

**CHINA'S POLICIES TOWARDS THE STATE-OWNED
ENTERPRISES, 1992-2012**

*Thesis submitted to Jawaharlal Nehru University
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DECLARATION

I declare that the thesis entitled “China’s Policies towards the State-Owned Enterprises, 1992-2012” submitted by me for the award of the degree of DOCTOR OF PHILOSOPHY of Jawaharlal Nehru University is my own work. The thesis has not been submitted for any other degree of this University or any other university.

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For My Parents, Sumitra & Anil

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LIST OF ABBREVIATIONS

ABC	:	Agricultural Bank of China
AMCs	:	Asset Management Companies
AML	:	Anti-Monopoly Law
APEC	:	Asia-Pacific Economic Cooperation
AQSIQ	:	General Admn of Quality Supervision, Inspection and Quarantine, PRC
ATC	:	Agreement on Textiles and Clothing
BOC	:	Bank of China
CBRC	:	China Banking Regulatory Commission
CCB	:	China Construction Bank
CCP	:	Chinese Communist Party
CDB	:	China Development Bank
CEO	:	Chief executive officer
CHI	:	Central Huijin Investment Ltd
CIC	:	China Investment Bank
CIRC	:	China Insurance Regulatory Commission
CLSA	:	Credit Lyonnais Securities Asia
CNOOC	:	China National Offshore Oil Corporation
CNPC	:	China National Petroleum Corporation
CNPC	:	PetroChina Company Limited
CNSPC	:	China National Star Petroleum Corporation
COD	:	Central Organization Department
COSTIND	:	Commission of Science Technology and Industry for National Defense
CRS	:	Contract Responsibility System
CSRC	:	China Securities Regulatory Commission
DGT	:	Directorate General of Telecommunications
DSB	:	Dispute Settlement Body
E&P	:	Exploration and Production
ERS	:	Economic Responsibility System
Exim	:	China Export-Import Bank (also China Exim)
FDI	:	Foreign Direct Investment
GATS	:	General Agreement on Trade in Services
GATT	:	General Agreement on Tariffs and Trade
GDP	:	Gross Domestic Product
GPA	:	Agreement on Government Procurement
GPL	:	Government Procurement Law
ICBC	:	Industrial & Commercial Bank of China
IMF	:	International Monetary Fund
IPO	:	Initial Public Offering
IPR	:	Intellectual Property Rights
ITO	:	International Trade Organisation

LAO	:	State Council Legislative Affairs Office
M&A	:	Mergers and Acquisitions
MFN	:	Most Favoured Nation
MII	:	Ministry of Industry and Information
MIIT	:	Ministry of Industry & Information Technology
MNC	:	Multi National Company
MOF	:	Ministry of Finance
MOFA	:	Ministry of Foreign Affairs
MOFCOM	:	Ministry of Commerce
MOFTEC	:	Ministry of Foreign Trade and Economic
MOR	:	Ministry of Railways
MOU	:	Memorandum of Understanding
MPI	:	Ministry of Petroleum Industry
MPT	:	Ministry of Post and Telecommunications
NBS	:	National Bureau of Statistics
NDRC	:	National Development and Reform Commission
NEC	:	National Energy Commission
NOC	:	National Oil Company
NPC	:	National People's Congress
NPLs	:	Non-performing loans
NTBs	:	Non-Tariff Barriers
OBOR	:	One-Belt-One Road
OD	:	The Department of Organisation
OECD	:	Organization for Economic Co-operation and Development
PBC	:	People's Bank of China
PBSC	:	Politburo Standing Committee
PETROCHINA:		China National Petroleum Corporation
PRC	:	People's Republic of China
PTAs	:	Post and Telecommunications Administrations
RMB	:	Renminbi (The Chinese currency)
SAFE	:	State Administration of Foreign Exchange
SAIC	:	State Administration for industry & Commerce
SASAC	:	State-Owned Assets Supervision and Administration Commission
SCCICGATT	:	State Council Committee on Inter-ministerial Coordination on GATT
SCICGGATTN:		State Council Inter-ministerial Coordination Group on GATT Negotiations
SCM	:	Subsidies and Countervailing Measures
SCRES	:	State Commission on Restructuring Economic Systems
SETC	:	State Economic and Trade Commission
SEZs	:	Special Economic Zones
SINOPEC	:	China Petrochemical Corporation (Sinopec Group)
SIPO	:	State Intellectual Property Office
SOAE	:	Law on State-owned Assets of Enterprises

SOAE	:	State-owned Assets of Enterprises
SOBC	:	State-owned Commercial Banks
SOBs	:	The State Owned Banks
SOE	:	State-owned Enterprise
SPC	:	State Planning Commission
SPS	:	Sanitary and Phyto-Sanitary Measures
TBT	:	Technical Barriers to Trade
TPRM	:	Trade Policy Review Mechanism
TRIMs	:	Trade Related Investment Measures
TRIPs	:	Trade Related Aspects of Intellectual Property Rights
TVEs	:	Township & Village Enterprises
UCL	:	Anti-Unfair Competition Law
UNCTAD	:	United Nations Conference on Trade and Development
USD	:	United States Dollar
WTO	:	World Trade Organisation

CHAPTER 1 INTRODUCTION

1.1. THEORETICAL PROBLEM OF THE STUDY

When China joined the World Trade Organisation (WTO) in December 2001, many people hoped that this would curb the power of its state-owned enterprises. Ten years on, they seem stronger than ever. A preliminary study of the three broad phases of reform and restructuring of the Chinese State Owned Enterprises (SOEs) in the post liberalisation era, suggests that the SOEs continues to be (however informally) the extensions of the Chinese state and their very operations are in stark contrast to the market claims of that economy. Despite their integration into the global capitalist system, the SOEs remain the hallmark of Chinese “socialism”. When classified in terms of the way, the Chinese government manages the SOEs, they can be classified into 1) central SOEs, under the supervision and administration of State-Owned Assets Supervision and Administration Commission (SASAC) of the State Council; 2) local SOEs, under the supervision and administration of the local SASAC; 3) three types of enterprises, under the supervision and administration of the Ministry of Finance: enterprises affiliated to central government institutions, financial SOEs and enterprises that have their financial relations listed separately by the Ministry of Finance.

The road that China has taken from a centrally planned economy has been brave. The market oriented reforms introduced in the SOE sector over the past two decades have seen the government loosen its control over SOEs, the shedding of a large number of loss-making enterprises, and significant restructuring of remaining enterprises, including by public listing. However, these achievements still fall short of making Chinese SOEs “modern enterprises”, where the Chinese Government retains considerable influence over them through the exercise of its owner's rights as well as multiple regulatory channels (Hsueh, 2011). Today, in 54 of the 100-plus central SOEs, the chairman or CEOs (Chief Executive Officer) of these companies hold ministerial rank and are appointed directly by the State Organisation Department (Walter and Howie, 2011). These men are of the equal rank with provincial governors and ministers on China’s State Council and many are members or alternates of the Central Committee of the

Communist Party of China. As far as the status of the party committees within the SOEs is concerned, the CCP has tried to balance relations between the party committee and the management (Broadsgaard and Zheng, 2009). Thus, the central question which this study seeks to answer is: What explains the continuity in Chinese policies towards SOEs in the post liberalisation era?

To achieve the stated objective, the study shall document and review the Chinese experiments and policies towards the reform of SOEs and cast light on some of the key linkages between the state power and economic transformation of the state socialist system. It shall search for theoretical coordinates in which to explain the transitional path China has taken so far and also locate possible routes of future change. In examining the process of SOEs reform, the study shall critically analyse their contractual, distributional and power relationships with that of the Chinese state. The ‘state’ in these cases, of course, includes many different governmental bodies, ranging from central government bureaus to provincial bureaus and many other types of state units. Although the time period under study has been chosen as ‘1992-2012’, this study necessitates a comparison of economic policies since the beginning of the reform era in 1978. The year “1992” is significant because of the historic “southern tour” by Deng Xiaoping who declared during the tour that there would be no reversing economic policies in the face of Soviet collapse; the special economic zones (SEZs) would be allowed to develop in their own manner; and the economy formed the measure of stability (Deng, 1994).” The study is limited to the leadership regime of Hu Jintao and would not include the changes from the 18th party Congress.

1.2 BACKGROUND

Since the 1970s, the fundamental transition from ultra socialism to the market socialism has changed the economic landscape of China. One of the central aims of the reform was to improve the functioning of the economy by undertaking a series of restructuring and reforms in the SOEs. The traditional SOEs in China were mainly established in the mid-1950s through the “Three Great Socialist Reforms”, Elimination of Private Property Rights” and the subsequent “National Industrialisation (Sheng & Zhao, 2013: 1).” In the pre-liberalisation years, these SOEs existed in the forms of the branches or affiliates of governmental departments under highly centralized and

planned management. It was only after 1978, economic experiments began to be gradually carried out in the SOEs. Most of the reforms during the first phase of the SOEs reform in China “1978-1984” were carried out within the framework of planned economy. The first phase only witnessed a change in the distributional relationship between the state and SOEs through the financial incentives. The SOEs were allowed to retain more profits, implement bonus and price wage system and acquire more depreciation fees. As a result, the first phase of SOEs reform can well be understood as “reform without losers” (Naughton, 2006).

As China’s urge to promote global economic integration grew stronger and a desire to join the WTO, an understanding of privatization and adaptation of the state firms became critical. The second phase of reform began in 1984 when the dual system of “planned track price” and “market track price” was formally put in place. The Contract Responsibility System was actively promoted and rapidly spread among state enterprises (Leutert, 2016). Under this system, contracts based on negotiation between SOEs and relevant levels of government or government departments were established, generally for a period of three years. The enterprise managers started enjoying some freedom to appoint their assistants and to hire or fire middle-level administrative staff. However, despite some changes in the power relations between the state and SOEs, the governmental intervention in enterprises’ operation remained strong. The government could take over the managerial authority any time and the traditional reliance of the enterprises on the state bureaucracy continued.

In the early 1990s, it was common to contrast China’s reform process with the transitions from socialism in East and Central Europe and the former Soviet Union, describing the former as ‘gradual’ or ‘evolutionary’ and the latter as ‘Big Bang (style)’ or ‘revolutionary’ in nature (Li and Putterman, 2008). The sharp difference between China’s and the ex-Communist countries’ reforms began to blur when, after years of deepening SOE losses, declining state revenues, and a massive accumulation of non-performing loans by the banking system, China’s leaders decided to push reform to a new stage since 1992, which also marks the beginning of the third and the ongoing phase of SOEs reform in China. As part of the reinvigoration of the reform process that followed an intervention by Deng Xiaoping in 1992, a new Company Law was adopted in 1994, providing a framework for a process of ownership restructuring that was to include the

conversion of SOEs into corporations. The diversification of SOEs ownership has seen major implementation under the “grasping the large and releasing the small” policy; a reference to a policy enshrined in the 9th Five Year Plan (1996–2000) concentrating the government’s resources on the larger SOEs while relaxing state control over smaller SOEs. According to a retrospective panel survey of 683 firms in 11 cities reported by Garnaut et al. (2005), 86 percent of all SOEs had been through the new restructuring process called *gaizhi* (change of system) by the end of 2001. It took various forms, including internal restructuring, corporatisation and public listing of shares, sale, lease, joint ventures, and bankruptcy. Among the surveyed mid and large-scale SOEs that were restructured, 13 percent had gone through bankruptcy or debt-equity swaps, 28 percent were sold or leased out to private owners, 27 percent introduced employee shareholding, 20 percent went through internal restructuring, 8 percent went through ownership diversification including public offerings and private placement to outside investors, and the remaining 4 percent became joint ventures. In more than 70 percent of these cases, *gaizhi* involved the transfer of at least a portion of ownership from the state to private hands (Garnaut et al., 2005).

Thus, since 1990s reform efforts in China have been directed towards the consummation of market supporting external environment. When all of these indirect ways that the state ultimately controlled listed companies are combined, the dominant shareholder in 2001 turned out to be the state in 84percent of the companies. In 2002, the state-owned company continued to gather towards key industries and large-scale key enterprises and breakthroughs were made in oil, petrochemical, power, telecommunications, metallurgy, railway, defense and other key major sectors. The Report of the 16th Party Congress in 2002 gave new stipulations on the framework of the state-owned assets management system (Xinhua, 2002). According to the report, the central government should represent the state in performing functions as investor in large SOEs, infrastructure and important natural resources that have a vital bearing on the lifeline of the national economy and state security while local governments should represent the state in performing the functions as investors with regard to other state property.

The Chinese government’s commitment to the market versus the state has fluctuated over the course of the reform period, which in turn has affected the pace and nature of SOEs reform in the

country. Each generation of leaders has had different approaches to reform. The nature of the Chinese leadership and its ruling faction thus has left significant imprints on the nature of SOEs reform in China. The Chinese leadership centered on Deng Xiaoping and Chen Yun at the beginning of the “opening up” and liberalisation shared a fairly consensual view on the reform of SOEs. Since both of them still viewed the debt-ridden SOEs as the cornerstone of socialism, they understandably pinned their hopes of reform on SOEs. However, these two veterans had different views on the relation between market and central planning in socialism. Chen was a defender of central planning and in his vision, if the socialist economy was a bird, then the central planning capacity of the socialist state was represented by a cage (Coase & Wang, 2012). Although this view facilitated economic reform at the initial stage, this representation of the state and economy was too restrictive to accommodate a genuine market economy. On the other hand, Deng was eager to push forward economic reform, no matter it was driven by either state or private sector.

While Jiang Zemin advocated “upholding the banner of Deng Xiaoping’s theory” at the 15th Party Congress in 1997, he was not in full support of Deng’s expedient pragmatism in economic affairs (Jiang, 2002). Jiang’s report to the 15th Party Congress outlined the government’s plan for reforming the SOEs through promoting a shareholding system without clearly defining the ways to accomplish this (Nathan, Hong, & Smith, 1999). He explicitly recognized that “personnel mobility and layoffs” would be hard to avoid during the course of reform of SOEs (Tien and Chu, 2000). The reform in the mid-1990s also mirrored the two quite different political philosophies of Zhu Rongji (Zhu, 2015), the Vice-Premier, and Li Peng, the Premier of State Council (Xu, 2012). Li Peng favoured large centrally controlled companies, particularly in energy sectors, believed “without solid state-owned enterprises, there will be no socialist China”. In his work report to the National Party Congress session, Premier Li Peng specified that “Beijing would concentrate on “rejuvenating” 1000 large SOEs through the infusion of credit and merger into competitive enterprise groups while sloughing off China’s small SOEs through merger or bankruptcy” (MacFarquahar, 2011). Zhu Rongji, on the other hand, was in favour of competition even in the strategic sectors and detested monopoly or oligopoly to the core (Zhu, 2015). The Shanghai clique built around Jiang Zemin and Zeng Qinghong who were promoters of ever greater economic liberalization and associated with the boom economies of coastal China

and global economic integration. The Shanghai clique had overseen China's entry into the WTO in 2001 and dominated politics after Deng until at least the 16th Party Congress of 2002. Thus the leadership transition since Deng has also been couched in terms of a very simple 'two-line' conflict; either between a Shanghai gang/clique and their opponents or between the economic task of generating growth and a political task of promoting development.

Both Jiang Zemin and Hu Jintao continued advancing China's economic reforms and adapting them to changing economic circumstances (Jiang, 2010; Hu, 2012). Their core consideration continued to be the adoption of policies which would promote the rapid economic development. Hu Jintao in his speech to the 17th Party Congress in 2007 has mentioned the need to "deepen reform of monopoly industries by introducing competition and strengthening government regulation and public oversight of them" (Brown, 2012). However, the reform model under Hu-Wen faction has faced criticism time and again from the New Left academic clique that focuses on economic nationalism and emphasizes strong domestic control of economic life in China, represented mainly by Zuo Dapei, Zhang Hongliang, and Lang Xianping (Freeman III & Wen, 2012). According to them, China's current pro-market economic development model is a blunder since the financial crisis has already illustrated "the bankruptcy of the privatization idea." After the 2008 financial crisis, the New Leftists were quick to pronounce the death of the market-centric approach and proposed with much fanfare the advance of "state capitalism" as a new development model that the Chinese leadership should adopt.

After nearly three decades of reform, China's SOEs no longer totally dominate the economy. Nevertheless, that does not undermine the sector's significance to the country or its global outreach. It has been China's ambition to build a national team in several key industries, called the "monopoly industries" which include automotive, pharmaceutical, electronics petrochemical and telecommunications in which SOEs have a dominant presence (Nolan, 2001). Today, there are some 115 companies which comprise of the largest and most important SOEs in China (KPMG Report, 2013). They are called the *Yangqi* which means 'central enterprise' in Chinese and they operate in the most strategic industries in China. The SASAC is directly responsible for the administration and oversight of the *Yangqi*. SASAC is organized both centrally, for the control and management of China's central SOEs and regionally, for the control of local and

subsidiary SOEs. It is chaired by the Premier of the State Council and includes the heads of each governmental department and agency.

1.3 EVOLUTION AND CHARACTERISTICS OF REFORM

The economic transition beginning in the end of 1970s created conditions for SOE reforms in China. A majority of these initiatives related to market liberalization and WTO entry, began in the form of an experimental programme to expand autonomy of SOEs in China. The first of such initiatives that began in 1978 with six SOEs in Sichuan Province in China was a success, following which it was adopted across the country. By the end of 1979, 6600 firms accounting for 60percent of total output and 70percent of the profits under the state budget had adopted it (Naughton, 1995: 100). One of the major achievements of this initiative, which also the marks the beginning of enterprise reform in China was the freedom granted to enterprises to retain a few profits after fulfilling the state targets. The profit retention system as, popularly known underwent some reformulations, faced with a financial crisis and the Economic Responsibility System (ERS) was adopted in 1981 (Tian, 1996). The main objective of this system was to increase the state revenues besides providing incentives for SOEs to improve their efficiency in production. Most of the SOEs in China, during the pre-reform period, was highly inefficient in absence of real profit based incentives, operational autonomy and lack of an independent identity (Chen et al., 1988; Dollar, 1990; Xiao, 1991; Jefferson, Rawski & Zheng 1992 & 1996). While the profit-retention remained at the core of this system, it also established a direct relationship between employee income and SOE performance. There were no fixed profit quotas and retention rates and they were subject to negotiations between enterprises and supervisory authorities. However, this system failed to improve SOE performance beyond a period. The problem according to Naughton (1995) lay in the distorted price system due to which profitable firms failed to reap the benefits of extra-profits due to the higher quota targets imposed by the government, whereas the losses faced by the weak enterprises were covered by the government. As a result, profitable SOEs slowed their production, resulting in major state revenue drops between 1981 and 1983.

In 1984, the State Council promulgated the “Provincial Regulations on Further Enlarging the Autonomy of the State-Owned Enterprises”, introducing the dual-track price system, which granted ten new rights to SOEs and enabled many SOEs first in light industry and then increasingly across all sectors of China’s industrial economy, to sell a portion of their output at market prices, after meeting the state targets (State Council, 1984). With the exception of necessities and agricultural products, prices could fluctuate within a 20percent range of the state price. Although this system yielded some favourable results, such as an increase in SOE profits, but suffered due to the lack of a proper price reform in China during that period. Hence the government tightened monetary control and the dual track price system was replaced by the contract responsibility system in 1986 (Diao, 1987). During this period, there was also a simultaneous increase in non-state firms in the form of collectives, township and village enterprises (TVEs). These firms, as new competitors, began to push SOEs to reform.

The Enterprise Contract Responsibility System (CRS) was introduced through an issuance by the State Council *Decisions on Intensifying the Enterprise Reform and Revitalizing Enterprises* on December 5, 1986 (People’s Daily Online, 2008). The document separated ownership from management, granting firms greater autonomy. CRS was introduced in large and medium sized enterprises whereas small and the loss making one were allowed to apply their lease agreements (State Council, 1986). By the end of 1987, almost all state enterprises were under the new “contract responsibility system.” CRS was, in fact, a revised version of the economic responsibility system and the idea to strengthen and clarify the system of incentives and rewards for SOE managers and staffs, and also for capital investment. Under the CRS, the responsibility system of the enterprises underwent change. Previously, there were no financial constraints on the enterprises, such that under fulfillment of profit quotas did not result in any penalty. However, after 1987, firms were required to make up for their losses from their own funds, exposing them to volatility and risks (Hay, Morris, Liu & Yao, 1994). CRS had also introduced an open bidding system, where the contractors selected through public bidding process were allowed to determine production, sales, and allocation of profits beyond the profit quota mentioned in the contracts. As a result, firms could set aside some profits for technological innovation and investments. For example, Sah (1990) mentioned in his work that the mainland Chinese textile industry had developed 10,000 new products.

It is true that CRS had better results as compared to price retention and ERS. In the beginning, it had received a positive response from the enterprises as they could retain profits and incentives provided to workers had direct impacts on the firm performance. Between 1986 and 87, the total output value of firms increased by 11.3percent, employee productivity by 7.6percent and profits by 9.9percent (Sah, 1990). This figures encouraged the Chinese government to extend the CRS for contracts to be signed in the 1990s. Despite the success of CRS, the incentives provided under the system were beset with problems and turned out to be less profitable than projected. First, the tax over profits to each enterprise varied and was subject to change depending on the profits of the enterprise. As a result, this affected the incentive structure of the firms and they were made to pay higher than expected. Secondly, the contracts between the firms and the state authorities involved a complex negotiation process. In absence of a formal procedure to decide profit-remittance quota, the state authorities had a difficult time to determine profit taxes by the firms. SOEs, on the other hand, paid more attention to the negotiations to maximize profit-retention, while production and efficiency became secondary priorities. Thirdly, SOE managers often engaged themselves in short-term activities at the cost of long-term interests. Given the poor quality of the managers, and nature of their contractual jobs, they hardly emphasized on technical efficiency and innovation of the firm. Fourthly, the managers were not compensated properly because a high salary to management was socially and ideologically unacceptable in China. So, when profits used to be high, the workers received additional compensation in the form of durable goods such as colour TV sets and refrigerators because monetary wage was fixed as per the national scale (Chow, 2004: 130). Also, the investment policy was sub-optimal in the sense that risk taken by a manager of the enterprise was not sufficiently compensated. Lastly, red-tapism continued in the early reform years, and the managers and executives were often selected through personal and political connections. Thus, CRS continued to be under the centralized control and despite the document, there was no real move to the formal ownership change.

