also substantial improvement in the competitiveness of domestic producers. As late as 1995, China still imported 30 percent of the telecom network equipment. In 1996, however, Chinese companies (including joint ventures) produced 90 percent of the newly installed telecom equipment. Government officials suggest that the presence of domestic competition based on lower costs has kept equipment prices substantially lower than would have been the case had China relied on imports. Indeed, the expansion of domestic production capacity and competition has driven down the prices of program-controlled switches in China and is believed to have saved China hundreds of millions of dollars in procurement costs as it dramatically expanded its telecommunications network into the second largest in the world by 1997 (Yang, 1998).

Competition has speeded up the introduction of technology into the Chinese market as well. In cellular telecommunications, for example, the nationwide services have made the transition to digital GSM services. Several trial CDMA (Code Division Multiple Access) networks have been set up and are competing to make the technology a viable one in the Chinese market. Moreover, Chinese switching equipment producers such as Shanghai Bell and China Great Dragon Telecommunication Group Co Ltd have apparently gained technical prowess in competition and begun to capture some export orders for telephone exchanges (Yang, 1998). Meanwhile Chinese firms have also begun to enter the wireless infrastructure area. In spring 1998, the Datang Mobile Communications Equipment Co. was set up in Shanghai through a joint venture between First Research Institute of Post and Telecommunications (42 percent), Shanghai Post and Telecommunications Equipment (40 percent), and the Academy of Telecom Technologies of Post and Telecommunications (18 per cent). This company hopes to produce GSM digital switchboards and equipment used in wireless telecoms stations, which have so far been the preserve of Western telecom companies. The two research institutes were funded by the government during the Eighth Five-Year Plan period to pioneer the domestic production of equipment used on the 900/1,800 Global System of Mobile phones (GSM) (*HKS*, 10 March 1998).

Photographic film: using foreign investment to restructure state enterprises

Another highly visible case is the photographic film industry. China is still an under-photographed market. Less than one in ten Chinese households owns a camera; and the average family shoots only half a roll of film per year. Yet China is already the third largest film market in the world, with sales quickly approaching one billion dollars a year. If each family takes a full roll, that would be equivalent to adding an entire American market to the film industry (*The Economist*, 28 March 1998: 60).

As in the rest of the world, Fuji and Kodak have become industry leaders while Chinese producers have gradually fallen by the wayside because of backward technology, poor capitalization and inadequate marketing. One after another, Chinese film producers joined forces with the giant multinationals to escape the fate of oblivion. The last remaining major Chinese film producer is Lekai Co., commonly known as China Lucky Film Co., which has about 20 percent of the local market. In consequence, there has been much discussion in the Chinese media about the prospect of China without an indigenous film producer and thus losing its national film industry to multinationals.[29] The general manager of Lucky claimed that competition from Lucky kept film prices within China much more affordable than had only foreign brands existed. He also argued that foreign control of Lucky would lead to difficulties for Lucky's suppliers and affect industries such as electronics, defense, and certain specialty areas that used Lucky's products (*JJRB*, 1 August 1996: 1). The Chinese government was reluctant to let Fuji and Kodak to take over Chinese film-makers. Instead, foreign producers were asked to enter cumbersome and restrictive joint ventures with Chinese partners. Until recently, most Kodak films sold in China came through Hong Kong and were often smuggled in.

It was not until the much-heralded Fifteenth Party Congress of 1997 that the Chinese government finally relented. Kodak, which had until 1997 lagged behind Fuji, was, after four years of negotiations, allowed by the State Council to take over three obsolete Chinese film and photographic-products companies for $380 million. It would team up with Shantou Era

Photo Materials Industry Corp and Xiamen Fuda Photographic Materials Co as well as Wuxi Aermei Film and Chemical Corp to form two new companies to be controlled by the US side. Kodak promised to spend another $700 million to modernize these companies. With the deal, Kodak gained the right to locally manufacture and distribute film and sensitized photographic materials, thus allowing it to escape the 40 percent import duties and gain a competitive edge over arch-rival Fuji (*The Economist*, 28 March 1998: 61). Moreover, Kodak has also provided funds to three other money-losing Chinese film-makers in exchange for a promise not to tie up with a non-Kodak partner until 2001. In other words, Fuji will be locked out of similar ventures in China except through China Lucky Film, the only other and profitable Chinese film-maker that both Kodak and Fuji have sought to control.