These concerns created pressures for deep SOE restructuring, including the formal conversion of SOEs, prompting another round of reforms in 1993. The Third Plenum of the 14th Central Committee of the Chinese Communist Party (CCP) in 1993 put forward in the *Decisions on Issues Concerning the Establishment of a Socialist Market Structure*, which led the foundation of

modern enterprise reform in China (Beijing Review, 2008). The plenum pointed out that the socialist market economic system is combined with the basic system of socialism. The plenum decided to further transfer the operating mechanism of state-owned enterprises and establish modern enterprise system with clear property rights, clear powers, and responsibilities, separation of government from enterprises and scientific management measures that meet the requirements of the market economy (People's Daily Online, 2008). The characteristics of the Modern Enterprise System include corporatization of SOEs by bringing in some features of Western company structure such as boards of directors and shareholders, reducing government interference in the running of enterprises, and making them more entrepreneurial and less reliant on the state through *gaige*, *gaizao* and *gaizu* (Chen & Lin, 2002). *Gaige* refers to reform, which means the adoption of the new enterprise-management mechanism; *gaizao* refers to reconstruction which involves technical transformation and improvement, while *gaizu* means restructuring, which refers to re-organization of property rights and assets. One of the major steps towards corporatisation was the setting up of stock exchanges in Shanghai and Shenzhen in 1990, to enable SOEs to raise capital from equity markets. The first Chinese Company Law was enacted in 1993 and went into effect on July 1, 1994, along with the various goals, to facilitate the legal requirements of the modern enterprise reform (China Daily, 2006). The Company Law, China's first national law was adopted to govern the establishment and operation of corporations since 1949. The Law provides a nationwide standard of establishing and operating limited liability companies and of those firms with limited shares in China. It became a part of the overall legal framework essential for transforming China's SOEs into independent entities. It also encouraged the security exchanges of Shanghai and Shenzhen as well as attracted foreign investment (although in limited scale) by infusing investor confidence in Chinese corporations (Torbert, 1994; Huo, 1995). In the pre-reform period, China lacked any such national legislation as there was no need to govern the operation of private companies during that time. The socialist economy was comprised almost exclusively of SOEs that functioned as state units under the command system of the Chinese party-state.

Like all other SOE reform initiatives in China, the modern enterprise system also began as an experimental program on 100 large and medium sized SOEs, known as "100 firm corporatization experiment" in November 1994 (Jeffries, 2007). The state departments such as the State

Economic and Trade Commission (SETC) and the State Commission on Restructuring Economic Systems were in charge of supervising the pilot project. The pilot experiment scheduled for two years included firms from diverse geographic regions of China. During this period, firms under the program defined their property rights and responsibilities which were separated from government functions. Before the experiment, the pilot firms were asked to clarify their assets and debts in the audits conducted by the state authorities. A new institution, “Managing Institutions of State-Owned Assets” to manage assets of SOE firms was established (Development & Research Centre - State Council, 2008). Towards the implementation of modern enterprise reform, the pilot firms underwent organisational transition, into limited liability shareholding companies. The Company Law further introduced the supervisory board as part of corporatization into SOEs (Huo, 1995). The pilot program, however, failed to achieve all the targets set by the third plenum of the 14th CCP. They did achieve some layers of corporatisation but the management structure was not independent of the government control and influence. Also, each firm in the program chose their own method of appropriating modern enterprise reforms, due to regional variations.

The 15th Party Congress in 1997 adopted the shareholding system as the new model and the policy of “Grasp the large and let go the small” (*zhua da fang xiao*) was set out (Jiang, 2013). As for the large firms, the plan was to be grasped by the state. By grasping, the central committee meant that large SOEs were to be merged into large industrial conglomerates and the control over these conglomerates would be with the central government or local governments. The main objective of this grasping was to maximize profits for the large firms under the control of the Chinese State. For example, in China’s steel sector, large industrial groups were formed in the late 1990s and early 2000s, and ownership of the state-owned steel manufacturers was transferred to these groups. Three of these groups are owned by the Chinese central government (the BaoSteel Group, the WuSteel Group, and the AnSteel Group) and two by provincial governments (the Hebei Steel Group and the Shandong Steel Group) (Hsieh & Song, 2015: 7). “Letting go small” indicated that small SOEs would be privatised or closed. By the end of 1998, more than 80percent of state and collective firms at the provincial level or below had undergone restructuring (ibid). Thus, this three-year phased reforms had a threefold objective: i) to privatize or sell off small SOEs at the county level that were loss-making and unproductive; ii) to lay off

SOE workers at the city level to improve efficiency; and iii) to carry out various realistic methods, such as joint venture, mergers, and acquisitions, leasing, contracting, shareholding and SMEs mergers, groupings/conglomerations, of some of the larger SOEs (Cao, Qian & Weingast, 1997). This resulted in seven types of corporate restructuring: i) public offering; ii) internal restructuring; iii) liquidation; iv) employee-shareholding; v) public tender sale; vi) lease contracts; and vii) a joint venture or merger with a local or foreign firm (Garnaut, Song & Yao, 2006).

The policy initiated by Zhu Rongji's administration had an ambitious strategic perspective. China was beginning to make its full-fledged entry into the world market economy and therefore, it became necessary for them to learn from the experience of the industrialised countries in the world, in order to establish profitable, giant enterprises and to increase their competitiveness in the world markets (Zhu, 2015). The other rationale behind the creation of strong and large enterprises modelled along western lines was to ensure national economic security. Also, the rise in non-performing loans and slow economy due to the Asian financial crisis and the China's quest to be part of the WTO exacerbated pressures of SOE restructuring. Moreover, a large number of small and medium sized SOEs were inefficient and unprofitable, reeling under huge debts. As a result, privatisation or shutting them down became either of the options available to the government. Whilst the policy was relatively successful in terms of reforming SOEs, a number of problems remained unresolved. First, the policy of "grasping the big and letting go the small" was carried out too hastily and was problematic in many ways. The implementation of "grasping the big" was taken too seriously by all levels of government, who tried to use political and administrative means to merge enterprises in order to create giant monopolies. All they were concerned was with the word "big", regardless of any other economic and social considerations. On the other hand, both "letting go of the small" as well as "grasp the big" created "reform with losers". They resulted in dramatic layoff and decline in the size of the SOE workforce. Between 1995 and 2001, the year China joined the WTO, the number of jobs in the urban state sector fell by 36 million, from 59 percent to 32 percent of total urban employment (The Economist, 2011). Second, there was a lack of accountability and transparency in management in which other stakeholders were excluded from the reform process. Third, despite corporatisation efforts, in many SOEs, there was virtually no change in management team despite the adoption of modern

management principles because the party-state continued to dominate the management process. Fourth, some of the small SOEs were bought by managers or investors, who then stripped off their assets and sold them bit by bit. These problems revealed in the reforms, as well as the superficiality of certain changes in the SOE structure and losses in productive capacity, were as a result of ‘firewall’ sales of SOEs. Also, despite these attempts at extensive restructuring, productivity and profitability gains, as well as a reduction in the number of firms and their share of total industrial output, serious efficiency problems in SOEs persisted (refer to table 1.1).

Table 1.1 Economic Efficiency of the State-Owned and Private Sectors

Ownership	Year	Number of firms	Assets			Sales			Return on Assets (Sales/Assets)
			Value	percent of National Total	Firm Average	Value	percent of National Total	Firm Average	
SOE	2000	53489	8401	66.6	0.157	4220	50.2	0.08	0.5
	2001	46767	8790	64.9	0.188	4444	47.4	0.1	0.51
	2002	41125	8909	60.9	0.217	4784	43.7	0.12	0.54
	2003	34280	9452	56	0.276	5803	40.5	0.17	0.61
	2004	35597	10971	56.2	0.308	7143	38	0.2	0.65
	2005	27477	11763	48.9	0.428	8557	39.2	0.31	0.73
	2006	24961	13515	46.4	0.541	10140	32.3	0.41	0.75
	2007	20680	15819	44.8	0.765	12262	30.7	0.59	0.78
	2008	21313	18881	43.8	0.886	14751	24.5	0.69	0.78
	2009	20510	21574	43.7	0.052	15170	28	0.74	0.7
	2010	20253	24776	41.8	1.223	19434	27.9	0.96	0.78
Private	2000	22128	387	3.1	0.017	412	4.9	0.02	1.06
	2001	36218	590	4.3	0.016	695	7.4	0.02	1.18
	2002	49176	876	5.8	0.018	1043	9.5	0.02	1.19
	2003	67607	1453	8.6	0.021	1719	12	0.03	1.18
	2004	119357	2372	12.2	0.02	2945	15.7	0.02	1.24
	2005	123820	3033	12.6	0.024	3991	18.3	0.03	1.32
	2006	149736	4051	13.9	0.027	5632	18	0.04	1.39
	2007	177080	5330	15.1	0.03	7734	19.3	0.04	1.45
	2008	245850	7588	17.6	0.031	11222	22.4	0.05	1.48
	2009	256031	9118	18.5	0.036	13437	24.8	0.05	1.47
	2010	273259	11687	19.7	0.043	20784	29.8	0.08	1.78

Sources: Based on National Statistical Bureau, China Science, and Technology Statistical Yearbook, Luo, Li & Duan, (2012) & Duan & Saich, (2014).

Thus, the transformation of SOEs has been characterised on the one hand by a rapid decline in the number of SOEs and on the other hand by a steady accumulation and expansion of state-owned assets as well as profits in large and medium-sized industrial enterprises (refer to table 1.2). Signaling the fourth stage in the SOE reform process, the SASAC was established in 2003 as the key government body charged with supervising China's SOEs. The primary responsibilities of SASAC as outlined in the document of its formation was to consolidate state assets management of SOEs, except the assets of the financial enterprises and the state banking sector. Before SASAC's creation, SOE responsibility in China was scattered over eight central government departments: the State Economic and Trade Commission; the Central Work Committee for Large Enterprises; the former CCP Enterprise Work Commission; the related state-owned assets management of Ministry of Finance; and the Ministry of Labour and Social Security, and others. The Law on State-owned Assets of Enterprises (SOAE) was promulgated in 2008 after nearly a decade of legislative decision making (State Council, 2008: Order No 5).

Table 1.2 - The Changing Share of SOEs in China's Economy: 1995–2012

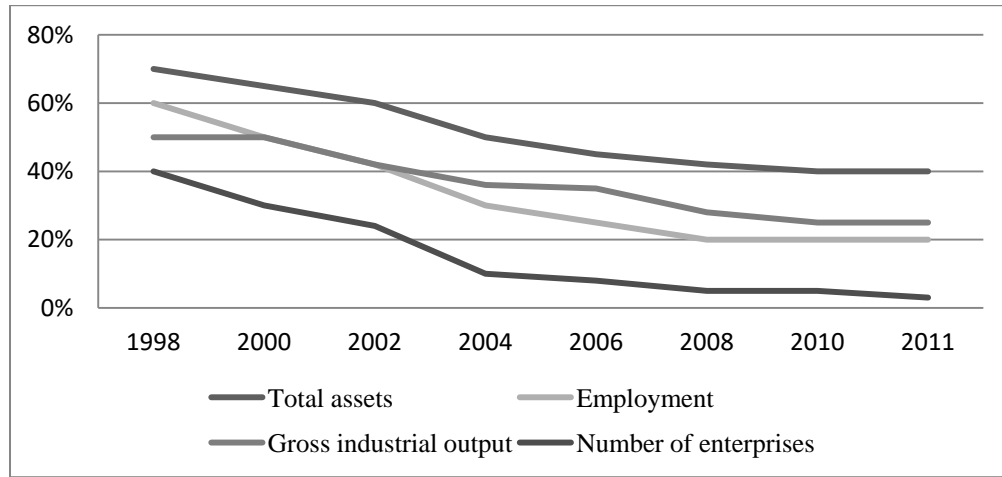
	Number of SOEs	Share of SOEs in total number of industrial enterprises (percent)	Employed persons by SOEs 10,000 persons)	SOEs Share in employment for urban area (percent)	Gross Industrial Output Value by SOEs (100 million yuan)	Share of SOEs in Gross Industrial Output Value (percent)
1995	118,000	23.12	10,955.00	73.48	31,220.00	56.82
1996	113,800	22.47	10,949.00	73.76	36,173.00	57.66
1997	98,600	21.05	10,766.00	73.4	35,988.00	52.65
1998	64,700	39.19	8,809.00	71.4	33,621.00	49.63
1999	50,651	31.26	8,336.00	70.8	22,215.89	30.56
2000	42,426	26.05	7,878.00	69.97	20,156.29	23.53
2001	34,530	20.16	7,409.00	68.65	17,229.19	18.05
2002	29,449	16.22	6,923.81	65.58	17,271.09	15.59
2003	23,228	11.84	6,621.28	63.11	18,479.40	12.99
2004	23,417	8.47	6,438.21	60.88	65,971.10	32.7
2005	16,824	6.19	6,231.98	57.44	N.A	N.A
2006	14,555	4.82	6,170.47	55.29	30,728.16	9.71
2007	10,074	2.99	6,147.61	53.8	36,387.12	8.98
2008	9,682	2.27	6,126.12	53.2	46,856.89	9.24
2009	9,105	2.1	6,077.86	51.4	45,648.02	8.33
2010	8,726	1.93	6,145.11	50.16	57,013.00	8.16
2011	6,707	2.06	N.A.	N.A.	66,672.56	7.9
2012	6,770	1.97	6,467.24	44.9	N.A.	N.A.

Source: Chen & Whalley (2014)

The State Assets Law is considered to be the most comprehensive legal framework with respect to the regulation of transfer procedures, management and governmental oversight of state owned assets and equity interests. Till the Law on SOAE came into being, SASAC's powers were governed by the *Interim Regulations on Supervision and Management of State-owned Assets of Enterprises* issued in 2003 (State Council, 2003). While the State Assets Law have includes all the provisions of the Interim Regulations, some provisions in the Interim Measures that are not addressed by the State Assets Law remain valid and enforceable. With China's entry into WTO and rise in foreign direct investment (FDI), the changes to limited liability companies became imminent. As a result, The New Company Law was adopted in 2005, which replaced the Old Company Law. The New Company Law, a complete revision of the old law, encourages shareholders of limited liability companies to take a flexible approach to company management (Dickinson, 2008: 3).

With respect to SOE management, Articles 68 and 71 of the Company Law (amended in 2005) stipulates that the members of the board of directors and supervisors of a wholly state-owned company shall be appointed by SASAC, whereas the representatives of the firm employees shall be elected by the assembly of the representatives of the employees of the company (ibid). Most of the Chinese companies do not have a system for establishing board committees and a few have succeeded in it and the new Company law, rather than reinforcing the employee supervisors, has further bolstered the power of the board of supervisors (who are rank-holders in the CCP) (Feinerman, 2007: 608). Thus, the revised Law has failed to make an impact in China as expected. The primary reason is the inept judiciary system and a bureaucracy, ill-equipped in handling complex corporate cases. There is also a lack of awareness about such sophisticated legal procedures. The current profile of surviving SOEs shows that the reform of China's centrally state-owned and state-controlled enterprises has resulted in the consolidation of a limited number of merged mega-firms, numbered at 115 in 2012 (refer to annexure 1). Notwithstanding this concentration of CSOE activity in 115 mega-firms, SOEs continue to pervade the Chinese economy, extending well outside the industrial and financial sectors (refer to Fig. 1.1 & table 1.2). In the view of Chen Zhiwu, a finance professor at Yale University and an adviser to China's cabinet in 2007, "Many of China's structural distortions, both economic and otherwise, are due to the dominating positions of the SOEs" (Bloomberg, 2015).

Figure 1.1 - The Share of SOEs in All Industrial Enterprises



Source: China Statistical Yearbook 2012

Table 1.3 - SOEs in Selected Industries (percent)

SOEs in Selected Industries (percent)	Number of firms		Gross industrial output		Total assets	
	1998	2011	1998	2011	1998	2011
Mining and washing of coal	49.5	11.5	81.9	53.6	92.7	72.0
Extraction of petroleum and natural gas	81.7	40.2	94.5	92.1	98.9	94.7
Manufacture of food	44.1	4.1	29.7	5.8	41.1	9.9
Manufacture of tobacco	87.2	79.1	98.3	99.3	98.2	99.3
Manufacture of textiles	24.0	1.2	32.2	2.4	46.2	5.0
Printing, reproduction of recording media	58.0	8.0	37.9	11.5	51.2	18.2
Processing of petroleum, coking and nuclear fuel	28.3	10.9	91.0	68.6	90.3	58.8
Manufacture of chemical products	32.3	5.0	50.4	18.7	69.5	29.1
Manufacture of medicines	45.3	7.1	49.6	11.8	60.8	20.3
Manufacture of rubber	21.0	3.1	34.3	12.1	50.7	16.2
Manufacture of general machinery	29.6	3.2	38.4	12.5	60.7	22.3
Manufacture of special machinery	40.9	5.2	41.2	20.5	63.3	32.2
Manufacture of transport equipment	40.1	7.6	67.0	44.0	78.2	53.2
Manufacture of communication equipment	29.8	5.2	37.7	8.3	51.0	19.6
Production & supply of electric power & heat power	85.6	66.4	85.4	93.0	89.1	90.7
Production and supply of water	92.6	61.4	87.8	69.4	90.3	79.6
Production and supply of gas	84.0	29.9	71.6	44.4	93.7	54.3

Source: China Statistical Yearbook 1999 and 2012

1.4 DEFINITION, RATIONALE, AND SCOPE

The study primarily deals with understanding the changes and continuities of SOE reform policies in the post liberalization period. Notwithstanding the changes that have taken place in the SOEs during the course of reform, the study at hand attempts to explain the continuity in

policies vis-à-vis SOEs in China despite their deep integration with the world economy. The focus is, therefore, to examine and explain this anomaly using the institutional frame of reference in political economy studies. However, a couple of concepts which have surfaced during the course of formulating the research proposal necessitate further clarification, mainly what is meant by terms such as ‘reform’, ‘market’ and ‘state-owned enterprises’. The rhetoric of ‘reform’ as understood by international agencies and consultants fundamentally confuses and distorts the underlying basis of the process. They tend to view ‘reform’ as a highly instrumental, top-down image of both the process of change and the nature of control. Nevertheless, the study engages with the term ‘reform’ in a slightly different way. The diversity of interests and goals involved in the process defy encapsulation under one overarching umbrella. It is true that in the context of China, ‘reform’ is mostly a top-down process but external forces and pressures from the international agencies poses its own problem of autonomy and capacity. Therefore, the ‘reform’ of the SOEs is understood as describing a complex, multi-arena process of strategic actions by state business interests, state bureaucrats, party leaders and other state actors who are engaged in the process of managing and restructuring state commercial activities (Painter, 2003).

The concept ‘market’ as used in social sciences is both simple and controversial. The tendency is to assume an ideal definition of the market as understood by the neoclassical theorists. In the dictionary of modern economics, the ‘market’ is understood as “generally, any context in which the sale and purchase of goods and services take(s) place” (Pearce, 1986). It can also be treated as a particular type of social relations i.e. exchange relations linked by the price system (Lindblom, 1977). The concept of ‘market’ becomes intricately controversial when the terms of exchange i.e., prices, are singled out as the core element of the market and abstracted into an integrative mechanism of economic action. In that case, the market becomes a synonym for the price system. It is seen as a mechanism of resource allocation which, via the fluctuation of prices, reflects and synthesizes demand and supply, signals the directions, quantities, and frequencies of resource flow among different spheres of the economy, and makes demand and supply meet. In the course of effecting resource allocation, the market also plays a role in shaping organizational structure, evaluating organizational performance (i.e. selecting winners in price competition and weeding out losers), and determining the relative size of payoffs or real income among various economic players. Despite it being a price centric definition, what it

misses is the social aspect or the sociological perspective into the dynamics of the market. A sociological perspective enriches the understanding of how economic actions are embedded in networks of interpersonal relations, and how social institutions are necessary pre-conditions to the existence of such markets. Institutions refer to shared rules, which can be laws or collective understandings, held in place by custom, explicit agreement, or tacit agreement. These institutions; property rights, governance structures, conceptions of control, and rules of exchange enable actors in markets to organize themselves, to compete and cooperate, and to exchange. Through an examination of the effects of price changes on decisions regarding these questions, two types of market are derived. The first is called instrumental market-market through which resources are allocated, and the second may be called allocative market- market by which resources are allocated (Brus, 1989). A firm is said to be in an instrumental market if price changes do not prompt changes in its major decisions in the direction of economizing, and this may be due to a number of reasons: absence of a strong will to economize or the firm may lack a free hand to do so even if it intends to. In such a setting, the price system is primarily a medium or instrument of exchange rather than an allocative mechanism that directs and coordinates the flow of resources. In contrast, a firm can be regarded as operating in an allocative market if it is both price-sensitive and capable of economizing by adjusting their decisions in response to changes in price signals and incentives. In most of the capitalist economies characterised by a relatively independent economic sector, these two types of the market can coexist. However, in the case of China, it is the former type of market, called instrumental market, which is relevant in this study, where the role of price in resource allocation is limited in scope and price changes do not carry much incentive for economizing oriented adjustment in organizational decisions. In this context, the Chinese state becomes important to the formation and ongoing stability of markets. Some states have greater capacities for intervention than others, and the likelihood of intervention depends on the nature of the political situation and the institutional history of the state (Evans, Skocpol & Rueschmeyer, 1985; Laumann & Knoke, 1989). This study will also analyse the role of the instrumental market in SOE reforms.

The study focuses on SOEs under the central government. These SOEs often referred to as central state-owned enterprises in China used to be wholly owned by the state until the early 1990s when the central government decided to list some large state firms and sell off small state

enterprises (Lin et al., 2001). The current definition of SOE includes “state-owned and state-holding enterprises” where they are wholly state-funded or those firms whose majority shares belong to the government. They are dominant in China’s strategic industries, such as banking and finance, telecommunications, crude oils and chemicals, iron and steel production, petrochemicals, civil aviation, railroad, automobile production, other infrastructure and general utilities.

There are both theoretical and policy-relevant reasons behind pursuing such a study. First, the reform of Chinese SOEs has been an integral part of the economic reform program of the Chinese Government (Child, 1994). Thus, a study of the SOEs reform policies would clearly help us tackle two important questions: How should we view reform of SOEs in China? What role did SOEs play in China’s economic integration in the past and how will that role develop in the future? Second, Government industrial policies are the institutional setting that determines the success of enterprise reform because it defines the legal parameters of the environment in which enterprise survives and develop. Thus, studying such policies shall provide not only the background for an understanding of the rationale, process, consequences and the problems of the reform but also a base from which to predict the future development of enterprise reform. Third, by bringing back society into the institutional analyses the study shall contribute in identifying the key ingredients of the “embedded relations” between the Chinese state and the market mechanisms that have led to sustained economic growth for three decades. Although the study is limited to the examination of policies of Chinese SOEs reform from 1992 to 2012, this investigation necessitates a brief comparison with the policies at the beginning of the reform era in 1978. The year “1992” marks the starting reference point of the study due to the significant “southern tour” by Chinese leader Deng Xiaoping where he advocated changes required to mark a transition to market economy. The study is limited to analysing the economic reforms till 2012. A concluding chapter will, however, briefly reflect on the new set of reforms announced after the 18th Party Congress by the Xi Jinping leadership. These reforms throw several interesting research puzzles in the light of historical changes & continuity in SOEs reforms policies. Discussing such puzzles is though, outside the scope of this study, the concluding part will attempt to crystal gaze into the enterprise policy reforms under the new leadership.

1.5 RESEARCH QUESTIONS AND HYPOTHESIS

The study seeks to investigate the following key questions:

- i) What are the major changes in China's state-owned enterprises in the post-liberalisation era? How have central government policies shaped these changes?
- ii) What have been the stipulated objectives of the reform vis-à-vis SOEs? To what extent are the objectives fulfilled?
- iii) How has the WTO membership affected SOE reforms in China?
- iv) What explains the continuity in China's industrial policies towards SOEs across the various phases of reform?
- v) How continuity and change in the policies towards SOEs are shaping the discourse on the role of the Chinese state in industrial enterprises?

The study premises on the two hypotheses; i) SOE reform in China is shaped by the ownership based control of economic organizations and the logic of the state's power structure, ii) The relationship between economic institutions and political leadership in China have ensured the continuity in industrial policy practices.

1.6 ORGANISATION OF CHAPTERS

The research subject and the questions are portrayed in this Chapter One. This chapter serves to introduce the main thrust of the research. It involves a brief exposition of 'what', 'why' and 'how' questions of the study. The chapter also introduces the state of existing debates on the issue and traces the evolution of enterprise reforms in China in detail. Chapter Two positions this study of China's SOE reforms in both the post-communist transitions and in the political economy literature. The chapter begins with the classification of SOEs and a description of the institutional matrix. It then reviews the various approaches to the political dynamics of economic reform, capturing the market-plan debates of the neoclassical and neoliberal economies which have been popular in the field of China's political economy since the beginning of its reform years. While these theories describe the economic transitions in communist countries, they fail to capture the institutional dynamics or changes in the post-transition years. In fact, they also treat

the state as a constant while studying such economic transitions. The chapter then outlines institutionalist theories that inform this thesis which analyses the relationship between the political institutions and the actors and how the principal agent relationship is shaped both by their quest for legitimacy, material interests, their visions about market economies. While outlining the frame of reference, the chapter then delves into the larger debates about SOE reform in China, turning its discussion into the efficiency issues of SOEs. The chapter concludes by pointing out the gaps in the literature and how the study contributes to the extant scholarship.

Chapter 3 is about research methodology and gives information about the details of the research design. This chapter begins with the description of variables, drawn from the theoretical puzzle and the assertions made thereafter. A large portion of the literature explaining China's SOEs reform attempts to identify the key variable in the transition, be it state, elite (political, economic, or intellectual), or local factors. It is, therefore, crucial to unpack the variables, operationalise them and establish the causal relationship between the different variables. Since SOEs reform is most complicated among other economic reforms in China, involving a myriad of contradictions, singling out one variable runs the risk of oversimplifying the whole picture. It then describes the methods and techniques grounded in the institutional analysis as they cover a large range of practices varying from case study analyses to sophisticated institutional evaluation frameworks. The study adopts the multiple case studies design, and through the case study methods, it generates findings and provides explanations that are beyond quantitative statistical results and help the researcher to comprehend the behavioural conditions in an organisation through the actor's perspective. It then shifts to describing various methods of data collection and validity testing. The validity testing of primary data, mainly collected through interviews is as crucial as generating a research strategy. After outlining the technique for data analysis, the chapter then discusses the academic as well as policy impacts of the research and its target audience in think tanks well as policy institutes.

The fourth chapter describes the neoliberal context of China's economy, how the neoliberal turn has impacted SOE reforms in China. The chapter begins with an examination of China's WTO accession related commitments and briefly assess the impact of these commitments on the key sectors of China's economy. The accession related compliance suggests that these commitments

have left a deep imprint on the Chinese political economy. The next section then discusses the extent to which Chinese laws are equipped to deal with WTO principles of transparency, competition, and accountability. Assessing China's ability to comply with WTO principles, a study about its institutional, as well as its domestic laws and regulations, is crucial. The chapter then moves its focus to analysing the Competition Law in detail, tracing its evolutions, debates and the conditions that led to its framing. It examines cases in which the anti-monopoly law was put to test and how the Chinese state superseded the law. Finally, in that section, the chapter analyses the scope of the law and its applicability to China's SOEs. The chapter then summarises the state subsidies that SOEs enjoy before shifting into focus into the WTO procurement negotiations. In the concluding section, based on the evidence, the chapter tests the hypothesis that despite China's move towards economic liberalisation, there has been substantial wavering in the commitment to privatizing SOEs and limiting the state sector, a debate that continues to the present day.

Chapter five explains why state ownership remains dominant in telecommunications basic services. Like the SOEs reform in general, the opening up of the telecommunication sector has been in phases. Although the sector has shifted from being a fully regulated and state controlled to a more liberalised one by introducing structural adjustment and institutional changes, the major telecom companies continue to be state-owned and there exist considerable restrictions on foreign and private sector engagement. The chapter undertakes a study of two major SOE firms in this sector: China Telecom and China Unicom. In the early phase of reform, while the two SOEs maintained their dominance in the Chinese economy, the Chinese government as part of the accession led negotiations, welcomed competition and foreign participation into the telecom market (Mueller and Lovelock, 2000). The telecom sector in China throws a great deal of light on the bureaucratic decision making, inter-departmental competition and the overall organisational and ownership structure, which is controlled by the government and represents a good case study which illustrates the continuity of China's SOE policies in the post liberalisation era. One of the major attempts at centralization on the telecom sector is carried out by the SASAC. While the MII puts more emphasis on breaking up the old monopolies and develop a market guided telecommunications industrial structure in China, it has no substantial authority to direct the market players (Lan, 2014).

The sixth chapter analyses China's financial enterprises, the banking sector, which remains an indispensable part of the SOEs reform. It is the bank loans and the interest rates that redefine the relationship between the Chinese state and the SOEs. The Chinese banking sector is characterised by a diversified portfolio of institutions with different degrees of state and public ownership. The top four banks in China are state-owned enterprises administered by the CBRC. The organizational structure is similar to the administrative mechanism of the centralised SOEs and represents a parallel corporate and Communist Party hierarchy (Bejkovsky, 2016: 6). Even after years since China's entry into WTO, foreign securities agencies are still not permitted to establish a full-fledged branch in China. In fact, they are subjected to various regulatory measures and require complying with several categories if they wish to enter the Chinese banking market (European Chambers of Commerce, 2015). As a result, the banks fail to attract foreign funds and the shares of foreign entities have remained low even in the joint commercial banking sector. The interdependent relationship between China's banking sector and the SOEs, also make it clear that profit maximization is not what drives the lending decisions in banks (Bejvosky, 2006: 6). This often blurs the distinction between China's banking system and the SOEs, and that banks are run as SOEs and the government influences affect both their operations to a large extent. One of its main functions which are subject to direct party-state influence is the lending decisions by the State owned banks of China. The threat of mounting non-performing loans, therefore, puts China at risk of revisiting the 1990s non-performing-loan problem.

Chapter seven analyses oil industry, which is not only one of the strategic SOEs but is one of the strongest bureaucracies in China. The leaders from the oil sector, who suffered setbacks during the Cultural Revolution, regained their former political clout during the reform years (Meidan 2016:7). Regarding the ownership and regulatory structure, the Chinese government maintains strategic control of these companies through various means, from ownership to finance and to determine the management of the companies. Amongst all, the key mechanism that ensures government control is the state ownership, where the mother SOEs is in charge of subsidiaries and is under the direct control of the government. Therefore, the attempts to reform the sector and establish a corporate governance structure have been limited and mostly superficial. Evidence of party-state interference in Chinese National Oil Companies (NOCs) can also be noticed in the way Central Organisation Department (COD) tends to treat the heads of the SOEs

and manage their appointment transfer and even dismissal. Thus, the chapter will examine the interaction between the government and NOCs in China is marked by overlapping degree of centralization and decentralization and also exhibit a great level of convergence with the government policies.

The concluding chapter eight will enlist major findings from the study and provide explanations for the research puzzle which underlie this study. It will discuss the contributions of this study to the extant scholarship, bring out the theoretical and policy implications of the study and provide further suggestions. In the appendices, data and summary tables of the investigated projects are depicted.

CHAPTER 2

REFORM OF THE STATE-OWNED ENTERPRISES: A FRAME OF REFERENCE

2.1 INTRODUCTION

The economic reforms undertaken by the Chinese Communist Regime especially the market embracing policies poses enormous explanatory challenges for the researchers. While China appears to present a new variety of capitalism, frequently labelled as “state capitalism”, the features and implications of this system are still poorly understood. One highly distinctive characteristic of Chinese state capitalism is the SOEs (*guoyou qiye*) which also form an important component of China’s reform experience, illustrating the way the Chinese state interacts with the market forces. Classic studies of the formation of market economies in Europe by Karl Polanyi and E. P. Thompson, and in Southeast Asia by James Scott, share two central “moral economic” premises. First, the transition from the premarket economy to a market economy entails the undermining of overarching social norms that govern economic actions (Polanyi, 1944; Thompson, 1991; Scott, 1985). Second, the ascendant “self-regulating market” imposes an encroaching and integrative logic on the society as a whole (Kornai, 1986). The second theme underlines the importance of the central state in breaking down social and institutional barriers to a national market, coordinating private initiatives, and supplying the capital and infrastructure necessary for an unbridled liberalisation. However, the most salient structural differences between the premarket and post-socialist transitions center on the magnified role of the central state and the relative importance of its fiscal prerogatives in supporting market ideology and institutions (Lin, 2006). Thus, countries like China and Russia have faced the daunting challenge of relieving the state of its ownership liabilities while reinventing its regulatory and fiscal capacities. Concurrently, these countries have also felt the compulsions by creditors, multinational investors, and international organizations to adjust to further global integration (Chaudhry, 1992; McMillan & Woodruff, 2001). In light of the contrasting historical roles of the state in shaping market structures at home, Miles Kahler has argued that the resilient restructuring policies will succeed or flounder depending on the existence of effective national institutions and role played by decision makers in organisations, which also directly determine whether the national economy would reap the benefits of the

global market (Kahler, 1990). Kahler identifies the “orthodox paradox” in the contemporary developmental task of using the state to change policies in a less statist way. Drawing primarily from the institutionalist approach within the political economy, the study shall examine and explain China’s response to this “orthodox paradox” and also how through the SOEs, the Chinese party-state exerts control while encouraging marketisation.

2.2 CLASSIFICATION OF SOES AND THE INSTITUTIONAL MATRIX

The traditional classification of SOEs in China depended on the economic sectors they belonged to: state owned industrial enterprises, building installations, commercial services, and financial enterprises such as the banking sector. In the pre-reform period, SOEs were classified much more categorically, and “state-owned enterprises” and “state-holding enterprises” used in official statistics, were wholly state-funded firms established by central and local governments, and whose supervisory officials belonged to the government. However, this narrow understanding of SOEs underwent change as the nature of these institutions changed along with the assets with the onset of economic reform in China. The contemporary understanding of SOEs, in terms of its ownership, regulation and management incorporate aspects of corporatization, privatization along with centralization in their functioning as key entities in the Chinese economy. While these varying forms of SOEs have given them some flexibility, it nevertheless complicates ownership policy, makes them less transparent and insulates SOEs from the legal framework applicable to other enterprises, including anti-monopoly laws, procurement laws, etc.

i) Classification by Ownership

In 1998, the National Bureau of Statistics (NBS) of China revised its ownership classification. The Chinese government in its new classification has defined SOEs in broader terms. The SOE classification now excludes the 100 percent state-owned limited liability companies as well as the joint operations between two or more state-owned enterprises. In addition to wholly state funded enterprises, SOEs include state-holding enterprises, such as shareholding cooperative enterprises, joint-operation enterprises, limited liability corporations, or shareholding corporations, whose majority shares are owned by the government or SOEs themselves. Urban

collective enterprises and government owned township and village enterprises (TVEs) also belong to the state sector but are not considered SOEs. The ownership further underwent changes in 2010, when large SOEs through a variety of shareholding reforms, were transformed into a more diversified structure across the sector. From being purely state-owned, the large SOEs now include non-state investors (with partial ownership) through joint ventures, joint partnership, joint business operations, or public listing.

Based on the nature of assets, state-owned assets can be classified into three categories: i) Productive state-owned assets; ii) administrative public institutions and iii) resource assets and other equity assets (Sheng & Zhao, 2013: 35). “Productive state-owned assets” refer to the capital and equities in enterprises in which the Chinese state has invested. This can be further classified into state-owned assets of non-financial enterprises such as assets of state-owned industrial and commercial enterprises, state-owned assets of financial enterprises which include the assets of the banking sector, insurance, funds etc., and state-owned assets of public institutions. After the joint stock reforms of 2003, the majority of state-owned financial assets are held by Ministry of Finance and China Huijin Investment Ltd. which is a state-owned investment company that invests in the public equity markets of China (Sheng & Zhao, 2013: 43). The productive category has more of Commercially-oriented SOEs which aim to increase their market value and become profit-seeking in their operations. State-owned assets belonging to “administrative public institutions” refer to the non-profit and non-productive assets belonging to the public institutions in China. The category which primarily focuses on ensuring social responsibilities and providing public products and services also includes property owned by the army, hospitals, research institute, educational institutions and other public and social welfare organisations. “Resource assets” are the land, mineral resources, natural resources owned by the state. Based on their operations, state owned companies can further be divided into local SOEs (owned by the local government), central SOEs (owned by SASAC representing central government), public SOEs (owned by public institutions) and others (owned by the state but unclassifiable).

ii) Classification by Supervision and Administration

SOEs administered by SASAC, operate at two levels; one at the central level and other at the local level. In 2004, under the guidance of SASAC, China's central SOEs were gradually relieved from fulfilling social responsibilities and other ancillary operations, which then became the exclusive domain of public SOEs (Wang, 2004). *Yangqi* is further officially divided into two groups based on their strategic importance and size (Leutert, 2016: 87). The first is a core group of strategic firms known as "important backbone state-owned enterprises" (*zhongyao guban guoyou qiye*). This group includes many of China's largest and best-known companies, such as Shenhua, Sinopec, Baosteel Group, China Telecom, State Grid and Bank of China. They are considered strategic by the Chinese government for providing political, social, economic stability and also due to their significance in foreign relations (Xu, 2012: 2). The second group comprises a varied mix of global industry players such as Sinosteel, lesser-known companies like the China National Salt Industry Corporation, state-run research institutes like the General Research Institute for Nonferrous Metals, as well as science and technology enterprises. Science and technology enterprises were initially part of the scientific research institutes affiliated to ministries in the pre-reform period. These two groups of *yangqi* are also differentiated by their administrative ranks. The first category of strategic firms is ranked at the vice-ministerial level (*fubuji*), equivalent to political elites of the same administrative rank (for example, vice provincial party secretaries or governors) (Leutert, 2016: 87). The remaining centrally owned firms belong to the department-level (*zhengtingji*) rank. On the basis of these ranks, the managers and executives of the firms enjoy privileges, both monetary as well as political¹ and can also leverage certain benefits for the firms. Although SASAC claims that these administrative ranks are in no way related to the management of central SOEs, however, in reality, they are critical to determining the influence of the firms in the society.

At the local level, the regulatory scope of SASAC varies on SOEs, depending on the region and they are not directly linked to the central government. A number of provinces, for example, Shanghai, Guangzhou, and Chongqing have brought financial state-owned assets fully under the scope of municipal SASACs (Miura, 2015). The Article mentioning the local level administration of SOEs in the *Law of the People's Republic of China on the State-Owned Assets*

¹ These political privileges include access to documents, both classified and declassified ones, invitations to high level meetings, and the opportunity to participate in study groups and further training at the Central Party School of the CCP.

of Enterprises, prescribe: “The State Council and the local people’s governments may, when necessary, authorize other departments or bodies to perform the investor’s functions for state-invested enterprises on behalf of the corresponding people’s government” (NPC, 2008: Order 5) Following this, many local offices exercise investors’ rights along with local SASACs.

iii) Role of SASAC

SASAC, established in 2003, came into being as a major formal institution to govern the government ownership as well as to guide SOE reforms. Upon its creation, Li Rongrong, a minister in charge of the State- SASAC of China's State Council, announced five measures that SAASC would take to promote the restructuring and reorganization of the China’s SOEs (<http://en.people.cn>, 2003). Since 1998, most of China’s ministries dealing with industries were abolished or downgraded, and the past efforts to establish an Asset Management Agency, subordinate to the Ministry of Finance, had conspicuously failed. SASAC therefore marked a major shift from fragmented to concentrated regulatory power. The new asset management system was created by the charter, *Interim Regulations on the Management of Enterprise State-owned Assets*” (Xinhua, 2003). The regulations established the equal authority of the State Council as well as to the provincial level government, dealing with SOE reform. SASAC operating at the central level was established in the Interim Regulations as a special administrative unit (*shiye danwei*), which is directly under the authority of the State Council, and at the provinces, the local governments were asked to establish their own directly subordinate special administrative units (Article 12). These agencies are diverse in their scope and functions as compared to central- SASAC and a variety of ad hoc arrangements characterise its decision-making. Thus, Article 7 of the Regulation clearly demarcated the functions of SASAC dealing with central and local governmental ownership. Following this, central SASAC published a list of 196 specifically named centrally-run SOEs over which it exercises direct ownership (Naughton, 2006: 3). This list was reduced to 169 through consolidation and merger by 2005, limiting SASAC’s authority. To reduce the number of central SOEs further, SASAC in 2006 issued some guiding opinions on SOE capital investments, mergers, and acquisitions, according to which if central SOEs did not rank among the top three of their industry, they would be merged and acquired.

Central SASAC in 2003 accounted for 17 percent of all state-enterprise workers and 43 percent of industrial assets. SASAC is also in charge of ownership of all three national telecom providers. Some of the other strategic sectors under central SASAC's control were petroleum and refining, metallurgy, electricity, and military industry. These five sectors accounted for two-thirds of central SASAC's workers and three-quarters of the value of its assets (Naughton, 2006: 4). SASACs are also empowered to make appointments at the central government and local government levels, such that they can appoint SOE managers and members of the Board of Directors as laid down in Article 13 of the Provisional Regulations. However, in reality, it is the party which makes the key appointments to retain its supreme control over strategic SOEs. For example, the top manager and chairman of the Board in a central SOE are appointed by the Communist Central Committee Organization Bureau. SASAC also plays a very important role in defining the scope of permissible incentive mechanisms. To increase the efficiency among SOEs, SASAC has induced effective incentive mechanisms and at the same time defined its limits to prevent asset-stripping. In its efforts to corporatize SOEs, SASAC also encourages professionalism into the SOE management process by introducing competition for managerial posts, based on international standards. However, these initiatives often face challenges from the CCP, as it is the ultimate decision maker in any high-level appointments. In Naughton's words, "SASAC's mandate is to "own" these corporations and to manage them in the public interest. SASAC is thus ally and adversary of the central enterprises. SASAC is the ally of these large public corporations in that it seeks to improve their managerial competence and technical capability and increase the value of the state-owned assets.....In a politicized environment, that makes SASAC the adversary of today's entrenched managers and their politician allies" (2008: 8).

Analysts with the SASAC have tried to defend SOEs from time to time. Most of the criticism directed at them is based on their performance and the benefit they enjoy due to excessive state protection. In support of SOEs, they argue that SOEs have played a huge role in raising China's global competitiveness. In 2007, SASAC director Li Rongrong identified the development of 30-50 globally competitive companies as the "clear goal" for central SOE reform. Shao Ning, deputy director of the SASAC, said: "China needs its SOEs, as well as other types of ownership, to compete internationally". He further added, "SOEs play a leading role in advancing

technological innovation and help support industrial competitiveness” (China Daily, 2012). Another popular analyst Cheng Enfu, with the Chinese Academy of Social Sciences, said: “private ownership does not mean high-efficiency”. According to Cheng, large SOEs are better placed to stand up against the economic downturn than their smaller private counterparts. He added that the exit of SOEs could be riskier for China to compete globally (ibid).