So far, the Chinese government has refused to allow a foreign investor to take control of Lucky. Indeed, Lucky itself has been seeking a joint venture partner but has publicly resisted any deal that would mean loss of majority control (and its brand name) and has been supported by former premier Li Peng as well as premier Zhu Rongji and vice premier Wu Bangguo. While China has opened the door to Eastman Kodak, it has also worked hard to ensure the survival of Lucky. Lucky was promised an 800 million yuan ($96 million) state capitalization, credits of 3.2 billion yuan and tax breaks on imported equipment, a concession usually reserved for foreign investment in high-technology industries, to help finance a major expansion project.[30] Lucky may also be granted special treatment in corporate income tax. At the start of 1998, through the intercession of premier Li Peng, Lucky converted into a shareholding company and listed on the Shanghai stock exchange, raising about 450 million yuan. In the meantime, Lucky has worked hard to improve management practices. It has broken down internal boundaries, strengthened its sales and service network that lagged behind its international rivals, as well as strengthened its research and development. Lucky hopes to have sales of 3.3 billion yuan by 2000 and 8 billion yuan by 2010 and sell one third of its products on international markets (Zhu Jianhua and Wen Hong, 1998).

It remains to be seen whether Lucky can survive independently. In fact it continues to search for a foreign partner but in the form of a joint venture or technology transfer. Yet the Chinese government's strategy in overseeing the photographic industry is also quite clear. Until 1997, China steadfastly resisted the multinationals to protect domestic industry. While the Kodak deals in 1998, with the blessing of incoming premier Zhu Rongji, marked a major turning point, they also are beneficial to the Chinese side in that the deals aided China's efforts to restructure state-owned enterprises. Kodak not only spent a substantial amount to purchase the assets of three ailing state firms (the Chinese side kept minority stakes) but also would continue to employ 2,000 workers who would otherwise have faced difficulties if the three firms had not survived. In other words, the Chinese government is allowing multinationals to take control of firms in non-strategic industries in return for continued employment of state workers (Bacani, 1998). Such a strategy also allows the Chinese leadership to claim credit for opening up its domestic market and thus facilitate China's negotiations for WTO membership.

Soft drinks: multinational market leaders as corporate citizens

While the sort of bargaining between the Chinese government and multinationals is more common in manufacturing industries such as aircraft manufacturing, automobiles and telecommunications, occasionally such bargaining can also be found in relatively low-tech areas such as soft drinks.[31] While Coca-Cola has gained preeminence in the Chinese market, it has nevertheless been mindful of Chinese concerns about the loss of national industry since many of China's own soft drink companies have joined hands with Coca-Cola to become bottling plants. Partly to burnish its political image in China, Coca-Cola (China) developed several brands of fruit-flavored and bottled tea drinks such as Tian yu di (heaven and earth) and Smart specifically for the Chinese market (*DJN*, 1 September 1998). In exchange for unimpeded access to the Chinese market, Coca-Cola, prodded by the Chinese government's National Council of Light Industry, gave the receipe for Tian yu Di to the Chinese government gratis to ally Chinese concerns about multinationals taking over native brands. The trademark was registered by the Tianjin Jinmei Beverages Ltd. Nevertheless, Coca-Cola saw this as a win-win situation because its bottlers will be doing the bottling.

Discussion

The sectoral surveys presented here should adequately convey the relatively strong bargaining position the Chinese government has enjoyed vis-à-vis multinational corporations. While they are not exhaustive, the surveys also suggest the conditions under which the market-for-technology is more likely to be successful for China. First, the domestic market must be sufficiently large to attract a number of multinational corporations. The industries generally have enormous economies of scale. Tariff and non-tariff barriers must remain sufficiently high in order that corporations find it economical to invest in domestic production.[32] Second, there must be multiple players so that the host government can create a "musical chairs" situation (or divide and rule) and reward slices of the market to players who cooperate by making investments and transferring technology. Hoping to gain first-mover advantages, at least some of the multinationals are willing to meet the Chinese terms. Third, the government's bargaining position is especially strong in industries in which government procurements play a big role, such as automobiles, telecommunications and aircraft manufacturing, making it possible for the central government to use directives to affect market conditions.[33] In contrast, while consumer electronics met these conditions in the early 1980s, they now have saturated markets and competitive domestic producers, and the Chinese government is content to take a more hands-off attitude toward these industries as of the late 1990s.[34] In some consumer sectors, however, foreign players such as Coca-Cola have become so dominant that they are willing to make some minor concessions to placate the Chinese government and critics of foreign dominance.

Three caveats immediately follow. First, the Chinese government's attention was largely focused on high-profile projects which also enjoyed various favorable treatment, including exemption from tariff duties on importation of equipment. The absolute majority of overseas investments, however, did not have to deal with the central government at all and were eagerly welcomed by local governments competing for such investments. Most importantly, even in the case of highly regulated industries, the trend has been toward more market competition, not less (Yang, 1998). Moreover, in industries such as home appliances and electronics, the competitiveness of Chinese firms has enabled the Chinese government to embrace openness.

Second, the fact that multinational corporations are producing in China rather than simply exporting its products there does not mean that they are losers. In most industries, technological progress is so rapid that limited technology transfers to developing countries do not jeopardize the technological leadership of multinational corporations. Meanwhile, access to foreign markets through investment will allow companies to recover research costs and devote more resources for new product development. Moreover, as multinationals increasingly plan their production and marketing globally, it may be in their interest to promote parts production and product design locally to tap the cheap labor, raw materials, talent and local knowledge in those developing countries. In the case of China, some multinational corporations may make location decisions that they would not otherwise make had there been perfect global factor markets. But China does not seem to behave much more differently than most others, including some European governments. Most importantly, the corporations make their decisions based on assessment of their self-interests and they are there to win profits rather than run corporate charities.

Third, even where the Chinese state bargains hard with multinationals, it would be wrong to assume the Chinese state is always strong. In fact, a strong state may be an over-simplified explanation without a clear understanding of the institutional arrangement (Doner, 1992). Indeed, even where the Chinese state presents a strong façade, as in telecommunications regulation, it is nevertheless subject to institutional conflicts and compromises among different interests. It is these conflicts, particularly among different parts of the bureaucracy, that have so far prevented the passage of a Telecommunications Law and provided the institutional support for a competitor to China Telecom to emerge.

Securing energy and resources for growth

So far our attention has been on China's efforts to regulate the flows of trade and investment. Equally important, however, are the implications of China's rise for the global economy. In this section, we eschew the alarmist views (e.g. Bernstein and Ross, 1997) and instead offer an empirical examination of how China has so far coped with the resource constraints its rapid industrialization has caused. Such an exercise may offer useful insights into China's relationship with the international system.

In significant ways, the impact of China's economic growth on the global trade in resources can already be seen. Projections and speculations about China's demand or lack thereof routinely cause fluctuations in the prices of copper, grain, wool and other products, and have implications for other suppliers and consumers of commodities (Brown, 1995). Recognizing that resource dependence may imply vulnerability, China's government and industry leaders have in recent years began to adopt policies designed to alleviate China's vulnerability. Nowhere are such policies more apparent than in the oil industry, though similar but far less dramatic developments can also be seen in copper and iron ore.

Until the early 1990s, China had enjoyed a domestic surplus of oil production. Indeed, Mao's immediate successor, Hua Guofeng, had adopted a rapid industrialization program that rested on the sale of energy abroad to finance equipment imports. But rapid economic growth has increased demand while domestic supply has stagnated, as old oilfields such as Daqing have peaked and new fields in the western desert have yet to become major producers. In 1993, China became a net importer of oil and refined products. Since then, Chinese imports of crude and petroleum products have increased rapidly, partly in response to declining world prices. Crude oil imports, for example, rose from just 3 million tons in 1994 to 35.5 million tons in 1997.[35] In addition to increasing imports, China has stepped up efforts to boost its dwindling crude production to meet its growing demand. In 1997 crude production increased by 8.7 percent to 165.8 million metric tons (but only 17.6 percent higher than the 1992 level), a pace that is unlikely to be sustained (*DJN*, 4 February 1998).

With sustained economic growth, Chinese energy and especially petroleum demand is set to rise further over the long term, especially because China is finally seeing the emergence of private demand for automobiles.[36] This has elicited a two-pronged response from the Chinese government. Domestically, it has become more and more willing to invite foreign companies to invest in China's oil industry, although mostly in offshore and desert fields that Chinese companies find challenging. By the Fall of 1997, the China National Petroleum Corporation had signed thirty-six contracts worth a total of $790 million with oil corporations from nine countries and regions and the China National Offshore Oil Corporation had signed 126 agreements with oil companies from eighteen countries and areas to utilize $5.38 billion of foreign capital (Han Zhenjun, 1997).