2.3 THEORETICAL APPROACHES AND KEY CONCEPTS

The state-ownership and monopoly of state power by the Communist Party were widely regarded as major barriers to carrying out economic reforms in state socialist economies. In the Communist China, any reform process involves integrating various aspects of political, economic and social life into a single gigantic bureaucratic hierarchy, to what Whyte referred to as “structural bureaucratization” (Parish & Whyte, 1978). SOEs form the major corner stone of this hierarchy, and this has led to the total dependence of organisations on the Chinese party-state. In the pre-reform period in China, on the basis of public ownership, the whole economy was integrated into an all-encompassing organisational network, controlled by the central authority through a chain of command centres located at various levels of the Chinese government. In the aftermath of liberalisation, when a series of SOE reform was announced in China, the evolution of SOEs was often interrupted by government regulation and distorted by institutional barriers. For example, public sector firms in transitional economies, such as China, are subject to both market forces and institutional legacies from the planned economy. Thus, while theorizing the process of industry evolution in the face of institutional changes, the institutional theory in the political economy provides a better analytical framework to explain the factors underpinning change and continuity in SOE reform policies.

There is an extensive body of theoretical literature that attempts to explain the process of SOE reform in China. The first type of explanation which became popular during the early years of reform in China drew from the debate between plan and market. This debate which gained currency in the 1970s is based on the writings of Oscar Lange, Friedrich Hayek, and Ludwig Mises. The theoretical arguments that developed from these writings can be divided into two lines of thought. The first is called “incremental change thesis” which assumes that bureaucratic

allocation and the market allocation co-exist in state socialism and that they are related in a zero-sum fashion. In the context of SOEs reform in China, the incremental change thesis was used in the scholarship to explain how the market forces replaced the central planning, such that the reduced scope of governmental activities led to an increasing market influence. Scholars like Byrd, advocating market socialism concludes that “China is well on its way toward becoming an economy where the allocation of goods is determined primarily by the market, rather than directive plans and administrative controls” (Byrd, 1987; 295). The underlying logic of his argument is that the market has a dynamic of its own and can help transform the existing system in a piecemeal fashion. These changes occurring in a gradualist manner creates pressure on the organisation which tries its best to maintain its status-quo. Lieberthal and Oksenberg, arguing in similar lines, point out: “Incremental reform by its very nature means that the economy will not be transformed at one step into a market system. Nevertheless, leaders can use a growing role for the market as a source of pressure for ever greater reform...Internal markets by themselves are not sufficient to ensure the continuing spread of domestic economic reform, but to the extent, they can be created by fiat, they can under the right conditions contribute the energy sustaining incremental reform” (Lieberthal & Oksenberg, 1988; 415).

In contrary to the incremental change thesis, the threshold thesis downplays the significance of market in state socialist economies and raises doubt on the nature of change that partial economic reform can bring about. Scholars belonging to this school of thought argue that bureaucratic allocation has an inner logic of self-sustenance and, as long as it remains the dominant method of economic integration, it will be difficult for market mechanism to allocate resources or coordinate economic activities (Brus & Laski, 1989: 85; Nove, 1980:138). Summarising the threshold thesis logic, Kornai argues: “The market and bureaucracy are not a gin and tonic that can be mixed in any proportion wanted. There may be a certain level of bureaucratic market restrictions which still allows breath for the market. But beyond a critical limit, bureaucratic restriction cools down the live forces of the market, kills them-and only the appearance of a market remains. And there exists a combination of market and bureaucracy which unites, as it were, only the disadvantages of the two, while the separately existing advantages of both are lost” (Kornai, 1990: 14). Although there is some consensus among the scholars of this school who believe that a viable market mechanism is possible when the

boundary between the state and the economy is drastically redrawn to restructure property institutions and give SOEs real autonomy in decision-making, but they differ in relation to the “threshold of such fundamental change”. Kornai sees a “minimal state” as the critical point, whereas Nove contends that an institutional framework like that of welfare state capitalism would suffice to accommodate a viable market (ibid).

The research along the above theoretical lines have generated some empirical findings which form an important factual base for undertaking a comparative study of various aspects of economic change in state socialist countries. However, neither of these theses seems to be a very useful analytical tool in explaining the course of SOE reform in China. The proponents of the incremental change thesis consider market to have an increasingly significant impact on economic activities such that the patterns and outcomes of firms' behaviour tend to converge to those predicted by models developed according to conditions of the ideal type market. Disputing such claims, the proponents of threshold thesis contend that the impact of market forces on SOEs' decision-making is insignificant and, the emergence of such market like institutions will happen within the framework of bureaucratic intervention. Although studies along both lines have offered many sharp observations of economic change in reforming SOEs in state socialist countries, their interpretations often fall a victim to the one-dimensional typological map resulting in shaky or erroneous conclusions. Thus, to avoid stepping into similar pitfalls, there is a need to develop analytical models that discard the conceptual frame fitted solely to an invariable image of the market and treat the market as one of many types of social relations that have varying effects on and responses to organizational behaviour under different structural conditions. Another key point from which this theoretical framework suffers from is this oversimplified notion of bureaucratic allocation, which does not make room for changes in the organizational structure of the state to stand out as an important independent variable for the analysis of state-market relations, and fail to identify the incentives for various forces from within and without to make use of the party-state apparatus to advance their agendas through accesses and avenues opened by structural changes.

The second type of explanation for China's SOE reforms is based on the “Decentralization theory”, which argues that China's decentralized structures of government and public finance in

the liberalization era, played an important role in the SOE reforms, corporatization of SOEs, emergence of private economy, privatization and China's economic growth (Qian and Weingast 1996; Montinola, Qian, and Weingast, 1995; Qian and Roland, 1998; Chen & Ping 1993; Xu and Zhuang, 1998). Scholars arguing in this vein, view political decentralization as a tool that encourages local reform. In other words, political decentralization encourages economic experiments at the local level and also allows new reform ideas to emerge from the grassroots level. Decentralization also acts as a credible political constraint on the central authorities, infusing confidence among the investors (both private and foreign) that reforms would generate real changes in policies. In the context of SOE reforms, Cao, Qian, and Weingast (1999) argue that "privatization, Chinese style, rests on an adequate economic and political foundation - federalism, Chinese style". Qian and Xu (1993) suggest that, unlike the unitary hierarchal structure, the Chinese hierarchy has followed a multi-layer-multi-regional form mainly based on a territorial principle, which in their view "provided flexibility and opportunities for carrying out regional experiments, the rise of non-state enterprises, and the emergence of markets". Many of China's major reform efforts had begun as a pilot project, i.e. on an experimental basis in a few local areas. After its successful implementation, those initiatives were adopted in a gradualist manner on a moderate scale by a few provinces, following which if these experiments succeeded, they were recommended and promoted by the central government as a national policy. In this process of adoption, local governments in China often adapt these initiatives to their local conditions and sometimes giving ideas for new ones with better specification. In this way, local governments not only act as a business corporation but also as officials who are equivalent to the board of directors. This merging of state and economy in China leads to a new form of institutional development, popularly characterized as "local state corporatism".

Hayek (1945) examines the Chinese experience of decentralizing SOEs, by focusing on the role of local information. Based on empirical research, he argues that it is more efficient for a "central government with a greater distance from the SOE to decentralize the control rights to a lower government closer to the SOE". Moreover, with greater local inputs, the same distance results in a stronger tendency to decentralize in order to utilize local information. Additionally, when the communication costs are lower, the central government finds it less difficult to gather information about the SOEs, and the similar distance may lead to a weaker tendency to

decentralize (Bloom et al., 2014). However, according to Hayek's view, decentralization of SOEs is not compulsory in reform. In fact SOEs may be centralized for putting top-notch experts in sophisticated or strategic SOEs that specialize in dealing with complex problems (Garicano, 2000). Hence decentralization theory empowers the local governments in China, by granting them more autonomy and encouraging them to innovate practices. The decentralization theory, however, has its limitations. It emphasises more on the role of local governments and ignores the central-local tensions and the integrative mechanism which binds the state and market together in China.

Some scholars have couched theoretical explanation for SOEs reform in China's disadvantageous pre-reform conditions, such as the Maoist legacy, shortage of arable land, educational deficiencies, lack of scientific and technical expertise, low levels of per capita income, industrialization and urbanization, and a weak planning apparatus (Jefferson and Rawski 1994; Naughton 1994; Nolan and Ash 1995; Sachs et al. 1994). In their opinion, these conditions distinguished China's transition from the experiences in Eastern Europe and the Soviet Union, where there was over industrialization and over-urbanization, resulting in shock-therapy. However, these studies do not explain the sociopolitical process of the reform, the role of actors and the power relationship in the newly created institutions. The explanation developed by China's economists for SOEs reform is the 'modern enterprise theory'. According to Qian Yingyi's view, "enterprise theory" focuses on the following key aspects: the nature and limits of enterprises, the organisational structures, the capital structures and the separation of ownership from the control of enterprises (Qian, 1993). Scholars like Justin Yifu Lin and others point to the importance of information symmetry between the owners and managers in SOEs and how the issue of communication often leads to opportunistic conduct by the SOE managers, affecting the SOE performance (Lin et al., 1997). The principal agent theory is another explanation which tends to characterise corporate governance in Chinese SOEs. It refers to a dual principal agent relationship: between the government and the SASAC and between the SASAC and the SOE executives. A principal-agent model, according to Moe's classic definition is "an analytic expression of the agency relationship, in which one party, the principal, considers entering into a contractual agreement with another, the agent, in the expectation that the agent will subsequently choose actions that produce outcomes desired by the principal" (Moe, 1984: 756). The reform of

Chinese SOEs led to the appointment of professional managers in SOE firms which gave rise to a new principal-agent problem within the SOEs. Due to their access to superior information regarding the corporation's affairs, SOE managers pursue personal benefits at investors' expense which lead to a conflict of interests between the SASAC and SOE managers.

i) Institutional Theories

There has been a renewed interest in the study of institutions both in economics as well as in political economy scholarship. Institutional theories aim to explain why institutions exist, their roles and functions, their evolutionary path and most importantly, the process of decision making within them. The first of the major approaches to institutional analysis is the normative approach advocated by March and Olsen (1984; 1989; 1996) arguing that individuals are always parts of greater institutional frameworks and they behave according to institutional rules and prescriptions. They argue that the best way to understand political behaviour is through a “logic of appropriateness²” that individuals acquire through their membership in institutions. This also forms the underlying logic of rational choice institutionalism, where the members of the institutions behave in response to those basic components of the institutional structure. They contrast this normative logic with the “logic of consequentiality” that is central to rational choice theories. However, the preferences of individuals, who are also members of the institutions, are not shaped by normative standards of the institutions, rather the occupants who interact with the institutions have their own well-ordered sets of preferences that remain largely unchanged and institutions play a role of vehicles to convey them. This argument has been further extended by scholars in politics (March & Olsen, 1989; 1994; Brunsson & Olsen, 1993; Olsen & Peters, 1996) and economics (North, 1990; Alston, Eggerston & North, 1996; Khalil, 1995).

To explain the role of culture, norms, beliefs as institutional forces shaping the organisational practices (which the early theories of institution largely ignored), the neo-institutional arguments were first formulated by John Meyer, Brian Rowan in 1977, Richard Scott in 1983, and by Lynne Zucker in 1977. Early neo-institutionalist studies have focussed on the

² The logic of appropriateness is a perspective that sees human action as driven by rules of appropriate or exemplary behaviour, organized into institutions.

agency versus structure debate by suggesting that patterns of behaviour and action were shaped by powerful agents within institutions rather than only by instrumental calculations (DiMaggio and Powell, 1983; Meyer and Rowan, 1991). These studies emphasized the role of agents in institutions and their power in constraining and enabling certain organizational structures and practices, and thus explained the convergence of organizational action within the same institutional environment. DiMaggio and Powell (1983 & 1991) highlighted three isomorphic processes such as “coercive, normative, and mimetic” backing institutional reproduction. They drew on Bourdieu’s conception of the field, elaborated by Bourdieu and Wacquant in 1992, emphasizing on the agential and cultural aspects of membership. For Bourdieu, fields denote the structured spaces that are organized around specific types of capital or combinations of capital, by connecting the social structure with cultural practice. They view “organizational field” as a community of disparate organizations, including producers, consumers, overseers, and advisors, that engage in common activities, subject to similar reputational and regulatory pressures. Adding to this definition, Hoffman (1999) argued “field is formed around the issues that become important to the interests and objectives of a specific collective of organizations” and that “as the field evolves, so does that range of options”. Scott (1995) describes institutional evolution as transitions among three levels, regulative, normative and cognitive. Regulative elements emphasize setting of rules and sanctions, which guide organisational actions. Normative elements of institutions refer to obligatory dimensions or professionalization, while cognitive factors involve symbols as well as cultural rules and frameworks which form the cultural basis of legitimacy, which is not questioned. Thus, each of Scott’s pillars offered a different rationale for legitimacy, either by coercion or means of legal sanction, moral obligation, or through cultural construction. While Scott argues that co-evolution or interaction between these institutional pillars may not be expected, Hirsh & Lounsbury (1997) counters this view by adding that while one pillar may be dominant at any given time, the three levels co-exist and are inter-connected. Thus, these interactions at levels of analysis prescribe the appropriate organisational arrangements, or to put it simply, as Battilana, Leca and Boxenbaum (2009: 65) understand the field as “shared understanding of the goals to be pursued and how they are to be pursued.”

One enduring criticism of neo-institutional theory has been its failure to adequately address the concept of change (DiMaggio, 1988; Brint & Karabel, 1991; Hirsch & Lounsbury, 1997). Some

of the major drivers and sources of institutional change include socio-political pressure, role by actors, technological innovation, and the legitimacy crisis. Institutional change possesses both direction and magnitude. To this view, Greenwood and Hinings (1996: 1024) argues “radical (divergent) change at the level of the organization – such as the incorporation of ideas and practices of sustainability - is unlikely without an accompanying change at the level of the organizational field”. They further add “change, in this sense is about the relationship between the organization and the organizational field” (ibid). Colomy (1998) views organizational change as linear and incremental, involving a process of delegitimization and the construction of new institutions. Clemens and Cook (1999: 442-446), argue that institutions can be destabilised by disaggregating its schemas and resources, and that institutional durability is a function of the extent to which they are inculcated in political actors at the individual or organizational level, and the extent to which they thereby tie up material resources and networks. Mahoney and Thelen (2010) offer a perspective on gradual institutional transformation, how smaller internal shifts can cumulate into substantial institutional change (see also Streeck and Thelen, 2005: 9). This change is shaped by a number of gradual, subtle and self-reinforcing transformations and not by radical fractures. On the basis of their empirical research, they have forwarded five types of gradual change (Streek & Thelen, 2005: 18-33; Mahoney and Thelen, 2010: 15-17): displacement (where new and alternative institutional arrangements replace existing rules), layering (where new rules are added to old ones through amendments), drift (decreasing importance of the established institutions due to lack of adaptability to changes but the rules stay the same), conversion (rules stay the same, and modification of arrangements take place) and exhaustion (characterized by the gradual collapse and failure of the institution).

Thus, discussions of the institutionalization, delegitimization, relationship between actions, meanings and actors, and cultural factors, help in understanding the gradual transition from planned economic institution to market institution in socialist economies. The complexity of institutional and sociopolitical systems in developing economies has been recently pointed out by Hausmann, Rodrik, and Velasco (2000, 2005 & 2006). Hausmann argues that standard measures of defining institutions cannot amply capture the developments in the transitional economy. A similar point is made by Rodrik (2007, 2008) who underline the variety of political choice and of institutional forms in developing economies. The framework focuses on the economic constraints

to growth and development in developing countries. Talking about institutional variations among different political systems, Djankov et al. (2002: 19) argues that institutional diversity “can in part be understood in terms of the fundamental trade-off between controlling dictatorship and avoiding disorder”. They further claim that institutional reforms in any country “should be evaluated relative to its own institutional opportunities, rather than some idealized benchmark (...)” (Djankov et al., 2002:19).

ii) Core Concept

The key theoretical concepts for the study have been drawn from North (1990, 2005). He offers the following definition: “Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction” (North, 1990: 3). In his view, institutions can be both formal and informal rules, capable of limiting choices made by human beings. Talking about economic reforms, economic institutions influence the structure of incentives of key economic actors in society; in particular, they influence investments in physical and human capital and technology and the organization of production. However, economic institutions in a society are endogenous and there is an inherent conflict among the groups and individuals about the set of economic preferences. Since there is no consensus about the economic preferences in economic institutions, political power becomes the ultimate arbiter. It is the political power that determines economic institutions, manages the distribution of resources and therefore directly or indirectly influences economic institutions. Talking about political institutions, which are similar to economic institutions, they also determine the constraints and the incentives of the key actors in the political sphere.

Thus, political institutions and the distribution of resources which are the two key variables in this dynamic system and also forms the major focus of this study change relatively slowly, and more importantly, they determine economic institutions and economic performance both directly and indirectly. In authoritarian societies, it is political institutions which directly affect the choice of economic institutions. This framework, therefore, introduces a natural concept of a hierarchy of institutions, with political institutions influencing economic institutions, and thereby determining economic outcomes. The political institutions further create a tendency to hold onto

power and this tendency to retain influence, affects the evolution of both economic as well as political institutions. This has been the case in China, where even in the post-reform period; the Chinese party-state manages to retain control of the economy through SOEs.

In the context of Least Developing Countries (LDCs,) North (1990: 9) argues that the set of opportunities is a mixed bag of incentives (towards increasing productivity activities and towards decreasing ones), but they favour activities that promote redistributive rather than productive activity, that creates monopolies and restrict opportunities. In transitional economies and in LDCs, institutions, in his view are more of political arrangements, and may or may not produce an efficient outcome. Bardhan (2001 & 2005), offers that one of the reasons is the uneven distribution of economic resources and that collective action is not necessarily organized or even possible, enabling the suboptimal institutions to function despite their negative impacts on the society. Extending the argument further, North (1981), argues that the political elites often opt for economic references which suit them best, sometimes at the expense of society. The unevenness between the actors in terms of economic wealth, preferences, and political powers is at the root of these conflicts and constrains the coordination between institutions in a society. In the context of China, it's the central government and its institutions which directly influence the SOEs and its evolution in the liberalisation years. Through SOEs, the Chinese party-state tries to maintain its control as well as the distribution of resources. Empirical evidence in the following chapters will show how the interests of the political elites often prevail over the interests of SOEs and directly affect the economic outcomes.

Despite its role often overlooked by neo-institutionalism, the state and its strategy are necessarily a key organization which is not readily prone to change (Rodrik et al., 2003; Rodrik, 2008). North does not put much emphasis on his definition of the institution. In his view, the state is an “organization, constrained by political institutions and producing economic institutions”. As a consequence, the new institutionalists never focus on it as an actor despite its obvious potential influence on the economy through laws and institutions, and through policies and incentives. Rodrik (2003) has offered three institutions such as property rights, judiciary, and bureaucratic capacity, as key to sustaining economic growth. In the context of China, Rodrik (2004) argues that it took a very different approach to reform, experimental in nature and relied on a series of

institutional innovations reflecting Chinese political, cultural and historical characteristics, and that departed significantly from Western norms. For example, China did not even adopt a private property rights regime and its adoption of a market system was planned within the command economy structure. Instead of privatizing land and other assets, the Chinese government implemented institutional arrangements such as the Household Responsibility System and Township and Village Enterprises (TVEs). In the words of Lau, Qian, and Roland (2000), this was “an ingenious system that generated efficiency without creating any losers”. Thus, the Chinese experience represents the functioning of unorthodox institutions which produce orthodox results, with the Chinese state guaranteeing stability to the society.

2.4 ISSUES & DEBATES

The intention of this section is to capture the debates on major aspects of SOEs reform in China through a survey of the existing literature to the extent based on which a suitable research design is formulated in the next chapter. Several studies on the Chinese SOEs reform, its economic policies in general and industrial policies, in particular, are available. A preliminary survey of literature on the Chinese SOEs reform, especially on the question of continuity and change can be categorised into two broad sets of opinions: the group of pessimists who sees a negative correlation between the performance of SOEs and role played by the state during the reform era; the group of optimists who conclude that the reform policies by the Chinese state has led to increased efficiency, better performance, and profitability of the state owned enterprises. However these two categories of writings can be subjected to further classification; one who views that that the intervention by the Chinese state remains strong even after years of reform and the other who talks about a qualitative change in SOEs brought about by the reform, especially diminishing state intervention.

Optimists: Hassard, Morris, Sheehan and Xiao (2010) along with other scholars have extended five set of arguments, based on their extensive research of SOEs in China: first, the decline of the SOEs has been a relative one: between 1980 and 1995, for example, levels of output and employment in SOEs actually increased, albeit slightly (State Statistical Bureau, 2000). Unlike earlier experiences of SOEs reform, Hassard (2010) views that the state patronage in SOE

business affairs has been progressively fading since the third phase of SOEs reform beginning in 1994. In the process, the central government has made SOEs far more accountable for their profits and losses, with access to “soft” (below market rate) capital being far more restricted. Second, while a large proportion of SOEs are loss making, they are not necessarily inefficient, and many are both profit making and efficient (Cooke, 2008). Third, the economic reform process within the non-SOE segment in China could not have proceeded without SOEs, particularly as many non-SOEs depend on the SOEs for business ties and subcontracting relations (Hassard et al., 2007). Fourth, a large percentage of foreign investment activity has been conducted through joint venture activity with SOEs (Fishman, 2005; Cooke, 2008). And finally, SOEs have been the buttress of much tax revenue and social welfare provision in China (Hassard et al., 2007).