Since domestic production has stagnated, oil imports have become a fact of China's economic life. This represents a fundamental reorientation of China's emphasis on oil self-sufficiency, a legacy of the Maoist era when the Daqing oilfield was held up as a model for national emulation. Even though low prices have made oil imports relatively inexpensive in the 1990s, China's growing appetite makes dependence on foreign oil an uncertain prospect at best. As one Chinese study points out:

> Oil is both a crucial strategic resource and one that is deeply affected by international economics and politics. Every world economic crisis, change in the world political order, and local conflict, particularly conflict in major oil-producing regions, affects the security of the oil supply.
>
> (Lin Ye and Zhang Zhong, 1997)

Studies of Chinese foreign policy have tended to emphasize the potentially destabilizing consequences of China's growing dependence on imported oil. Many studies have pointed to the South China Sea as a potential flash-point as countries with competing claims for resources (primarily oil and natural gas reserves) may settle their conflicts by military means (Calder, 1996; Chang, 1996; Hyer, 1995; Ji Guoxing, 1998; Studeman, 1998; Valencia, 1995).

There is little doubt that China is not content with simply buying oil on the spot markets and subjecting itself to the gyrations of world oil markets, particularly if China relies on one oil-producing region and would thus be vulnerable to a blockade of any one shipping lane or an embargo on any one exporter (Rashid and Saywell, 1998). The sense of vulnerability does not have to translate into military action, however. Indeed, there is growing evidence that China has already chosen an alternative to military action by embarking on competition in the marketplace. Fortunately, the trend toward globalization and privatization has left room for China to satisfy its energy needs and ambitions in the international marketplace. So far, with the slump in world oil prices, oil producing countries such as Kazakstan have welcomed Chinese investments with open arms. While China continues to emphasize domestic production (including production in China's territorial waters), there will be active exploration of overseas operations in order to secure stable sources of energy supplies.[37] In short, the Chinese strategy now is to utilize both the domestic and international markets, thus marking the internationalization of China's oil industry.

Indeed, 1997 may be said to have been a watershed in China's energy policy: instead of simply buying oil on the world market, China has been investing in oil fields worldwide. In order to secure energy supplies for its surging domestic demand, China will prefer to buy foreign oil that is produced by Chinese companies abroad. Chinese policymakers clearly assume that investment in foreign oil fields makes China less vulnerable to disruptions in international oil markets. On September 15 1997, a tanker carrying 60,000 tons of crude oil, the first tangible fruit of China's overseas expansion, berthed at the port of Qinhuangdao in China. This was the first shipment of the overseas-produced oil in the history of China's oil industry. By Fall 1997, the China National Petroleum Corp. and its engineering construction company had bought into oilfields in Canada, Peru, Thailand, Kazakstan, Venezuela, Malaysia and Pakistan.[38]

China's sense of urgency is reflected in the huge investments it has made. In less than a year, during 1997, the China National Petroleum Corporation (CNPC) pledged more than $20 billion US dollars for oil concessions and oil and gas pipelines overseas. It has invested in or conducted exploration in twenty-three countries. In addition to oil concessions in Azerbaijan, Kazakstan, Kuwait, Iraq, Sudan and Venezuela, it has also negotiated with Iran, Turkmenistan and Russia.

The most significant indication of China's strategic oil policy shift is seen in Central Asia, especially Kazakstan, which declared its independence from the Soviet Union at the end of 1991. Occupying a territory as large as Western Europe, this sparsely populated country of 17 million is home to vast oil and gas reserves but has been frustrated by its continued dependence for oil and gas exports on pipelines going through Russia. In September 1997, CNPC signed agreements with Kazahkstan to invest nearly $6 billion in the Aktyubinsk and Uzen oilfields (the deal for Uzen was for 60 percent of the field). The Uzen oilfield is the second largest after Tengiz, with reserves estimated at 1.5 billion barrels. The agreement thus will provide China with a prime energy source in a neighboring country and outside the Middle East. It is a major step toward the CNPC's goal of having the equivalent of two 50–million-ton oilfields by 2010 (Li Yongzeng, 1998).

To win the Kazakstan fields over rivals such as Amoco, CNPC not only paid a premium price of about 30 percent more than its nearest rival but also promised to fund the building of two pipelines, a provision that US companies could not match for economic and political reasons (Rashid and Saywell, 1998). The Kazak-China pipeline, 3,000 km (2,000 miles) long, would run from Kazakstan's western oil fields to Karamay in Xinjiang in northwest China and the other (250-km long) would be from Kazakstan to the Iranian border. The Kazak-China pipeline would have an annual capacity of 20 million tonnes (400,000 barrels per day) and be built over extremely difficult terrain (Reuter, 2 October 1997; *Xinhua*, 12 December 1997; FBIS-CHI-97-346). It would cost at least US$3.5 billion, thus bringing the total price tag for China's Kazakstan commitment to $9.5 billion thus far.[39] For established American multinationals such as Amoco, Exxon and Texaco, China's aggressive entry into the international energy game means that they have to fight harder. Indeed, just as the Chinese government and especially premier Li Peng lobbied Kazakstan hard on behalf of CNPC, US Vice President Albert Gore also launched extensive lobbying efforts on behalf of US oil companies (Ottaway and Morgan, 1997).

While China has been paying top dollar for the investments, these investments may also make good business sense from a long-term perspective, as Chinese companies are investing at a time when oil prices are at their lowest in 1997–98. This behavior suggests that the Chinese companies assume either sharply increasing domestic demand at home or much higher oil prices in the future (or both).

China's entry into the international oil industry has geopolitical implications (Tsepkalo, 1998). In the case of Kazakstan, that oil-rich country found China, Russia and the United States competing for access to its resources. The deal allows Kazakstan to lessen its dependence on Russia for exports of oil and gas and, indeed, Russia is known to have opposed the Kazak-China pipeline. China's entry into the international oil exploration business thus strengthens the bargaining positions of the oil rich countries and provides countries such as Kazakstan with greater leverage and better prices.

But the Kazakstan case also shows that China can play tough in this arena of high stakes. In the words of one Chinese commentator, "China must not fail in Central Asia as this concerned the survival of the Chinese nation" (Liang Qiang, 1998). US competitors are not happy about the Chinese intrusion. On the surface, the US government has suggested China's participation in global oil and gas exploration provides welcome diversification from the Middle East, which the US also desires (Ottaway and Morgan, 1997). Nevertheless, because China deals with countries such as Iran and Iraq, which the US has sought to isolate, China's growing economic might will thus pose greater challenges for US foreign policy in these areas. In the Kazakstan case, the US is not only unhappy about losing the deal but is also concerned about the pipeline to Iran that might give Iran control over the flow of oil. Thus the China–Kazakstan deal pits China against both the United States and Russia commercially and strategically. For China, the Kazakstan deal not only secures a major source of oil but also serves Chinese domestic policy objectives in that interdependence between China and Kazakstan will make it less likely for the latter to support Muslim separatist activities in China, particularly among the Uighurs in Xinjiang.[40]

Yet all the talk about geopolitical consequences does not obscure the fact that the major players have agreed to compete in the marketplace. Most importantly, the huge stakes that China has been willing to pay suggests that China's oil development strategy will be market oriented.[41] After all, it is China's fear of political and military disturbances to the international oil markets that has prompted the Chinese leadership to secure overseas oil holdings. In this sense, as in other industries, China is becoming an important player in the global system, but by following current rules, China's entry into the international oil industry thus serves to reinforce the existing order.

Participation in international competition has in turn hastened reforms in China's own oil industry, making China's state oil companies more like their global competitors. Until 1997, the Chinese industry was segmented between upstream extraction and downstream processing. Two majors, China National Oil and Natural Gas Corporation and the China Maritime Oil Corporation engaged in land and maritime oil prospecting and development. In the downstream oil industry, the China Petrochemical Corporation (Sinopec) had thirty-eight large refineries and over 80 percent of China's oil refining capacity. Sinopec also monopolized domestic sales of refined oil while the oil import–export trade was handled by the China National Chemicals Import and Export Corporation, the China Oil and Natural Gas Corporation, and Sinopec.

The segmentation of oil production, refining, sales, and foreign trade served to hinder the emergence of domestic competition, which the Chinese leadership has gradually embraced by the 1990s (Yang, 1998). To promote domestic competition, the Chinese government in January 1997 authorized the establishment of Xinxing (New Star) Oil Co., which was backed by the Ministry of Geology and Mineral Resources at the time. Yet Xinxing, which had revenue of 3.8 billion in 1997 (*JJRB*, 17 January 1998: 3), is a minor player at best compared with CNPC and thus has had little impact on domestic competition. Also in 1997, China Eastern United Petrochemical Corp. was formed by the merger of five petrochemical firms.