SOEs also changed qualitatively, from being units in a command economy tasked with meeting quantitative targets and providing comprehensive services to their employees, to being (in the 1980s and early 1990s) enterprises responding to the price signals of a market economy but retaining the basic SOE organisational form and enjoying easy access to bank credit, to their most recent incarnation as corporations, often with some private shareholders, facing at least a somewhat more disciplined banking system and, for many of the largest among them, an active stock market (Li & Putterman, 2008). Chen et al. (2006) study data from all 1,078 enterprises that issued tradable shares in the period from 1991 to 2000, firms with a dominant private owner saw less, and less significant, declines in profitability. Moreover, Wei et al. (2003) compare share issuers to ordinary SOEs in the 1990–1997 period and find that firms that became listed recorded significant improvements in profitability and other performance indicators relative to those that did not. Estimates of the overall performance of the state and state-dominated sector of Chinese industry tell a story of continuing progress in recent years. Jefferson et al. (2008) estimate the combined productivity of labour and capital (multifactor productivity) in various Chinese industrial sectors during 1998–2005 using factor weights derived from production function estimates. Jefferson and Rawski (1995) discussed industrial reform in China and attributed its success to market institutional change, gradual relaxation of state ownership and control, and development of private property rights. The institutional change provided proper

incentives and changes in corporate culture that enabled firms, even state-owned ones, to make improvements.

Fan et al. (2007) investigate whether enterprises managed by CEOs with strong ties to Chinese government officials behave differently from those whose CEOs lack such ties. They find that having a CEO with political connections is a significant predictor that performance will worsen after the issuing of shares. China's industrial reforms yield varied results on details, they are generally in agreement that restructuring as partially or wholly private firms have led to improvements in factor productivity, profitability, or both. As the SOEs in China face increasing pressure from the new form and sources of competition, the pressure to perform has increased. The new generations of SOE managers are more capable of taking "calculated risk". They have greater autonomy and are therefore responsive to market demands than to policy makers. While the political pressure has lightened, it has by no means disappeared completely (Li & Atuahene-Gima, 2001; Tan, 2001). However, as the reform intensifies in depth and magnitude, SOEs have found themselves being thrown into the water of relentless competition from various non-state enterprises ranging from TVEs, privately owned start ups to foreign invested firms (Boisot and Child, 1999; Luo and Peng, 1999; Park and Luo, 2001; Yan and Gray, 1994). Granick (1990) has shown evidence that the SOEs supervised by the central government have softer budget constraints than the other SOEs.

Pessimists: Turning to shareholder identity, most of the relevant studies point toward either no relationship or a negative relationship between the proportions of shares owned by the state and enterprise performance or share value measures. Xu and Wang (1999), studying all companies listed on the Shanghai and Shenzhen exchanges during 1993–1995, found either a negative correlation or no correlation between profitability and the proportion of state shares, and a negative relationship between labour productivity and that fraction. Sun and Tong (2003) find no significant relationship between the state's share and profitability, while Sun et al. (2002), using data for the 1994–1997 period, obtain the only definitely contrary result, finding an inverted U-shaped relationship between the state share and performance, with a positive sign on state share in a linear specification. Sun and Tong (2003), Xu and Wang (1999), Qi et al. (2000), and Sun et

al. (2002) all find that the higher the proportion of shares owned by legal persons, the higher the profitability.

There are other surprising findings, such as Yusuf et al. (2006) fails to find significant performance differences between non-reformed SOEs and the domestic private and wholly foreign owned enterprises in their sample, despite their finding that joint venture enterprises performed significantly better than non-reformed SOEs. Wu Jinglian (2005) supports what other studies have shown that state ownership is consistently associated with the inefficiency compared to privately owned firms. More interesting, however, is the finding that among state firms, “the actual of restructuring efforts so far seems to be quite limited”. Restructured SOEs are more efficient, as one would expect, but the government has typically chosen healthier firms to restructure first, so when one strips out this effect, the restructuring itself doesn't seem to have any effect. He also laments the failure of the state owned companies to become truly independent entities and concludes that restructuring and reform policies of the SOEs remained only on paper than practice.

Once the mighty leviathans of the Chinese command economy, they have been depicted variously as “industrial dinosaurs”, “muscle-bound goons” or the “relics of a failed economic experiment” (Woetzel, 2008). SOEs have been characterized as possessing a lack of managerial flare, little concern for profit, low employee motivation and mobility, a tendency to maximize corporate size and as being ready for dismembering (Meyer et al., 2002). Commentators have described their dramatic decline – or even “death march” (Fishman, 2005) – in simple terms of a number of enterprises and contribution to Chinese industrial output (Tsui and Lau, 2002). This so-called “pessimistic” view argues that a significant proportion of the less “open” and less “transparent” SOEs pose a significant “problem” for the further development of market-based practices in the Chinese economy (Woetzel, 2008). In sum, the view traditionally expressed is that a significant percentage of SOEs are loss making, their managers lack real business acumen, and within them, significant enterprise reform is difficult to effect (Tsui and Lau, 2002).

The essence of this reform was an attempt to clarify and codify property rights and ownership as part of the wider transition away from the centrally planned economy (Byrd, 1991; Hay et al.,

1996; Chen, 1995; Hassard and Sheehan, 1997; Hassard et al., 2007). Despite self-proclaimed successes of the Contract Responsibility System (CRS) by SOEs (Chen, 1995; Hassard and Sheehan, 1997), the programme as a whole was deemed a failure for a number of reasons. First, it did not resolve the problems of government-management separation in that SOEs were still prone to government interference and control. Second, the SOEs under the CRS did not have “legal person” status and thus were not independent economic entities (none was, for example, responsible for financial losses). Third, bilateral negotiations led to disparities between contracts. Fourth, as every enterprise was expected to succeed under the CRS, inefficient enterprises were kept in operation by over-favourable contract terms. And finally, the CRS fostered a short-term profitability chase and thus, it is argued, longer term organizational instability (Lui, 1987; Chen, 1995; Lee, 1996; Hassard and Sheehan, 1997; Hassard et al., 2006a, b, 2007).

Child and Lu (1996) argued that the economic reform of large state-owned enterprises was moving very slowly because of material, relational, and cultural constraints. At the individual level, Lau (1998) suggested that political and market pressures were the institutional constraints faced by chief executives in Chinese enterprises. It was noted that chief executives of state owned enterprises had to be careful not to be too successful; for fear that bureaucrats would replace them to gain access to their resources. Woo (1994) shows that state ownership is associated with lower productivity growth. With aggregated (sector level) data, Brandt and Zhu (1997) compares the behavior of the state and non-state sectors and attributes the state sector’s excessive demand for capital and weak performance to the presence of soft budget constraints in the state sector. Kornai (1998) hypothesized that the protection received by the SOEs may reduce their sensitivity to market prices and production costs. As a result of which, the impact of competition on their performance may be severely weakened.

Some studies have shed light on the organisational change within SOEs in China (Campbell & Plasschaert & Brown, 1991; Child, 1994; Cooper & Zheng, 1998; Pan & Parker, 1998; Nolan & Yeung, 2001). Although many western management practices have subsequently been introduced, the management model established in Chinese SOEs still differs from that of the West (Heller, 1999). For example, even though less intense than previously, “State paternalism remains a dominant feature of China’s business environment” (Child & Tse, 2001). The Chinese

government still influences the decision making the process of SOEs through its control of key resources and its power to appoint and dismiss managers (Groves et al., 1995; Martinsons, 1999). Moreover, it retains powers to change the rules of the business system and to differentiate its policies towards firms of different categories (Child and Tse, 2001). A key problem is that both the central government and local governments perform regulatory and participating roles and they are not always consistent with each other (Wälde, 1995). This has led to the reform process of SOEs being closely caught up with the conflicting objectives of different interests inside different levels of government.

Five important conclusions follow from the review of the literature. Almost all the literature on SOEs reform focuses on the governance structure, productivity, efficiency or organisational change of the SOEs and how they gradually exited from the downstream sectors in the 1990s (Groves, Hong, McMillan, & Naughton, 1994; Qian, 1996; Li, 1997; Lin, Cai, and Li, 1998). Most of the studies have assumed the state-society dichotomous relations and in the process have overlooked the dynamic interactions among state actors and social forces in China's marketisation. Besides, the existing literature focuses more on analysing the policy-making processes than on the policies themselves. Most authors discuss the Chinese economic policies in general and do not pay sufficient attention to the industrial policies of the state owned sector. Furthermore, the writings also lack the comparative aspects across the time periods to analyse the nature of reform in the Chinese SOEs. Thus, the absence of a comprehensive and comparative analysis makes the current study of the content and effects of the industrial policy leading to the reform of SOEs both necessary and worthwhile.

2.5 KEY GAPS AND FOCUS OF THE STUDY

The extant literature on China's SOE reform largely misses the initial locus of institutional change, the alliance of the actors and the interplay between the economic practice and the framing. In the political economy study of institutions, the analyses are mostly centered on the organizational leaders and employees as actors in the process of institutional change, while they treat policy makers as exogenous factors. Such analysis has limitations in explaining institutional change for transitional economies like China. Furthermore, the element of power is missing from the analysis. The scholarly discussion, therefore indicates that in order to secure a deeper

understanding of China's gradual transition or of reforms, there is a need to examine the transition of legitimacy: how the actors made sense of or legitimized the modern enterprise system in the face of market forces; what are the criteria of effectiveness and efficiency under new institutional logics; the roles played by firms' bureaucracy as well as political leadership; and what is the interplay between the theory, the economic practice and the actors. The study also takes into account the central concerns associated with decision-making in economic organizations, which are centered on three key issues: "what" (what is produced and how much), "how" (what organizational forms and arrangements are adopted) and "for whom" (how payoffs are distributed). Given the focus of the study on central SOEs, geographical and structural variations are left out of the picture. However, it emphasises on the linkages to the state-SOE relation and probes into the major political institutions to piece out a comprehensive picture of SOE reform by identifying key structural variables in state-economy relations and establishes clearer patterns of correlation.

CHAPTER 3 RESEARCH DESIGN AND METHODOLOGY

3.1 INTRODUCTION

The Literature Review discussed in the previous chapter has established more clearly the theoretical problem motivating the project, and highlighted the role of politics among various factors, as the key explanation for the continuity of SOEs reform policies in China in the years following economic liberalisation. It seeks to explain the real dynamics of China's SOEs reform and capture the policy changes and continuities, with special attention to the context, process and actors involved. The various sources and mechanisms for institutional change, as well as the key actors and other context-specific elements form the explanatory variables and primarily determine the change and continuity while assessing the outcomes of the reform. Through this approach, the main constraints and impetus underlying the SOEs transformation process in China is explored and how the intertwined forces of institutional mechanisms and economic liberalization explain the SOEs reform process is analysed. Using a sector wise case study, it also seeks to gain more insights into the reform process, corporatization of the SOEs, and the interactions between the market forces and party-state actors who direct the reform process and governance practices.

3.2 DESCRIPTION OF VARIABLES

The proposed study is motivated by a puzzle in China's SOEs reform: What explains the continuity in Chinese policies towards SOEs in the post liberalisation era? A large portion of the literature explaining China's SOEs reform attempts to identify the key variable in the transition, be it state, elite (political, economic, or intellectual), or local factors. It is, therefore, crucial to unpack the variables, operationalise them and establish the causal relationship between the different variables. Since SOEs reform is most complicated among other economic reforms in China, involving a myriad of contradictions, singling out one variable runs the risk of oversimplifying the whole picture. As argued by Hurmerinta-Peltomaki & Nummela (2006; 440), "if a narrow methodological approach were to be applied in this complex context, only a small slice of the reality would be revealed". There always remains the possibility of deducing

different conclusions because China is constantly changing, socially and economically, particularly at the policy level. This can be demonstrated through many policies, legal drafts, and pilot reforms. Drawing from the institutional approaches to political economy (Coase, 1992; Stiglitz, 2002; Hurwicz, 2008), the study seeks to explain the formation of a market economy in China, with a special focus on the nature of central government and its relationship with the major SOEs.

Any kind of transformation in transitional economies, particularly from a centralized to a market economy requires both institutional support and institutional change. The reform that begins with existing institutions is further initiated and implemented by agents within these existing institutions. Industrial organisations, such as centralised SOEs firms are the agents, in this study, who being agents of the state play the role of economic as well as political actors under the guidance of state-party leadership in China. They are political actors because they have been established as part of the state to pursue political objectives and they are also economic actors as they participate in the market economy and create conditions for profit and other economic development. There is a symbiotic relationship between organizations and institutions, culture, and ideology, all changing slowly during economic transition which greatly impacts the performance of these institutions (North, 1990). It sets out a clear demarcation between the independent and dependent variables. The dependent variable, for the study at hand, (explanandum) is the continuity or change in Chinese industrial policies pertaining to the reform of the SOEs. As far as the question of independent variables is concerned, there is a possibility that independent variables (explanans) exist at all levels of analysis starting from personalities to ideological and socio-cultural factors to the structure of international politics and economy. However, the organisational theory fails to capture the dynamics of institutional change, and given this methodological limitation, the study draws from the contingency approach to complement the institutional analyses. The contingency approach grants conceptual primacy to the central political actors, who in the case of China, make choices that potentially shape and determine the outcome of any reform (Rustow, 1970; Bratton & van de Walle, 1997). Chinese central political leadership, one of the independent variables of this study, is considered a crucial determinant for the economic transition. Extrapolating the arguments by Rustow (1970), O'Donnell and Schmitter (1986), Linz (1990), Burton and Higley (1987, 1989) who view the

choices, behaviours, and strategies of few powerful elites in any political system, as crucial to triggering any reform, economic or political, the study would also shed light on the structural and managerial choices within the SOE firms. Depending on the answer to the empirical puzzle, either of these two sets of dependent-independent variables shall be operational.

3.3 INSTITUTIONAL METHODOLOGY

The introduction of institutional research, qualitative, quantitative or mixed approach helps to analyse theoretical or empirical problems in the field of politics, economics, education and policy studies. Unlike the neo-classical approach where the issues are treated in isolation, institutional analyses treat these issues based on system performance and on stakeholder or interest group positions. Thus, methods and techniques grounded in institutional analysis are consistent and prove to be useful instruments in socioeconomic research as they cover a large range of practices varying from case study analyses to sophisticated institutional evaluation frameworks. The approach involving mixed methods, i.e., quantitative and qualitative aspects to study the effect of institutions is represented by laboratory and field experiments (Poteete et al., 2010).

In political economy studies, institutional arguments are not a combination of individual action, but an integration of factors that influence political processes and outcomes and tend to produce regular patterns or stasis. There are mainly three varieties of institutionalism; historical, sociological and political institutionalism. Historical institutionalism is a social science approach, not linked to any particular theoretical project. Historical institutionalists mainly focus on empirical puzzles which involve macro problems and deploy comparative historical, analytical and other varied research strategies to address them. Although institutions are at the centre of historical institutionalist explanations, different types of institutional structures may come up in the course of explanations. However, historical institutionalism has meta-theoretical strictures on the nature of causation (Schmitter, 1974; Polanyi, 1994; Katzenstein, 1978). Causation is presumed to be multiple, conjuncture, and reliant on time order. Historical monographs, mainly comparative in nature, containing one or two country cases are the general outcome of a historical institutional investigation and there are often overlaps with political institutionalists

due to an emphasis on political theorization. Although they do not identify with any particular theoretical framework, historical institutionalists are mainly situated in political science and constitute a less self-conscious academic grouping than the sociological institutionalists. They more or less agree on approach and method with sociological institutionalists but hardly on theoretical stance. Although many historical institutionalists rely on economic or social institutions in their theoretical arguments, they also tend to view political institutions as being “distinctive” and “influential” whereas sociological institutionalists are concerned with issues of power.

Sociological institutionalism is primarily a variant of organizational theory and essentially a cultural theory (Saurugger, 2017; Meyer & Rowan, 1977; Meyer & Scott, 1983). It treats states and political actors as organizations, and provides a broad cultural theoretical perspective on organizations and politics of it, with the theory emphasising on the diffusion of ideas and other cultural forms within organizations, as it attempts to reinforce its legitimacy. Sociological institutionalists generally tend to examine political behaviour and processes and explain similarities among institutional forms and policies by describing issues around the development of public policy as the “diffusion” of forms and policies, often through the intervening influence of organizations which are often international/ external agents. The research along this line mainly involves includes quantitative articles deploying event history or time series analyses of the diffusion of a policy form or innovation. Political institutionalism, on the other hand, is not a much discussed or well-researched school of institutionalism, and became popular since the 1980s, as primary explanations for the “state-centered” systems.

Like the neo-institutionalism in organizations, political institutionalism addresses power explicitly and emphasizes the causal role of political institutions on political outcomes and processes (Carnoy, 1984; Hall, 1986). Scholars working in this field initially relied on state structures and actors in their explanations in reaction to Marxist and Weberian accounts of politics. They viewed the state as an area and identified causal variables in politics to formal actors and managers and workers. The main focus of the political institutionalists is on the systemic and structural aspects of states, such as the political party systems and on the evolution

of organization in constructing causal arguments as these political institutions shape political identities, interests, and strategies of governments and political actors.

As already discussed, the study uses political institutionalism and employs relevant strategies for data collection and analysis. For example, analyses examining the level of institutionalization of a particular political structure could use survey research in which respondents were asked directly about the degree to which they perceived a given structure to be necessary for efficient organizational functioning (Rura and Miner, 1994), or use questionnaires that ask about attributes related with varying degree of institutionalization (Zucker, 1977). The institutional analysis suggests that identification of the determinants of changes and continuity within the institutional structures presents a significant area of theoretical and empirical work. Extant studies have already suggested a number of potential determinants at the institutional level, analysing them provide cues for theoretical or empirical problem. For example, a large amount of research has shown that when centrally linked organizations are innovators readily adapt to a given structure, that structure is more likely to become fully institutionalized than other structures (DiMaggio and Powell, 1983; Fligstein 1985; 1990; Baron et al., 1986; Davis, 1991).

Studying the determinants of institutionalization processes also involves comparative study on the development and spread of different structures. For example, this entails construction and comparison of several histories of structural formations that have been recently made the object of theorizing- SOE reforms, privatization, banking policies, telecommuting policies, and so forth. Comparing cases of this kind enables the researchers with important insights into whether there are any similarities in the processes through which adoption and diffusion of different types of structures occur. Institutional theories which apply the quantitative method and confine it to empirical “tests” are generally applied to contexts which are devoid of major actors and lacks incentive for organizations to adopt a given structure, either through legal means or through the withholding of critical resources. This approach is also applied to studies involving unconstrained adoption processes involving some coercive elements, as studied by Tolbert & Zucker (1983) in the adoption of civil service reform in states where it was not required by law (Tolbert & Zucker, 1983). Thus, for an institutional theory to develop as a coherent paradigm

and to make an enduring contribution to organizational analyses, the explanations for the institutionalization processes require both conceptual and empirical answers.

3.4 MULTIPLE CASE STUDIES DESIGN

Given the objective of the research, multiple case studies seem to be the most appropriate one. Although the method is extremely time-consuming, the evidence created from this type of study is considered robust and reliable. There are many definitions of case study and it is not easy to explain. In simple words, a case study can be understood as an intensive study of a person, a group of people or a unit, which tends to generalise over several units. Recognised as a tool in many social science studies, the role of case study method in research becomes more prominent when issues with regard to policy reform, education (Gulsecen & Kubat, 2006), social issues (Grassel & Schirmer, 2006; Onwuegbuzie & Turner, 2007), such as poverty, unemployment, illiteracy violence, etc. are discussed. Its primary significance and popularity lie in the fact that case study as a research method fills up the gap and the limitations of quantitative methods which fail to provide a holistic and in-depth explanations of the social and behavioural problems in question. The case study methods generate findings and provide explanations that are beyond quantitative statistical results and help the researcher to comprehend the behavioural conditions in an organisation through the actor's perspective. The case study may also include both quantitative and qualitative data while explaining both the process and outcome of a phenomenon through complete observation, reconstruction, and analysis of the cases under investigation (Tellis, 1997).

According to Yin (1984; 23), the case study research method can be defined as “an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.” Gall et al (1996: 545) defined case study research as “the in-depth study of instances of a phenomenon in its natural context and from the perspective of the participants involved in the phenomenon”. Stake (1995) uses three terms to describe case studies; intrinsic, instrumental, and collective. According to Stake, an intrinsic case study is conducted when the researcher has a unique situation in hand to describe. This simply means that with an

intrinsic interest in the subject, the results have limited transferability. However, when the objective at the outset is gain deeper insights and understanding of a particular situation or phenomenon, Stake, in that case, suggests use of an instrumental case study to conduct research. This author also uses the term “collective case study” when more than one case is being examined. Once the cases are determined and the boundaries placed on the case it is important to consider the additional components required for designing and implementing a rigorous case study.

As mentioned above, multiple case studies, in particular, enables the researcher to study multiple cases in order to understand the differences and the similarities between the cases (Baxter & Jack, 2008; Stake, 1995). Also, that the researcher is able to analyse the data both within each situation and across situations (Yin, 2003). Yin also argues that multiple case studies can be used to either augur contrasting results for expected reasons or generate similar results to bolster the primary argument in the studies (Yin, 2003). When the case studies are compared to each other the researcher also can provide the literature with an important influence from the contrasts and similarities (ibid). Through this, the author can distinguish between the significant and not so significant results and choose and pick from the findings (Eisenhardt, 1991). Thus, the evidence created from a multiple case study is measured strong and reliable (Baxter & Jack, 2008). These include: (a) propositions (which may or may not be present) (Yin, 2003, Miles & Huberman, 1994); (b) the application of a conceptual framework (Miles & Huberman, 1994); (c) development of the research questions (generally “how” and/or “why” questions); (d) the logic linking data to propositions; and (e) the criteria for interpreting findings (Yin, 2003). Elaborating on each of these components, propositions in any case study increases the likelihood that the scope of the study will remain within feasible limits. They guide the data collection and discussion and can be drawn from the literature, personal/professional experience, theories, and/or generalizations based on empirical data. Issues are similar to propositions but more contexts specific that guides the research.

One of the trademarks of case study research is the use of multiple data sources, a strategy which enhances data credibility (Patton, 1990; Yin, 2003). Case Studies combine a variety of data collection methods such as interviews, questionnaires, observation, archives but are not limited

to documentation, archival records, interviews, physical artifacts, direct observations, and participant-observation. Unlike other qualitative approaches, in case study research, data from these multiple sources are converged to generate a coherent and comprehensive analysis rather than treating the data in isolation. Eisenhardt (1991) emphasizes on the volume of the case study, which depends on how much new information the cases bring and how much is known. Dyer & Wilkins (1991), on the contrary, argues that the page length, the number of cases or the length of the researchers' stay in the field per se, is not that important and does not affect findings to a great extent. The important issue in their opinion is the ability of the researcher to describe and understand the context of the problem in question and able to adopt a particular theoretical framework that fits the context well and explains it properly. Further, Dyer & Wilkins explains that a single case study does not guarantee the generation of rich theoretical insights and in a similar way, it can be argued that multiple case studies approach may not necessarily produce this kind of insight. Each data source, in its capacity, contributes to the understanding of the whole phenomenon which further provides an explanation to the theoretical or empirical puzzle. While assimilating and analysing the data, it requires effectively organizing them in a database which makes the retrieval easy at a later date.

There are various types in which data can be analyzed. Yin briefly describes five techniques for analysis: pattern matching, linking data to propositions, explanation building, time-series analysis, logic models, and cross-case synthesis. One of the challenges associated with the analysis phase is that each data source might be treated independently and the findings reported separately which would defeat the very purpose of the multiple case studies. Rather, the researcher must ensure that the data are converged in an attempt to understand the overall case, not the various parts of the case, or the contributing factors that influence the case. Lastly, the reports prepared out of these case studies should be done in a comprehensive manner and dealt with the research question. Yin (2003) suggests six methods for reporting a case study. These include: linear, comparative, chronological, theory building, suspense, and un-sequenced. However, the basic foundation to achieve this rests on the following: (a) the case study research question is clearly written, propositions (if appropriate to the case study type) are provided, and the question is substantiated; (b) case study design is appropriate for the research question; (c) purposeful sampling strategies appropriate for case study have been applied; (d) data are

collected and managed systematically; and (e) the data are analyzed correctly (Russell, Gregory, Ploeg, DiCenso, & Guyatt, 2005). Thus, case study research is more than simply conducting research on a single individual or situation emphasizes detailed contextual analysis of a limited number of events or conditions and their relationships. Besides, providing an opportunity to gain insight into each case, it is also argued that the use of multiple cases yields more robustness to the conclusions from the study. The study is based on the following case projects:

Table 3.1 - Case Projects

Sr. No.	Case Firms
<u>Telecommunication Industry</u>	
1.	China Telecom
2.	China Unicom
<u>Banking Industry</u>	
3.	Bank of China
4.	China Construction Bank
5.	Industrial and Commercial Bank of China
6.	Agricultural Bank of China
<u>Oil Industry</u>	
7	China National Offshore Oil Corporation
8.	China National Petroleum Corporation
9.	China Petrochemical Corporation

3.5 DATA COLLECTION AND VALIDITY TESTING

The study at hand, therefore, follows a multiple case studies method, where data from SOEs in three major sectors in China's industries are analysed. The sectors are telecommunication industry, banking sector, and oil industry. As the source of evidence, the primary sources shall include white papers, policy documents, and annual reports of these firms, questionnaire survey, and interviews. The data on the leadership from the organizations and sectors to which they belong were collected through conduction of semi-structured interviews and administration of questionnaires to the managers/SASAC officials, the researcher's observations, documents related to China published by multilateral organizations such as the World Trade Organization,

the Organization for Economic Cooperation and Development; and China's five year plans, analyst reports, and other relevant published documents. Most of the data on SOEs are obtained from the China Statistical Yearbook, which contains extensive data on SOEs. An interview guide, as suggested by Patton (2002), was utilized to provide a framework for discussion and consistency in collecting data from each interviewee. Hence it makes epistemological sense that an deductive logic be followed in studying the text in the form of interviews, archives, and/or scenes while simultaneously reflecting on the researcher's own interpretations so as to get inside the perspective the text presents and develop an understanding how each component relates to the entirety in a specific political, economical, and socio-cultural context. The Chinese telecom industry, from an institutional perspective, presents a good example, where the researchers observation may not be what he/she gets, as institutional cues cannot be easily observed and explained and this appears to be the cornerstone for better knowing China's economy and politics in general and the telecom industry in particular. Hence, it is imperative to have an insider perspective on the issue. The sole reliance on secondary documents in a case study like this may not only be confusing but also lead to major methodological challenges. Accordingly, a research report based solely on methodological stereotype, while leaving the institutional analyses for the reader to draw up generalisations, may fail to serve the purpose of the research well. In other words, the methodology should be adaptable to accommodate China's unique circumstances. In this situation, the substance may matter more than the form when it comes to the ritual aspects of the methodology. In a politically closed society like China, domestic scholars, although ostensibly more informed, face disadvantages than an outside researcher. For example, in some situations, they simply can't report what they see or hear, and there is a wide discrepancy between their findings and analyses. Secondary data, in this case, involves archival documents, mainly in the form of government rules and documents, companies' disclosures, news reports, and scholarly publications.

The validity testing of primary data, mainly collected through interviews is as crucial as generating a research strategy. With reference to the interviews, the validity of the interviews remains a worry. Interviews are often vulnerable to misunderstandings, misconceptions and subjective contributions. Kvale points out one type of validity as pragmatic validity (Kvale, 1996). This type of validation of a subject's verbal statement is based on supporting action that

accompanies the statement. In this research, this approach cannot be used as an ultimate test for validity but can be applied as one source of validity check. The information about SOEs is obtained from the interviews and by collecting supporting documents and data. Financial figures of the firms will be beneficial to have an idea about the size of the firms. Miles and Huberman point out that another issue of concern to check the validity of the interviews is the internal coherence of answers (Miles and Huberman, 1994). In this research, a question is asked once within the interview questionnaires. There is one exception. In the firm-side interview questionnaire, the link between the firm and academic institutions is asked in different concepts. Consistency is sought after, here. Although making interviews is an effective way to collect data, they involve some difficulties, as well. The interviewees are often reluctant to talk about some subjects, particularly the failure cases. However, failure cases may provide significant information about the subject. In such cases, additional information about the cases collected before the interviews may help the interviewer to direct better questions and obtain as much information as possible from the interviewee.

i) Interviews with Members of SASAC

The interviews are semi-structured containing open-ended questions. The questions correspond to the explanatory variables indicated above and exploring the relation between the explanatory variables and the dependent variable forms the main concern of this research. During the interviews, tape recording will not be used in order to let interviewees speak freely. The interviewer will take notes as much as possible and just after the interviews; record his own voice telling a long summary of what is talked about during the interviews. Recording sometimes makes the interviewee cautious and some important aspects of the subject would not be revealed. Thus, the objective should be to extract most possible information from the interview talks. The questions cover SOE reform processes, phases of reforms carried out by the particular SOEs, degree of liberalisation and corporate governance approach adopted, resistance faced (if any), management structures, laws adopted in the background of WTO accession, internationalization of firms, and lastly the role by the party-state in ensuring the monopolistic nature of SOEs. China's SOE reforms cover phase wise liberalisation and centralisation, debates within the government, public-government interaction before the adoption of a policy or law related to

policy, competition between different organs of central government, SOEs response to the reforms and its relationship with the party-state. The nature of SOEs, its proximity to the central government, the nature of ownership, its technical competency, and its significance in the Chinese economy usually affect the reform process and the degree of privatization enjoyed by the firms. Interviews, therefore, act as a key source in evaluating the reform, defining corporate governance, and transmitting the real picture to the researcher, etc. In addition, to gain an official perspective, interviews are conducted with SASAC officials and ministers associated with SOEs. This perspective, however, has to be further analysed to distinguish between the reality and rhetoric.

ii) Interviews with SOEs

The questionnaire that will be applied to the firms is based upon the literature of the institutional theory of political economy. Interviews are semi-structured having open-ended questions as in the interviews with members of SASAC. The questions are aimed to obtain the association between the initiatives by SASAC towards reforming SOEs and firms capabilities to implement them. Some of the questions also point towards analysing the managerial behaviour, challenges faced by firms and also the strategies adopted by them for SOE reform.

iii) Interviews with economists and policy analysts

The primary objective behind conducting interviews with economists and policy-analysts is to capture the debates between Chinese academia and policy making, the extent to which the academia is able to influence policies related to SOEs reform in China. Through the interviews with economists from some leading think tanks, universities, and policy-institutes, the researcher is also able to reflect on the debate/difference in opinion within the academic establishment. The interviews conducted in the think tanks, universities and institutes include Chongyang Institute for Financial Studies, Unirule Institute for Economics, China Institute of International Relations, Peking University, Renmin University, Tsinghua University, Jinan University, Chinese Academy of Social Sciences, Yunnan University of Finance and Economics and Beihang University. There are various opinions about SOE reform in China. Some economists view it as purely economic

reform and that it should be approached from a neo-classical, neo-liberal point of view. However, a majority from the academia believes that SOEs reform is a political process and that it should be carried out in an incremental manner, without letting national responsibilities affected in any way. The anonymity of the interviewers is maintained for various reasons.

iv) Analysis of the Interview Findings

The interview findings can be used for two purposes. One is to find out the relationships among the explanatory variables and the other one is to find out the relationships between the explanatory variables and the dependent variables. The latter one asks the main research question while the former one seeks to deepen the understanding of the political economic factors by examining their mutual relationships. There are more cases to explore the relationships between the explanatory variables since a subset of projects investigated under the SOEs will be investigated in the firm-side interviews. Since there are only two to three projects involved per case study, no statistical method can be used for the evaluation of the firm-side interview findings. Predictive generalization will be made based on a pattern-matching. Ultimately, policy implications will be offered based on the findings. Since the intended subject is both a historical and contemporary issue in China's economy, a case study is a suitable method in developing rich information and in-depth analysis (Yin, 2003).

Leedy and Ormrod (2001) suggested the following steps outlined by Creswell (1998) and Stake (1994) when analyzing data in qualitative studies. These include i) Organization of details from the case. The specific "facts" about the case are arranged in a proper chronological or phase-wise manner; ii) Developing categories in relation to the independent variables and categorization of the data. Categories are identified that can help cluster the data into meaningful groups; iii) Interpretation of single instances. Specific documents, occurrences and single instances are examined for the specific meanings that they might have in relation to the case, iv) Identification of patterns, based on which the data and their interpretations are scrutinized for underlying themes and other patterns that characterize the case more broadly than a single piece of information can. These patterns, in turn, will help identify the changes or continuity in SOE reform policies, v) Synthesis and generalizations to construct a comprehensive picture of the case

studies under review. Conclusions are drawn from the case studies that may have implications beyond the specific case that has been studied. (Leedy & Ormrod, 2001; 150)

The majority of supporting sources come from published literature, internet data, and official reports. For the secondary data, National Library of China in Beijing has been intensively consulted. However, with regard to China, there are some country-specific/region-specific challenges which most researcher encounter. The biggest problem encountered is to find trustworthy and updated data. Most of the data compiled from the China Statistical Yearbook, National Bureau of Information as well as from the SOE websites, are hardly accurate and fail to portray the real picture. Most of the times, the data is either inflated or deflated, trying to cover the problems of the Chinese economy. It, therefore, becomes extremely hard to find consistent information since there are no universal statistical standards even in governmental reports. Besides, electronic data before 1995 are almost impossible to trace, since the internet was only introduced to China in mid-1995 and it is still difficult to find multi-level or disaggregated data in China, even on non-sensitive economic issues. Many of initially planned issues, therefore, are left untouched because of lack of data. For instance, an overall layout showing the provincial disparity in GDP, population and employment are aborted due to incomplete information; the objective to compare the development of major domestic players/ actors becomes meaningless since they are in the frequent process of merger or split. The second challenge is the constantly shifting market situation or external stimuli and frequent modification of policies (to control or liberalize), which adds to the difficulty of data collection and even compels the researcher to change the direction of research or restructure its objective several times. Finally, language forms a great barrier in conducting research in China. Even with the help of a translator, the interviews suffer because of poor language skills of the researcher, due to the trust factor (language helps in building trust between the interviewer and interviewee), and the translation work, which is cumbersome and often fails to capture a lot of special terms and expressions.

Given the challenges in conducting research on China, especially on the SOE reform issues, there is no completely objective views or lens, as the empirical world is not simply out there and occasionally what one sees may not be what one gets. Owing to the intrinsic mechanisms of governance and market interactions in China, the underpinning forces, the interactions thereof,

and their combined effects on competition are subject to interpretations. Based on this ontological assumption, the scholarship about the empirical reality that can be produced is to offer carefully contemplated interpretations of specific events in specific settings. The main research question, pertaining to this study is to find the connections between SOE reforms, WTO accession, laws formulation and specific policy-making contexts and chosen strategies. Accordingly, in data collection and interpretation, reports and accounts from key stakeholders concerning the content and motivations behind SOE reforms at different stages are also conducted. As already discussed, to improve the data reliability, multiple data sources (Klein and Myers, 1999) are used. In summary, data are mostly analyzed by finding facts about specific policy-making outcomes and then exploring interviews and other data to find reasons for the continuity in policies. These will provide direction to understand the main contours of the changes and continuity and also the specific reasons at the level of national policy in order to maintain continuity despite China's commitments to liberalisation.

3.6 CONCLUSION

This Chapter depicts the structure of the research methodology in relation to the literature and the research questions. The resources that can be accessed and people that can be contacted to explore the subject, fallback strategies that will be implemented when problems are encountered and validation mechanisms are described. The next chapters shall deal with the external as well as internal factors and case studies and enable more appropriate interpretations about the research findings. They shall identify the incentives for various forces from within and without which make use of the party-state apparatus to advance their agendas through accesses and avenues opened by structural changes. The chapter on case studies, in particular, shall examine the structural incentives and constraints experienced by China's centralised SOEs as shaped by the interplay among various integrative mechanisms of the internal coordination system and by the international context.

While the empirical findings accumulated as a result from previous studies have formed an important factual base for the enrichment of knowledge on various aspects of social change in state socialist countries, neither of these seems to be a very useful analytical tool that can help

adequately explain the course of change and identify the continuities in policies and shed some light on the challenges that lie ahead. To fill in the void of the existing scholarship and advance our understanding of the on-going social and economic transformation in China, there is a need to go beyond the one-dimensional conceptual frame fitted solely to an invariable image of market and treat market as one of many types of social relations that has varying effects on and responses to organizational behaviour under different structural conditions.

Three different constituencies of scholars and students will benefit from this research. First, it will provide a new reference text for research in China's economic reform, SOE policies, anti-trust law and WTO accession commitments. Research findings, whether published as a book or a series of journal articles, will be a significant addition to the China studies scholarship. The second set of scholars and students who will be deeply interested in this research are the economists from both developed and developing the world. The Chinese economy has been regarded as one of the most dazzling phenomena in the current world economy. A systematic, objective and academic analysis on the key aspects of contemporary Chinese economy such as SOEs reform, however, is still lacking. A large section of this research will, therefore, contribute to the theoretical literature on decentralization and conflicts of interest between principals and agents. By bringing out the complexity of relations between Chinese party-state and SOEs, it will provide a new perspective on the central-government intervention in carrying out SOEs reform in the backdrop of WTO commitments. Lastly, researchers working on political economy issues may use it for comparative analysis: why different states with similar economic circumstances pursue a different variety of public sector reform? However, the purpose of this research is also to write a narrative for general readership interested in China's SOEs reform and the challenges encountered by its SOEs after WTO accession.

Both in the academia and the policy world, interest in economic issues concerning China is proliferating. This is largely due to the potential emergence of China as a great power. Therefore, in investigating the SOEs reform in China and explaining the change and continuity in policies, this proposed research, thus, will leave a significant impression not only on the academia but also on the policy-analysts dealing with public sector in countries such as Taiwan and South Korea where market economy has thrived under the rule of authoritarian government, and also in

India which runs on a market economy but also a large public sector often plagued with low performance. Lastly, It will also find an attentive audience in the larger area-studies community interested in China and its domestic economic policy in particular and foreign policy and international negotiations in general.

CHAPTER 4 EMERGING NEO-LIBERAL CONTEXT & CHINA'S STATE-OWNED ENTERPRISES

“The key to seizing opportunities to develop ourselves is to develop economy”

- Deng Xiaoping³

The beginning of economic liberalisation in China since the 1970s coincided with the neo-liberal turn of the capitalist world. Although the basic principle underlying neo-liberalism has influenced China's opening up through the reform of SOEs, opening of the domestic markets to capitalist forces, Chinese economy, however, remains guided by the state, in which direct control has been gradually replaced by the indirect regulation based on the leverages of economic and legal means. The reform consensus within the CPC leadership after the Third Plenum of 1978 could broadly be categorized into two broad groups – the ‘conservatives’ and the ‘new liberals.’ The members from both the groups felt the need to change the old system of central planning and give more scope to market mechanisms. What they differed in were the means to achieve it and the overall character of the post-reform socialist economy. The conservative camp led by Chen Yun, view that planning is fundamental defining characteristic of socialism and should retain a dominant role in the economy. They were only ready to accommodate markets for allowing certain commodities of an essential nature. He used the analogy of a “bird in cage”, to describe the plan-market relationship (Chen, 1999).

The new liberal camp led by Deng Xiaoping and represented by Zhao Ziyang, however, argued that a radical break was needed to break from the shackles of underdevelopment and backwardness. In their opinion, the guiding logic of reform should be defined as ‘socialist’ to the extent that they contributed to developing productive forces (Deng, 1994). With Deng Xiaoping's support, the reformers won this first round of factional differences over the adoption of a strategy to reform the economy as well as prepare for WTO membership. Amongst all the efforts carried out in the opening up direction, China's entry into the WTO is considered to be of major significance, both for its long term economic and foreign policy goals. And as part of the WTO accession, China was required to undertake a broad and deep trade liberalization measures

³ Excerpts from talk with a leading CPC member, November 12, 1991 (Li, n.d.)

including tariff reduction, elimination of subsidies and opening up domestic markets to conform its trade regime consistent with the WTO norms.

The long, grueling and onerous 15 years of negotiation surrounding China's WTO membership, followed by a lengthy and tough WTO accession agreement were certainly dramatic. Twice in the space of a century and a half, China emerged from relative isolation and autarky to engagement with the international system. On the first occasion, this engagement was a consequence of a forced opening of China by the imperialist forces. The dominant feature characterising such opening which actually turned China into a semi-colony was the treaty ports. Opening in the post-Mao era, however, was characterised by profound economic changes and a choice made by Chinese elites, to undertake a gradualist shift from a centrally planned economy to a market economy and a deepened integration with the international economic order. Deng Xiaoping, the architect of the reform, pointed out that economic development in a closed door way would not be successful and that the development of China could not do without the world (Li, n.d.: 988) which actually summed up the immediate needs and long term concerns that China was facing that time amidst waves of liberalization and growing interconnectedness in the world. Referring to the Resolution on Economic Restructuring adopted by the 3rd Plenary Session of the 12th Central Committee of the CCP, Deng Xiaoping said, "a preliminary draft of political economy has been worked out, and it is a political economy combining fundamental principles of Marxism with China's socialist practice" (Li, n.d.: 989). This served as a theoretic foundation for China's reform, opening, and modernization drive in the late 1980s.

The early phase of economic reform in China, to a large extent, was gravitated around the transformation of SOEs. Since the 14th Party Congress, the primary feature of the reform in cities centred on adjusting industrial structure and enterprise organisation of the SOEs in conjunction with conducting pilot projects of state-owned capital operation. Among the various implications of reform on SOEs, the impact of WTO accession on SOEs has generated wide concerns owing to their characteristics and significance in the Chinese economy and polity. For example, SOEs in China, prior to 2000s, enjoyed monopoly power in several sectors, which were closed to competition and other market forces. In this backdrop, this chapter will examine the influences of WTO accession on China's SOEs reform. The chapter is divided into three sections following

the introduction. The first section summarises various WTO commitments in key areas that China requires to fulfill as part of the accession negotiations, following which, in the second section, China's compliance with the WTO obligations, particularly the ones which have direct implications on the SOEs reform will be examined in detail. The third part will analyse in detail the effects of these policies on SOE reforms and assess the extent to which the neo-liberal forces have managed to curtail the state-party control on the SOEs over the years.

4.1 WTO ACCESSION RELATED COMMITMENTS

The origin of WTO goes back to the ITO (International Trade Organisation) experiment which started in 1944 as part of the re-construction efforts of the world economic order. The ITO envisaged by the Havana charter, largely a US initiative, had set certain unrealistic goals of free trade as a solution to post war economy, that it collapsed under the weight of its own ambitions (Narlikar 2005). Thus, the failure of ITO led to the creation of General Agreement on Tariffs and Trade (GATT) on January 1, 1948, a much more feasible trade agreement which was signed by 23 countries, 11 of them being developing countries. The GATT which was meant to serve as an interim trade agreement successfully lasted for 47 years as the basis of international trade system before it gave way to the formation of the WTO in 1995. The Ministerial Conference has a long-established tradition in the GATT. However, in the GATT, these conferences were held infrequently, usually at the time of the launch of a new round of multilateral trade negotiations. Under the WTO, the Ministerial Conference was institutionalized and regularized through Article IV.1 of the Agreement. It constitutes the top most decision-making body, composed of representatives from all member countries, that meet once in two years. The creation of the WTO not only expanded the mandate of the trading body but was also considered to address problems with which the old GATT structure could no longer cope. However, the mandate of the WTO was significantly more intrusive than that of GATT. The GATT's foray into rules on non-tariff barriers (NTBs) had been only through the mechanism of the plurilateral codes. This changed in the WTO through the Single Undertaking. The legalist character of the WTO, as an international organization had evaded the GATT because of its provisional nature.