To fundamentally reshape the Chinese oil industry and suit the needs of international competition, the Chinese government in 1998 launched sweeping restructuring of the industry to create integrated companies with both upstream and downstream operations. Instead of the upstream and downstream segmentation, the Chinese petroleum industry was reorganized along geographical lines. After the reorganisation, CNPC is mainly responsible for exploring for petroleum and natural gas in the northern and western regions of China. It may also develop some petrochemical products. In contrast, Sinopec focuses on the eastern and coastal areas (*AFP*, 10 April 1998). With the reorganization, the two conglomerates will likely join the ranks of the world's 500 largest.

In short, while China's surging energy needs may presage conflicts, China's actions suggest that the Chinese leadership has found the solution in the marketplace. China's willingness to abide by the rules of the market does not mean that Chinese leaders are ready to embrace the borderless markets unconditionally. China's effort to gain control over sources of oil suggests that it continues to value traditional ownership and is willing to pay for such ownership. The point is not lost on multinationals. After all, as global giants such as Caterpillar or CNPC have repeatedly found out, in tough, high-risk, high-opportunity markets, having a government providing support counts (Uchitelle, 1998). Nevertheless, China has in many ways become a status quo power as it spins a web of investments.

Conclusions

Two decades after Mao's death, China has shed its autarchic shell and embraced openness and competition (Yang, 1998). As a researcher from the Ministry of Foreign Trade and Economic Cooperation put it: "The national economy [of China] should be open; it should not discriminate against the globalized economy. The national economy is a part of the world economy; it is an extension of and a supplement to the world economy." (Liu Shu, 1997). At the time of Mao's death, a person making such a statement in China would probably land in political trouble. Today, global integration is the Chinese orthodoxy. The buzzword for China now is *jiegui* (literally, linking up the rail tracks), with China accepting international practices.

As China becomes more deeply integrated into the global economy, its behavior has also become more "normalized." Gone is the revolutionary rhetoric that China sported when it returned to the world stage in the early 1970s. It has entered the World Bank, International Monetary Fund (IMF), Asian Development Bank, Asia-Pacific Economic Forum (APEC), and is negotiating to join in the World Trade Organization (WTO). This further strengthens China's interests and stakes in an open global economy. Indeed, Chinese leaders regularly talk about China respecting international norms and playing by the global rules of the game (see, e.g., *QB*, 18 June 1998: 4).

Our study of Chinese engagement with the outside concurs with earlier studies about efforts by the Chinese leadership to control the process (Pearson, 1991). Yet the effectiveness of Chinese bargaining has varied over time. When China had just started its market-oriented reforms, few investors came. As the Chinese economy grew and reforms speeded up, China's attractiveness as an investment destination increased, giving China some leverage over foreign investment flows. That leverage was limited, however, as the Chinese leadership found out in adjusting its investment policies in the mid-1990s. Nevertheless, the central government has targeted large foreign investment projects and appears to have succeeded in getting multinationals to bring technology and know-how into China. Globalization has therefore helped speed up Chinese reform by forcing Chinese companies to meet international competition in both international and domestic markets.

While foreign investment has heightened competitive pressures on domestic enterprises, the Chinese now recognize that the multinationals have been instrumental in upgrading China's technological level whether in consumer electronics, consumer durables or telecommunications (He Xi, 1998). The Chinese have gone far beyond just "crying wolf." While they recognize the competitive dangers from the globalization of the Chinese market, the dramatic success of Chinese producers in the consumer electronics and consumer durables have convinced them that Chinese firms can become more competitive globally through competition. As one Chinese commentator suggested, China may have more successful companies as the Chinese open up further (He Xi, 1998). By the late 1990s, an economically rising China has become increasingly confident of its participation in the world economy.

China's economic ascent has meant both opportunities and concerns for the international community. China's reforms at home and interactions with the outside world since the 1970s suggest that China is increasingly becoming a responsible member of the global economic community. More evidence in support of this statement can be found in China's recent forays into the international oil markets. Whereas some analysts have suggested that China's surging energy demand may presage conflicts, China's actions suggest that the Chinese leadership has found the solution in the marketplace here as well. And as China spins its web of international deals, the incentives for it to become a status quo power increase.