The first round of the WTO began in the backdrop of dissent and dissatisfaction created by the Uruguay Round of trade negotiations (Huang 2008). The origin of this deep-seated dissent lay in the years of imbalances and discrimination suffered by the developing countries in the WTO due to the domination and upper-hand enjoyed by the developed countries in this regime. But its creation also resulted in a conscious exclusion of certain controversial areas and weak agreements in others. Despite notions of fairness, consensus and reciprocity laid out carefully in the pages of GATT/WTO and one-member-one-vote organization, the organisation necessarily followed a ‘hegemonic trade model’ driven by power politics and economic imperatives where agreements were typically negotiated in small group meetings amongst “the Quad” – the US, EU, Canada and Japan – and imposed upon the rest of the organization’s membership as a *fait accompli* (Kapoor 2006; Kelly and Grant 2005; Mortensen 2006). In WTO negotiations, the consensus is arrived at ‘if no Member, present at the meeting when the decision is taken, formally objects to the proposed decision’. Despite one- member-one- vote system, the consensus based practice discriminated developing countries over developed countries on the basis of numbers in the WTO meetings.

Problems intensified during the Uruguay Round as developing countries became vocal about their greater engagement and reciprocity in the WTO negotiation process. The Uruguay round which was the longest multilateral trade negotiations in the GATT era took seven years (1986-1993) to complete and involved 125 countries. The developing countries agreed to include some new issues like TRIPS, TRIMS and services in the Uruguay Round and agriculture, textile and clothing were for the first time placed within the multilateral rules of GATT (Narlikar, 2003). However, despite all the attempts and initiatives were taken by the developing countries to play a greater inclusive role in the bargaining process and enjoy nearing equal benefits from trade liberalization, the developing countries found themselves caught in a snare where they faced high, unexpected costs for implementing commitments. The lack of transparency in the WTO decision making process and deliberate exclusion of the developing countries from the green room meetings by the ‘rich man’s club’ became a huge issue at the Seattle Ministerial conference in 1999 which resulted in a stalemate followed by the closing down of talks. Thus, the failure of talks at the Seattle Ministerial almost offered a clarion call to the WTO representatives to address the imbalances and inequalities that had left the trade liberalization regime in deep crisis. As part

of the confidence rebuilding measures, initiatives were launched to address some of the difficulties facing least-developed countries in the WTO and to improve outreach to Members lacking representation in Geneva. Informal negotiations were also launched in the year 2000 in agriculture and trade in services under the “built-in agenda” of the Uruguay Round. These negotiations which formed the preparatory work in the run up to Doha were mandated as part of the outcome of the Uruguay Round and reflected the view of many participants that there was unfinished business to conduct. Commencing in April 2001, and in contrast with experience before Seattle, preparations for Doha took the form of an informal “bottom up” process which was supposed to emerge from intensive consultations based on an initial checklist of issues circulated by the General Council Chairman. Thus, the 4th WTO ministerial conference in Qatar is historic in many respects. First, the primary objective of the Doha round was to address the ‘development deficit’ in multilateral trade negotiations. Second, compared to the highly liberalized and pro-rich Uruguay round, Doha was meant to be much more developing-countries’ friendly and balanced in its trade negotiations. Third, China the emerging power during that time became a formal member of the WTO, a shift from its observer status, thereby adding to the weight and influence of the developing countries bloc in the multilateral trade negotiations.

After 15 years of arduous negotiations, China acceded to the WTO Agreement pursuant to Article XII of that Agreement, thereby becoming the formal member of WTO on December 11, 2001. Besides, China’s accession related commitments have been unique in many respects. As China entered the WTO with a developing country status, it demanded special and differential treatment to which all developing countries are entitled to in the WTO. However, given the size of the Chinese economy, it was denied those special provisions and on the contrary was heaped in with extra compliance related obligations (Halverson, 2004). China’s WTO commitments spanned eight areas, indicating the varying degrees of scope and complexity that each area under agreement represented. They ranged from China’s pledges for how it will reform its trade regime in accordance with the WTO’s principles and rules to specific market access commitments for goods and services. In the trade framework area, some of the commitments exceeded WTO requirements. For example, unlike other WTO members, China was asked to provide a public comment period prior to implementing certain trade measures. Furthermore, China committed to establishing a mechanism by which individuals can bring questions about the inconsistent

application of laws within China’s trade regime. Certain commitments in the area of safeguards and trade remedies also exceed what WTO rules usually require. For instance, China’s commitments allow WTO members to use standards for applying product-specific and textile safeguards against Chinese imports that are easier than the standards set forth in the WTO Agreement on Safeguards and the Agreement on Textiles and Clothing. Furthermore, commitments relating to the transitional review mechanism establish an additional review process that is more comprehensive than the WTO’s trade policy review mechanism for other WTO member. Here is a list of 685 trade regime commitments identified in all eight areas of the protocol and the working party report.

Table 4.1 - Eight General Areas & Number of China’s Trade Regime Commitments⁴

Area	Number of Commitments	Description of Area
Trade Framework	82	Includes uniform application of trade measures, transparency, judicial review, non-discrimination, and revisions to related laws and regulations.
Import Regulation	227	Includes border measures affecting imports, such as customs duties, other taxes, and charges; nontariff measures, such as quantitative restrictions (quotas); regulatory measures, such as standards for determining the value of imports (customs valuation); and technical barriers to trade, such as packaging, marketing, or labelling requirements.
Export Regulation	9	Includes border measures affecting exports, including licensing requirements, export duties, and other taxes and charges.
Trading Rights and Industrial Policies	117	Includes China’s restrictions on the right to import or export products (trading rights), limitations on trading to certain entities (state trading), and industrial policies such as price controls, subsidies, regulations on state-owned enterprises, investment requirements, and restrictions affecting foreign exchange.
Agriculture	101	Includes border measures and other policies that affect the agricultural sector such as customs duties, tariff-rate quotas, export subsidies, domestic support, and measures restricting imports for health and environmental reasons (sanitary and phytosanitary measures).
Services	45	Includes regulations and restrictions affecting trade in services and operations of foreign services suppliers in China, including commitments on non-discrimination and market access for particular service sectors.
Intellectual property rights	34	Includes laws and regulations providing for the protection and enforcement of intellectual property rights such as copyrights, trademarks, and patents.

⁴These 685 trade regime commitments exclude market access commitments discussed later but include commitments identified in other annexes. Additionally, these 685 commitments do not include 20 general commitments that describe, among other things, the relationship between the protocol and the working party report and other multilateral WTO agreements.

Safeguards and trade remedies	70	Includes additional protection of products faced with the market disruption caused by surges in imports from China, the ability to use the alternate methodology in antidumping and countervailing duty cases, and review of China's trade practices through a special WTO review mechanism.
Total	685	

Source: *GAO analysis of China's WTO accession agreement: October 2002*

As part of its WTO accession agreement, China committed to reducing or eliminating a variety of market access barriers to foreign products. Although China reduced its overall average tariff over the past decade, certain sensitive products such as agricultural commodities and automobiles continued to face high tariffs, as well as other trade-distorting measures. In its agreement, China made specific commitments on the tariff rates for more than 7,000 products covering all imports, as well as commitments on other trade-distorting practices, such as state trading and quotas, affecting more than 900 products. Through its WTO commitments, China agreed to reduce tariffs on numerous products including many sensitive items, as well as to eliminate duties altogether on other products, such as information technology goods. However, as per the accession negotiations, high tariff barriers on some products would be getting reduced over a phase-in period. China committed as part of its accession agreement to eliminate export subsidies for both agricultural and non-agricultural products.

Article 9 of the Protocol of Accession deals with price controls in China. This has particularly been of key interest vis-à-vis SOEs and the non-market status of China. As per the price control protocol, China shall “allow prices for traded goods and services in every sector to be determined by market forces” and provides for the elimination of “multi-tier pricing practices”. In this manner, WTO members sought to address the problem highlighted by Article III.9 of the GATT. The protocol further states, “except in exceptional circumstances, and subject to notification to the WTO, price controls shall not be extended to goods or services beyond those listed in Annex 4, and China shall make best efforts to reduce and eliminate these controls”. Also, to maintain transparency, it requires China to publish in the official journal the list of goods and services subject to state pricing and changes thereto. The WTO Agreement on Subsidies and Countervailing Measures, (SCM), brought a list of 22 types of subsidies, three of which should be phased out after accession (Annex 5.B). Those are subsidies provided to certain state-owned

enterprises which are running at a loss; the priority in obtaining loans and foreign currencies based on export performance; preferential tariff rates based on localization rate of automotive production. Article 10.2 of the Protocol of Accession considered that subsidies provided to SOEs will be viewed as specific if, inter alia, SOEs are the predominant recipients of such subsidies or they receive disproportionately large amounts of such subsidies (GAO Report, 2002).

Some WTO members have expressed concern that China's export regulations violated WTO rules by placing restrictions on exports of certain agricultural products, resource products, and chemicals. They were also concerned about China's restrictions on exports of silk and a number of raw materials or intermediate products that could be subject to further processing, such as tungsten, ore concentrates, rare earth, and other metals. In response to these concerns, China agreed to modify its export regulations and restrain its use of export duties. China had also committed to eliminating all taxes and charges on exports unless they are in conformity with WTO principles or specified in its accession agreement. The agreement lists 84 products (affecting products accounting for less than 1 percent of its total exports in 2001) that are subject to export duties of around 20 to 50 percent. China committed to bind its export duties on these products at these rates. Most of the products are base metals and related products, such as aluminum, copper, and zinc, as well as bars, plates, and wires made from them. China also agreed to refrain from increasing the present rate of duty on these products, except under exceptional circumstances, and to consult with affected WTO members in these cases. As seen from the table above, more than 100 commitments in China's WTO agreement deal with the area of trading rights and industrial policies. Upon its accession, China pledged to liberalize the availability and scope of trading rights for all enterprises in China over a 3 year period. Some of them included granting full trading rights to foreign-invested enterprises holding minority foreign shares one year after accession; two years for those holding majority foreign shares; and all enterprises in China and all foreign enterprises and individuals to obtain full trading rights 3 years after accession. In addition, this would exempt the foreign-invested enterprises from establishing in a particular form (such as registering as enterprises in China) to engage in importing or exporting. In addition, China had committed to a more transparent and disciplined state trading operations and it agreed to refrain from imposing excessive domestic price mark-ups on imports beyond what is allowed under WTO rules.

Summary of terms of China's WTO Accession of key sectors

I. Agriculture -- Agriculture had been a sensitive area in China's WTO accession negotiation. It was widely believed that agricultural sector would arguably be the hardest hit following China's accession to the WTO. Premier Zhu Rongji, who had been usually optimistic about China's WTO membership, told the press: "What I worry about most is agriculture." The restructuring of agriculture is now on the agenda of some of the highest level state meetings in China" (Wen, 2001). In China, the main problem was not only in the agricultural sector but a three-dimensional, entangled web of problems which must take into account the peasants, rural villages, and agriculture. The global experiences had resulted in the economic destitution of rural villages, the bankruptcy and displacement of small-scale farmers, and the rise of urban ghettos.

Figure - 4.1 Selected Aspects of China's WTO Accession

Trade in Goods – All tariffs on imported goods are to be eliminated or reduced, mostly by 2004. Tariffs on industrial goods will be reduced to an average of 9percent, and import quotas will be removed by 2005. Tariffs on agricultural goods will be lowered to an average of 15percent.

Trade in Services – Foreign access is to be ensured through transparent and automatic licensing procedures in various sectors, including banking and insurance, legal and other professional services, telecommunications, and tourism. Specifically:

- *Right to Trade and Distribution* - within two years (by end 2003) foreign service suppliers will be permitted to engage in the retailing of all products; within three years (by end 2004) all firms will have the right to import and export all goods except those subject to state trading monopolies (e.g., oil or fertilizers); within five years (by end 2006), foreign firms will be allowed to distribute virtually all goods domestically.
- *Banking* - Foreign financial institutions will be permitted to provide services without client restrictions for foreign currency business upon accession; local currency services to Chinese companies within two years (by December 2003); and services to all Chinese clients within five years (by December 2006).

Trading and investment regimes

- *National treatment/no discrimination* - Measures and practices that discriminate against imported products or foreign companies will be removed.
- *Export subsidies* - Upon accession, all forms of export subsidies inconsistent with WTO rules, including grants and tax breaks linked to export performance, were eliminated.

- *Trade Related Investment Measures (TRIMs)* - Foreign investment approvals will no longer be subject to mandatory requirements (e.g., technology transfer or local content requirements).
- *Trade Related Aspects of Intellectual Property Rights (TRIPs)* - China will enforce the rights protecting intellectual property within China.
- *Agricultural subsidies* - China has agreed to limit domestic agricultural subsidies to 8.5 percent of the value of production (i.e. less than the 10 percent limit allowed for developing countries under the WTO Agreement on Agriculture) and to eliminate all agricultural export subsidies upon WTO entry.

Trading partner safeguards

- *Transitional product specific safeguard mechanism* - As provided under the WTO Agreement on Safeguards, a country may impose restrictions on imports if it can demonstrate that they cause or threaten to cause serious injury to domestic firms producing similar products.
- *Special safeguard mechanism for China's textile and clothing exports*- As a consequence of its WTO accession, China has formally been included in the Agreement on Textiles and Clothing (ATC) and will eventually obtain unrestricted access to textile and clothing export markets. However, the existence of a special safeguard mechanism within China's WTO accession protocol is likely to extend this effect over a number of years, because China was not part of the ATC which took effect in 1995 and its exports have remained subject to sharp restrictions.
- *Anti-dumping* - Under WTO agreement, other members can invoke "non-market economy" provisions to determine dumping cases for 15 years following accession. Non-market economy provisions imply that domestic prices cannot be used as a reference point and make it much easier to reach a positive finding in an antidumping investigation.

Source: WTO News (2001 Press Releases) Available at https://www.wto.org/english/news_e/pres01_e/pr243_e.htm

This was the reason why Chinese people, particularly Chinese farmers, peasants were not willing to support it is that they have been constrained by such discourse: accession to the WTO was nothing but part of the economic reform program. China has traditionally pursued self-reliance in food production and raised many barriers to its agricultural market, such as high tariff rates and state trading. Given that the Chinese peasants have an average of 0.4 ha per household, they could not have been able to compete with US farmers and agribusiness which produce on factory farms and therefore was left with no choice but to engage in small-scale farming (Wen, 2001). China's WTO accession was thought to have intensified such unfair competition. The pressure of competition was considered to be direct and immediate, especially for the regions (such as

central, central western and north-eastern China) which have specialized in cultivating primary crops. In the long-term, as domestic crops would have been substituted by cheaper and higher-quality imports, China was bound to rely on imports to solve its food production problem. The State Council's Development Research Centre also estimated that 176 million peasants would be forced to abandon farming in the first decade after China joins the WTO and that job growth would mainly exist in financial and trade sectors which could hardly accommodate the rural population (Wan, 2001).

China's WTO commitments relating to agriculture cover four topics. Specifically, China committed to imposing lower tariffs on agricultural products; to administering a tariff-rate quota system to allowing controlled access for imports of some bulk agricultural commodities in a transparent, consistent manner and based on commercial considerations; to capping agricultural domestic subsidies and abolishing export subsidies; and to fully abiding by the WTO rules governing sanitary and phytosanitary (SPS) measures on imports, which place disciplines on how countries apply health and safety standards. Other commitments were in the domain of domestic support subsidies and state trading in bulk agricultural commodities. Like all countries that have recently acceded to the WTO, China bound tariffs for all agricultural products. The decision reached between Chinese side and WTO negotiators' committee was that China's agricultural tariffs need not be drastically reduced but done in a gradual phase by 2010. There are 977 agricultural tariff items in China's WTO accession schedule. Fifteen percent of the agricultural products (148 products) have a final bound tariff at or below 5percent. These products include soybeans, some grains (oatmeal and buckwheat), and some spices (cardamom and cloves). About 50percent of the agricultural products (490 products) have a final bound tariff of between 6 and 15percent. These products include dairy products (yogurt, butter, and cheese) and fruits (grapes, apples, and citrus fruits). Thirty-five percent of agricultural products (339 products) have tariffs above 15percent. These products include rice, cotton, and wool. The maximum final bound tariff is 65percent, which is on some grains (wheat, some rice, and some corn) and some tobacco products.

After entering WTO, the importance of agricultural trade in China's total trade has been declining. The share of agricultural trade in China's total trade had declined from 5.8 percent in

2001 to 4 percent in 2005. The share of agricultural export in China's total export declined even more rapidly from 7 percent in 2001 to 3.5 percent in 2005. The share of agricultural import in China's total import declined marginally from 4.8 percent in 2001 to 4.5 percent in 2005 (Chen 2006: 4). Although considerable resource shifts have taken place from land-intensive towards labour-intensive agricultural products in both production and trade, this transfer remains well below the potential due to trade barriers facing China's exports of labour-intensive agricultural products. Farmers' incomes also increased after WTO entry, with a growing off-farm portion linked closely with world economic cycles (Carter, Zhu & Zhong 2009). China followed its tariff reduction schedule specified in the protocol on the first day of 2002. The average tariff rate was reduced from 15.3 per cent in 2001 to 12 percent. For agricultural products, the tariff reduction was from 21 per cent to 15.8 per cent. China had also implemented its three years of transition for progressively liberalising the scope and availability of trading rights for agricultural products (Huang & Rozelle, 2011: 46). Three years after accession, the private sector had come to dominate the trade of almost all agricultural products and state involvement was maintained in three commodities: wheat, maize, and tobacco. Besides the elimination of export subsidies, the WTO accession commitments place strict controls on the types and amounts of certain investments. In particular, domestic support to agriculture is divided into 'Green Box' and 'Amber Box' support. As is the case with other WTO members, China faced no limitations on the amount of support classified as Green Box that it can give, but it had been facing carefully circumscribed rules regarding the amount of support that can be given to activities classified as Amber Box. WTO commitments were, therefore, most likely force China to shift the level and composition of its agricultural support in the future (Huang & Rozelle, 2011: 49).

II. Services

i) Telecommunication Services

Prior to its accession to the WTO, China prohibited foreign companies from providing any type of telecommunications services in China, and the market had been controlled by a government-run telecommunications monopoly. The WTO noted that these types of limitations were common among WTO members that had made telecommunications commitments. These limitations on

the participation of foreign equity in the joint ventures in China were eased to a certain extent following WTO accession, but prohibitions on foreign majority ownership would continue to exist. China's WTO IPR commitments relate mainly to how China implemented the various provisions of the WTO's Agreement on the Trade-Related Aspects of Intellectual Property Rights (TRIPS). TRIPS define both the scope and enforcement procedures of intellectual property rights in various areas. These areas include copyrights, trademarks, patents, geographical indications (where particular characteristics of a good are related to its geographical origin, like bourbon), industrial designs, integrated circuits (semiconductor chips), trade secrets, and control of anticompetitive practices in contracts. Other general IPR commitments confirm that China was going to modify laws, regulations, and other measures to ensure non-discriminatory treatment of foreign IPR holders, as required by the TRIPS agreement⁵.

Until the last few years of its 15 year-long march into the WTO, China resolutely resisted demands to undertake commitments on telecommunications as part of the price of its accession. The resistance was not only out of the hidebound bureaucrats in the ministry responsible for telecommunications, but also others in the government and the party leadership who were concerned that commitments in telecommunications could spiral out of control and undermine national security. However, President Jiang Zemin and Premier Zhu Rongji understood that China had no choice but to ante up substantial telecom commitments if it wanted to join the WTO. By 2001, Jiang and Zhu produced both a domestic consensus in favour of reform and a successful outcome in the WTO negotiations. WTO accession negotiations permitted them to shake up behaviour in the state-owned telecom sector and to put a number of reforms in train (Roseman 2005: 30). By submitting schedules of commitments, they effectively locked in those reforms. What appeared uncertain was how the trade-offs between economic and sectoral growth and concerns over national security and control would play themselves out.

The transformation of China's telecommunications sector did not occur overnight with WTO accession. There had been a long run-up since Deng Xiaoping's reforms in the early 1980s.

⁵The results of the negotiations are described and documented in China's final accession agreement, the *Protocol on the Accession of the People's Republic of China*, which includes the accompanying *Report of the Working Party on the Accession of China*, the consolidated market access schedules for goods and services, along with other annexes.⁷ The protocol contains the terms of China's accession and describes how China's trade regime will conform to WTO agreements, rules, and principles.

According to UNCTAD, China overtook the United States in 2003 to become the largest recipient of foreign direct investment for that year (UNCTAD, 2004: 367). Once the rules became clearer, China Telecom, China Mobile, China Unicom and China Netcom were re-organized into 100 per cent state-owned holding companies and geographic operating entities. In summary, while officially “China welcomes foreign telecom companies” overall China’s behaviour vis-à-vis foreign participation in the telecommunications sector exhibits both insecurity (i.e. a need for control by domestic authorities) and a mercantilist attitude: bring in the foreigners and their capital, not in order for them to establish operations to serve the domestic market, but so that locals will have the resources and know-how to better serve the domestic market and “go out” and become major world players.

ii) Banking Industry

China’s banking industry started gradually opening up since the late 1970s. In particular, China-US WTO agreement has been a breakthrough in Chinese banking sector where all geographic and customer restrictions regarding foreign banks were likely to be removed from five years following accession. China agreed on foreign banks to undertake local currency business with Chinese enterprises within two years of accession and allowed local currency business with individuals within five years of accession. American Trade Representative Charlene Barshefsky commented that the changes to be unleashed following WTO accession would be “profoundly important” (Barshefsky 1999). The Director General of WTO remarked, “Chinese banks will, for the first time face real competition”, (Panitchpakdi 2002: 168). As of end-October 2005, China’s banking system consisted of 238 operational entities of foreign banks. The total assets of foreign banks in China amounted to USD84.5 billion in 2006 compared with USD53.6 billion in 2004 and USD29 billion in 1996 (Peng 2006: 4). At the top tier of the Chinese Banking System (the largest part of the system) are four large state banks; China Industry and Commerce Bank, China Agriculture Bank, Bank of China, and China Construction Bank. These banks were also wholly state-owned and operated as quasi-fiscal entities that made loans according to government policy directives rather than commercial considerations (Laurenceson & Yong, 2008). The second tier involves locally owned banks, such as the Shanghai Bank, and the Shenzhen Development Bank. These operate in similar ways to the state owned banks but are under different political control.