Fundamentally, even though China started the process of opening up with the express aim of making use of foreign technologies while preserving the Chinese system, increasingly it is behaving like a member of the global system. This is suggested by China's quiet behavior in the IMF, the World Bank and other international economic organizations (Pearson, 1998). But the point is especially driven home by China's performance during the Asian financial turmoil of 1997–1998. Like its more prosperous neighbors, China chipped in with funds to help bail out Thailand and Indonesia. Most importantly, in spite of domestic difficulties, China's leaders stood by their pledge of currency stability after the collapse of the Korean economy in late 1997 rather than joining in the spiral of competitive devaluation that every Asian economy, including Japan and arch-rival Taiwan, took part in. While China's actions served its own interests (such as helping Hong Kong maintain its currency peg to the US dollar and not increasing the debt burdens for Chinese companies loaded with foreign debt), they have provided relief to beleaguered Asian countries and won grudging respect internationally.

China has thus shown itself to be not just a free-rider on the trend toward globalization, but one that is willing to play by the rules and take on global responsibilities even as it aggressively tackles painful reforms at home. Indeed, Chinese officials, such as central bank governor Dai Xianglong, commented that taking into account other countries reflects "the ethics and morals that a big country like China should have." In short, while China's international behavior is still far from ideal, it has nevertheless stepped up to the role as anchor of stability for the Asian economy, thus signaling its re-emergence as a regional and even global economic leader.

Notes

1 The authors are grateful to Bruce Dickson, Aseem Prakash, Jeffrey Hart, Peter Katzenstein and participants of the Globalization Conference for their helpful suggestions.
2 In the 1950s, China interacted extensively with the Soviet Union and Eastern Europe. Even during the Cultural Revolution, however, China continued to trade with the West via Hong Kong.
3 Hong Kong is treated as a separate trade area and ranked ninth in merchandise exports in 1997.
4 There is considerable debate on the meaningfulness of this measure owing to the difficulty of currency convertibility. For a discussion of these issues, see Lardy 1992, Appendix B. China's trade dependency ratio would decline substantially from the nominal terms if the GNP figure is adjusted for purchasing power parity. However, the robust growth trend remains.
5 Needless to say, foreign investment is distributed unevenly within China. Guangdong province, which borders on Hong Kong, had a trade volume of 130 billion dollars, or about 40 percent of China's foreign trade, in 1997. Every 3-percent increase in foreign trade translates into 1 percentage economic growth for Guangdong, versus 7 for China as a whole (*QB*, 10 March 1998: 20).
6 The number of companies refers to those that commenced operations in China, not the number of registrations.
7 China's growing presence overseas has begun to attract attention from host governments. While the amount of Chinese investment in Britain has been rather small so far (19 million dollars as of June 1997 according to Chinese statistics, which clearly is understated), the British government has sent its Chief Executive of the Invest in Britain Bureau to visit China and offer seminars on investing in Britain and to introduce policies to guide Chinese investment in Britain. "Britain Seeking More Investment by Chinese Enterprises," Xinhua in English, September 9, 1997; FBIS-CHI-97-252.
8 It can be argued that the availability of investments from Hong Kong, Macau and Taiwan eased the fears of conservatives resisting overseas investment to some extent because such investments potentially facilitated China's unification with these entities by creating business interests that favored interaction with the Mainland.
9 Calculated from *Statistical Yearbook of China*, various years.
10 While SOEs had a 55 percent tax rate, foreign investors generally paid only 15 percent. This discussion draws on field interviews.
11 Major enterprises also sponsored studies by research institutes that criticized foreign investment. Some firms, such as the Jianlibao Group, a Chinese soft drink company, sponsored conferences calling for government protection of indigenous industries (personal interview).
12 Personal interview.
13 It should be noted that China's general tariff levels were also coming down. A major objective of the policy changes was to replace particularistic tariff exemptions with a uniform tariff system.
14 Municipal authorities in Beijing required McDonald's to pay some thirty-one taxes and fees each year, of which seventeen have since proven illegal (Harding, 1997).
15 Globally the big five developed economies (US, UK, Japan, Germany and

France) accounted for 62 percent of the foreign investment up to the end of 1996.

16 For evidence of continuing criticism, see *Sing Tao Jih Pao* (Hong Kong), January 27, 1998, p. 4; translated in FBIS-CHI-98-035, February 4, 1998. See also Chen Bingcai, Wang Yunguan and Yao Shumei (1998) for a summary of the harmful effects of foreign investment.

17 Skillful marketing has also helped. Most Chinese consumers, for example, do not know that Sprite, called Xuebi in Chinese, is a Coca Cola product. In contrast, many Chinese products have foreign-sounding names.

18 As in industry, government leaders are concerned that rapid liberalization may hurt the domestic service industry. However, the resilience of Chinese industry has convinced some Chinese economists that the introduction of competition may speed up reform of domestic firms and make them more competitive over the long term (*CDBW*, 6 April 1998: 1).

19 Report on Wu Yi's speech at the national conference on foreign trade, *Xinhua*, 8 February 1998; FBIS-CHI-98-039.

20 For products using Xinjiang cotton, the rebate rate was increased from 9 to 17 percent.

21 The new rebate rates became effective on June 1, except for textile machinery (January 1). Note that the highly competitive electronics and home appliance industries failed to secure increases in tax rebate rates.

22 There have also been other measures. For example, following a precipitous plunge in Taiwan investments, the Ministry of Public Security significantly eased travel and residency rules for Taiwan investors in October 1998. As to forecasts on China's economic performance, they have predictably varied. A report in the *China Economic Times*, for example, said China's foreign direct investment could drop by a third to $30 billion in 1998 from $45 billion in 1997 (*CET*, 3 March 1998).

23 Until very recently, Chinese tariff levels have remained quite high. A foreign producer thus fears conceding the Chinese market to competitors making direct investments in China.

24 Because the auto industry case is so obvious, we have decided to focus on other sectors here, partly to provide more variations.

25 In the aftermath of a string of accidents, Chinese air travelers have tended to favor travel on planes by the top plane makers and tend to avoid planes made in the former Soviet Union.

26 In the Fall of 1998, Airbus dropped out of the project for financial reasons.

27 For an extended treatment of this topic, see Wei-chin Lee, 1997.

28 In 1998, the SPC became the State Development Planning Commission while the MPT was merged into the Ministry of Information Industry.

29 Kodak approached Lucky in 1995 and offered to buy 80 percent of the company and make Lucky use the Kodak name. The offer was rebuffed (Bacani, 1998).

30 The Ministry of Chemical Industry also lobbied for an anti-dumping law to protect the fragile domestic industry in 1997. But this would have been of limited usefulness as long as foreign films on the Chinese market were smuggled into China without paying tariffs (a smuggled brand name film sold for only one third to one half of its import price in Guangdong) (*CDBW*, 1 July 1997: 1, 8).

31 So far China has opened the door only slightly in the area of services.

32 This means that the market-for-technology strategy may gradually disappear as China steadily reduces its tariff levels.

33 In the automobile industry, the government's industrial policy links local content level with the level of parts imports so that automotive producers have strong incentives to boost the percentage of locally-produced parts.

34 Just a few years back, however, the Chinese government was much more active in this sector.

35 The State Planning Commission's Energy Research Institute forecast that China needs to import 30–50 million tons of oil and 20–40 billion cubic meters of natural gas by 2000. By 2010, oil import may surge to 90–170 million tons while natural gas imports is likely to rise to 50–80 billion cubic meters (Shuang Zhou, 1998).

36 Even with oil demand growing at only 50 or 60 percent of the rate of economic growth, the gap between domestic production and consumption is expected to increase steadily. Chinese forecasts call for China's oil imports to reach 40 million tons by 2000 and 80 million tons by 2010 (Han Zhenjun, 1997). In contrast, Xiao Guang Tong, president of CNPC International Kazakstan, told the fifth annual KIOGE oil and gas conference in Fall 1997 that China would need to import 30 million tons of oil annually by 2000 and 40 million tons by 2010 (Reuter, 2 October 1997). Xiao's figures were at the 1997 levels. He probably offered these conservative figures in order not to alert international players. In the meantime, others have estimated that China will need to import 50 million tonnes of oil or about 30 percent of its needs annually by as early as 2000 (Rashid and Saywell, 1998).

37 China's domestic oil development strategy now calls for joint promotion of oil and natural gas output and more intensive use of new technologies (such as tertiary oil recovery) in order to maintain domestic output of 120 million tons of crude oil through the year 2000.

38 The China Petroleum Engineering Construction Co. had signed 230 overseas oil and technological service contracts and completed 1.6 billion US dollars worth of contracts (*Xinhua*, 16 October 1997; FBIS-CHI-97-289).

39 Even then, the pipeline will still only reach China's western border and is still about 2,000 km from the eastern coast.

40 During his visit to China in May 1998, Kazakstan's prime minister, Nurlan Balgimbaev, pledged to back Chinese efforts to fight separatism and said separatists would not be allowed to operate in Kazakstan. "Kazakstan's Premier Supports China In Separatism Battle," AP-Dow Jones, May 7, 1998.

41 There is thus a significant similarity with the US case, see Ikenberry, 1988.

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