The third tier consists of three major policy based regional shareholder commercial banks, the Construction Agricultural Development Bank, the Import/Export Bank, and the Bank of China (foreign currency bank). A fourth tier involves mixed individual enterprise owned banks (Whalley, 2003). A number of foreign or joint venture banks had already received licenses as part of the implementation of China's WTO commitments. These include the Bank of East Asia, Citibank, Hang Seng, HSBC, and Standard Chartered. The post-WTO opening agenda posed a big challenge to China's banking financial sector: the technical insolvency of the major State owned banks made these banks highly vulnerable to competition from foreign banks, which could divert deposits from financially shaky domestic banks, causing disruption to the credit system and the whole economy (Sachs & Woo, 2002).

iii) Insurance

WTO opening also signaled gradual opening up of a monolithic, domestic oriented and government-steered insurance industry to increased foreign competition. The first insurance institution in China, the Canton Insurance Society, was established by foreign insurers in 1805. Between 1805 and 1948, numerous foreign and domestic insurers entered the Chinese market. With the founding of the People's Republic of China (PRC) in 1949, however, all foreign insurers were required to terminate operations and leave the country. China nationalized all domestic insurers and established a state-monopoly, the People's Insurance Company of China (Wu & Strange, 2000). From the reform and opening up era, insurance premiums grew at an approximate rate of 40 percent per year. With pressure from the international insurance community and in preparation for accession to the WTO, the China Insurance Regulatory Commission (CIRC) encouraged China's government to issue licenses to new domestic and foreign insurers (Ng and Whalley, 2004).

China's major WTO commitments related to insurance include measures on (Leverty, Lin & Zhou 2008) : (1) Geographic restrictions: Immediately after WTO entry, foreign P-C insurers and JVs will be allowed to offer services in Shanghai, Guangzhou, Dalian, Shenzhen, and Foshan. Two years after entry, foreign firms can extend their business to Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan, and Tianjin. All geographical restrictions

will be removed three years after entry. Upon accession, P-C insurers from abroad will be permitted to engage in general insurance policies and large-scale commercial insurance without any geographical limitation. 2) Reinsurance requirements: Gradually phase out the 20 percent reinsurance requirement over a four-year period following accession. 3) Business scope: Upon accession, foreign P-C insurers will be allowed to offer P-C services to overseas enterprises, property insurance to foreign-funded enterprises in China, and liability and credit insurance within its business territory. In addition, foreign P-C insurers will be permitted to offer P-C insurance service to clients beyond its business territory if the insurance meets the requirements of a Master Policy or a Large Scale Commercial Risk. Two years after entry, foreign P-C insurers will be able to offer all P-C insurance products (except third party motor insurance) to Chinese and foreign customers. Upon accession, foreign life insurance companies may provide individual life insurance services to foreign and Chinese citizens. Three years after entry, they can provide health insurance, group insurance, pension, and annuity products. (4) Ownership: Two-years after entry, P-C insurers will be allowed to form wholly owned foreign subsidiaries. Upon accession, foreign life insurers can hold no more than a 50 percent ownership stake in a JV. Before joining the WTO, China approved three life insurance JVs with 51 percent foreign ownership (AXA-Minmetals, China Life-CMG, and Allianz DaZhong Life), so this commitment is actually a step backward. In sum, WTO commitments allow foreign P-C insurers relatively greater access to the market on a shortened time schedule than foreign life insurers.

In the initial years after entering WTO, China began to gradually remove geographic, product, reinsurance, ownership and other restrictions, in a piecemeal fashion. Since some of the restrictions were not removed until 2005, the performance of foreign insurers relative to domestic insurers was difficult to project since a number of barriers impeded their ability to compete. It was also taking time for foreign insurers to familiarize themselves with the Chinese business climate, language, and regulations. However, the terms of WTO accession in insurance seemingly posed fewer problems for China than in banking because accession related commitments demanded fewer adjustment pressures for the insurance sector (Whalley, 2003).

iv) Security firms

As per the WTO deal, there had been a limited opening of the securities and fund management industries in the initial years after WTO entry. On June 1, 2002, consistent with China's WTO commitments for securities firms, the China Securities Regulatory Commission (CSRC) issued "Regulations on the Establishment of Securities Companies with Foreign Equity Participation" which became effective on July 1, 2002. These commitments allowed the establishment of foreign-invested entities authorized to undertake: (1) underwriting of equity shares (including A shares and B and H shares) and government and corporate bonds, (2) trading (brokerage) of B and H shares, and (3) trading (brokerage), and proprietary trading, of government and corporate bonds (Howson, 2007). The CSRC also reserves the right to invoke the right to participate of the foreigners in China domiciled foreign invested security companies. In 2002, Hong Kong SAR-based Credit Lyonnais Securities Asia (CLSA) became the first foreign securities company to establish a (Greenfield) Chinese-foreign equity joint venture securities firm after China's WTO accession.

III. Automobiles

Automobiles, one of China's pillar industries has experienced one of the fastest growth in Chinese economic history (Harwitt, 1996). In fact, China is becoming one of the world's fastest growing markets for automobile manufactures and services. According to a study by Pieter Bottelier on the impact of WTO membership on China's domestic economy, China currently has the largest market for automobiles. The total output (including saloon cars, champions and other special types) increased from 1475 thousand in 1996 to 5700 thousand in 2005, and the automobile possession rate per person increased from 0.2364 percent in 1996 to 1.1364 percent in 2004 (Francois & Spinanger, 2004). China had agreed to make several major reforms (including the Tariff Reduction Schedule and the Ration Abrogation Schedule) that would bring about great impacts on China's automobile industry. For example, China would reduce the import tariff ratio from the current 22.1 percent to 17 percent, and correspondingly the tariff will be also reduced from the current 80-100 percent to 25 percent by 2006 (Chen, Shi, Ni & Chen 2006). And all the quotas would be eliminated and foreign enterprises can import and export

their products without agents. During the period 2002-2005, the development of China's automobile industry had such characteristics: i) the total output increased continually, ii) the structure of products trended rationally, iii) the organization and structure of automobile industry have been adjusted and the producing scale has aggrandized in some extent, iv) Government increased the investment in the automobile industry continually. However, the boom of automobile industry in China have coexisted with the pressure faced by China's domestic automobile manufacturers after China's entry into WTO and the increasing import of foreign products produced by MNCs abroad such as Toyota, GM and BMW is likely to add more vigorous competition to the domestic industry, in the long run (Chen, Shi, Ni & Chen 2006).

IV. Energy

Along with the open door policy deepening, China's energy production structure and consumption structure has been changing a lot. The energy system of China changed from the independent, closed system into an open one, and consequently, both the domestic energy market and international markets were used to meet its demand. Access to the WTO has been like the two faces of the coin to the coal industry in China. On the one hand, it leads to a positive effect on the coal industry in three aspects (Shi & Xu, 2000): (1) the intermediate circulation costs have been reduced to raise the export competitiveness of coal in the international markets. 2) It has smoothened the coal market of China by promoting the scale economy of its coal industry. (3) It has also diversified the export system. With the entry into the WTO, China enjoyed the right to use licensing to control the foreign enterprises that entered its domestic coal industry according to WTO rules, at the same time, it failed to control the foreign coal enterprises that compete with its enterprises in the international coal markets.

The four large group corporations, namely, China National Petroleum Corporation (CNPC), China Petrochemical Corporation (SINOPEC), China National Offshore Oil Corporation (CNOOC), and China New Star Corporation (CNSC) have been in control of the petroleum industry since 1998. As per WTO rules, the non-tariff trade barriers (NTBs) on the import of crude oil and oil products was going to be canceled step by step, and the oil product sales market would be opened gradually. China had abolished all the non-tariff measures on the import of oil

and petrochemical products before 2004, except for the quota on crude oil, oil products, and chemical fertilizers to non-state-owned traders (Tian 2007). On the whole, as Shi & Xu (2000) argues that the impact of WTO entry on the down-reach enterprises was going to be larger than that on the up-reach enterprises, including refining plants and petroleum sales system. In the past five years after China became WTO member, the form of foreign investment had evolved from a joint venture to solely foreign-funded venture, acquisition, and merger.

Thus, WTO membership has imposed several systemic changes on part of China, subject to a special transitional review mechanism, provided in Article 18 of the Protocol of Accession of China. This mechanism examines China's implementation of its obligations both under WTO agreements and under China WPR and Protocol of Accession. It is worth noting that the transitional review mechanism operates in conjunction with the regular Trade Policy Review Mechanism to which all countries are subjected to regularly. However, China is subject to reviews each two years under the regular mechanism, the first review being conducted in 2006. The combination of both review mechanism made China's economy the most scrutinized since its accession, demonstrating the impact of its accession to the multilateral trading system.

4.2 WTO PRINCIPLES VERSUS CHINESE DOMESTIC LAWS

Unlike the GATT, WTO came into being with a stronger institutionalised mechanism for trade policy commitments and on enforcing a code of conduct among the WTO members. Although the term "protection" does not appear in the WTO agreement, it is implicit, however, in the term non-discrimination. Among the key aspects of WTO, the principles of 'enforcement of obligations' and 'transparency', have direct implications on China's accession related commitments and requires the Chinese government to establish a more open legislative and regulatory system in China. As per 'enforcement of obligations' under WTO, if a country finds the actions of another government in violation of a WTO rule, it can notify the government about it and ask that the policy is brought into compliance. However, if the actions of the defendant government are not considered satisfactory, in that case, WTO dispute settlement body (DSB) intervenes (Hoekman & Mavroidis, 2007). These involve the establishment of panels of impartial experts who are charged with determining whether a contested measure violates the WTO.

WTO being an inter-governmental agreement, private parties do not have legal standing before the WTO's DSB and only governments have the right to bring cases. The existence of dispute settlement procedures precludes the use of unilateral retaliation and also brings in necessary discipline into the WTO procedures. It also helps the developing countries and the least developing countries, under circumstances, where unilateral actions, if imposed by the developed countries, to be rendered ineffective and unjustifiable.

Transparency-one of the fundamental norms of the trading system is embedded in Article X GATT, Article III GATS, and Article 63 TRIPS, and in numerous provisions in agreements on specific trade policy instruments. The most explicit reference to the transparency as an essential legal obligation can be found in Article X of the GATT 1994 on 'Publication and Administration of Trade Regulations', which requires that 'Laws, regulations, judicial decisions and administrative rulings of general application -shall be published promptly' and that they be administered 'in a uniform, impartial and reasonable manner' notably by independent administrative tribunals or procedures (WTO, 2002a). In general terms, it refers to a number of interrelated actions, including how a rule or a policy is developed domestically, how the rule is enforced or a policy is implemented and whether the other members of the WTO are notified of the new rule or a policy action. These transparency norms, aimed at enhancing the effectiveness of the trade agreements, are not synonymous with the accountability or transparency of the WTO itself. They require the member states to publish their trade regulations, to establish and maintain institutions allowing for the review of administrative decisions affecting trade, to respond to requests for information by other Members, and to notify changes in trade policies to the WTO. Over the recent years, trading partners and economic actors need more information about a wide range of domestic policies that may affect the flow of transactions across borders.

Thus, the transparency requirements of the WTO can be divided into three categories (Wolfe, 2003; Halle & Wolfe 2010): The first form of transparency is the codification of Members' specific mutual obligations in the thousands of pages of 'schedules' attached to the general obligations of the WTO agreements. A second is the Trade Policy Review Mechanism⁶ (TPRM),

⁶ During the Uruguay Round, a negotiating group named "Functioning of the GATT" (the FOGs group in GATT parlance) recommended the creation of a surveillance mechanism whereby the WTO Secretariat would periodically review national trade policies. The WTO Trade Policy Review Mechanism, created in 1989, subjects all WTO

which aims at “achieving greater transparency in, and understanding of, the trade policies and practices of Members”. It is not meant to be part of the dispute settlement system. In the Annex 3 of the Marrakesh Agreement (WTO official website) that establishes the TPRM, Members also “recognize the inherent value of domestic transparency of government decision-making on trade policy matters for both Members’ economies and the multilateral trading system, and agree to encourage and promote greater transparency within their own systems, acknowledging that the implementation of domestic transparency must be on a voluntary basis and take account of each Member’s legal and political systems”. The Trade Policy Reviews constitute a unique source of information that can be used by civil society to assess the overall implications of the trade policies that are pursued by their government. From an economic perspective, transparency also helps in reducing trade policy-related uncertainty and injects confidence among the investors. A third and recently developed norm of transparency is the many provisions requiring publication of all legal requirements affecting trade, and ensuring timely dissemination of information to enable the states to comment and take advantage of the new opportunities created as well as to report the negative effects of the rules before they come into force. The agreements also have dozens of provisions requiring Members to notify each other through the Secretariat of changes in their rules. However, this does not favour developing countries as their ability to analyze the information generated by the transparency mechanisms remain a question.

In assessing China’s ability to comply with WTO principles, a study about its institutional as well as its domestic laws and regulations is crucial. The reform process began in the late 1980s, long before China’s formal accession in November 2001. The Chinese institutions particularly its foreign trade regime had undergone numerous changes to re-enter GATT and eventually become a part of international economy. It adopted a series of measures such as reducing mandatory plans, deregulating pricing for foreign trade commodities, cutting down on administrative controls on foreign import and export trade, stressing the role of regulation in foreign trade played by tariffs, exchange rate and tax revenue, setting up the construction of a legal system for foreign trade and drafting the Foreign trade law (Li, 2009). In 1986, the Chinese government also established the State Council Inter-ministerial Coordination Group on GATT Negotiations

Members to periodic review, the frequency depending on the relative importance of a Member in world trade (Hoekman & Mavroidis, 2007).

(SCICGGATTN) to co-ordinate the ministries with differing views on the GATT. In 1988 this group was renamed the State Council Committee on Inter-ministerial Coordination on GATT (SCCICGATT) and after its dissolution, MOFTEC became the co-ordinator.

The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) had carried out major reviews of Chinese domestic laws and regulations to fulfill obligations of international trade. For example, by the end of the year 2000, it had successfully carried out review of over 1400 laws, regulations, and similar documents, including six statutes (of which five were revised), 164 State Council regulations (of which 114 were to be repealed and 25 amended), 887 of its own ministry regulations (of which 459 were to be repealed and 95 amended), 191 bilateral trade agreements, 72 bilateral investment treaties, and 93 tax treaties (Clarke, 2003). In the first two months of 2001, the various ministries and commissions of the State Council reportedly reviewed some 2300 laws and regulations, of which 830 were identified as in need of repeal and 325 as in need of revision. For example, major laws governing foreign trade, including the Foreign Trade Law, the Customs Law, 33 and laws and regulations on technical and health standards, intellectual property and administrative procedures, 34 have all been revised to ensure WTO consistency. The courts, in China, undertook training and other activities, such as a review for WTO compatibility of existing Supreme People's Court interpretations and other directives, designed to meet the requirements of WTO accession.

Additionally, the Chinese government introduced new laws and regulations and carried out a restructuring of departments which were outside the purview of legislative revision. Chinese officials participated in many training sessions, mostly with foreign financial support (Goldstein et al, 2002). A Department of WTO Affairs was established by the MOFTEC to deal with issues related to implementation and litigation, and a China WTO Notification and Enquiry Centre were created to facilitate proper implementation of its transparency related commitments. MOFTEC also established a Fair Trade Bureau for Import and Export to handle issues relating to unfair trade practices. As the revisions and restructuring of laws and institutions were underway, more significantly, WTO norms, such as the market economy, non-discrimination, and transparency, gained wider acceptance among the Chinese population. With particular reference to improve the 'transparency' of China's regulatory regime in relation to trade and trade-related matters, these

commitments can be found in Part I, paragraph 2(C) of the Protocol on the Accession of the People's Republic of China (WTO, 2001a). They are mainly based on the requirements set out in Article X of the General Agreement on Tariffs and Trade (GATT) and Article III of the General Agreement on Trade in Services (GATS). The Chinese position stated that only published and readily available 'laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange' would be enforced (WTO, 2001a, paragraph (C)(1)). On request, all such laws, regulations or measures would be made available to WTO members before they were implemented or enforced (WTO, 2001a, paragraph 1). Second, China gave consent to establish or designate an official journal dedicated to the publication of these laws, regulations, and measures and to allow a reasonable period for comment before the implementation of such laws and measures (WTO, 2001a, paragraph 2). Third, China expressed willingness to create an inquiry point where 'all information relating to the measures required to be published under paragraph 2(C)(1) of this Protocol may be obtained' (WTO, 2001a, paragraph (C)(1)). As noted in the Report of the Working Party on the Accession of China (WTO, 2001b), the representative of China also confirmed that translations into one of the WTO official languages (English, French and Spanish) of 'all laws, regulations and other measures pertaining to or affecting trade in goods, services, TRIPS or the control of foreign exchange' would be made available to WTO members (WTO, 2001b, paragraph 334). In its efforts to comply with formal disclosure obligations, various Chinese ministries and agencies have set up websites to reply to queries and provide information. These include the Shanghai WTO Affairs Consultation Center, under the Shanghai Municipal Government, and the Guangdong WTO Affairs Consultation Service Center, who provide information and services relating to the WTO. The Shanghai WTO Affairs Consultation Center is considered highly successful a case study among all other WTO websites for effectively dealing with WTO inquiries and potential disputes. The website of the Shanghai WTO Affairs Consultation Center is also considerably easier to use as a source of information on China's WTO obligations than the official website of the Ministry of Commerce. The Ministry of Commerce (MOFCOM)), on the other hand, established an inquiry point and method for requests for information to be made in 2002 (MOFTEC, 2002). Also, the official inquiry point for technical barriers to trade (TBT) is now in English and the WTO/ TBT-SPS Notification and Enquiry of China website, under the General Administration of Quality Supervision, Inspection and Quarantine of the PRC (AQSIQ) has

gained visibility over the years. Although less comprehensive than the Chinese version of the website, the English version of the WTO/TBT-SPS Notification and Enquiry of China website provides a lengthy list of notifications and English summaries of standards for TBT (technical barriers to trade) and SPS (sanitary and phytosanitary measures) (Chen, 2009; 57).

The principle of transparency in the WTO, as incorporated in Article X of the GATT, Article III of the GATS and Article 63 of the TRIPs Agreement, thus, establish the environment of openness in governmental operations and also ensures a certain amount of predictability for players in international trade. Additionally, the other two core principles, most favoured nation treatment (“MFN”) and national treatment, aim to establish and maintain non-discrimination and openness in the international market (Woolcock, 2007). The principles of MFN and national treatment are designed to eliminate discriminatory measures adopted by the participants in international trade and create a level playing field for all the member states. China became part of these formal obligations in 2001. As already discussed in the previous section, China had adopted several reform measures in order to comply with transparency in international trading agreements. However, the most direct form of discipline brought upon by China’s WTO accession is the aspect of competition which directly impinges on the working of the State-Owned Enterprises (SOEs) from the opening up to foreign trade (Hoogmartens, 2001; Halverson, 2004). Although competition is implicit in the working of WTO, the formal rules or a framework agreement on competition do not exist in the WTO agenda. However, there are already elements of competition policy in a range of WTO agreements, both in bilateral, regional and plurilateral agreements. These elements not only ensure the freedom of the enterprises but also create competitive conditions based on market principles. The principle of transparency additionally, in any international agreement, provides information about the national competition laws and their applicability transparency and notifies to the relevant WTO Committee about the impact of these laws on international trading practices (Wolfe, 2003).

As discussed in the previous chapters, one of the major goals of the reform of the SOEs is driven by the efficiency syndrome. The fact that most of the SOEs in China have proven to be inefficient over the years, has compelled the Chinese government to undertake SOEs reform in order to improve the overall efficiency of the economy. SOEs form the backbone of the Chinese

economy and therefore improving efficiencies of the SOEs will prove critical to the future growth of the country. Also, the Chinese economy is gradually shifting from a low income to medium income, along with a shift from cheap intensive labour based to a more efficiency based growth and development. The AML, in this context, is designed to promote competition in the market, thereby improving the efficiency of SOEs, particularly after China decided to embrace market economy in 2001. In this case, the public opinion in China, as well as debates within the academia and Chinese government, has played an important and increasing role in government decision making (Wei, 2013; Peijuan & Saich, 2014). For example, the country's leading telecommunications providers have long been criticized for their low-end service and high prices and more recently legally challenged for abusing their dominant market positions (Hao, 2014). Also, an investigation by NDRC IN 2011 revealed a great deal of public dissatisfaction with the monopolistic behaviour of the telecom market, which has failed to yield any meaningful performance over the years (Hao, 2011). As SOEs have started 'going global' and began investing in other economies of the world, they are increasingly subjected to reviews by the competition authorities from other jurisdiction. The Chinese SOEs face strict supervision in the developed countries because the understanding of fair competition differs among the developing economies in a differentiated global value chains (Pin-guang, 2015). In order to improve the disadvantageous position of developing countries in international trade and investment, they try to protect their domestic industries, while simultaneously promoting competition, which makes the application and use of competitive neutrality in a flexible manner. For example, the European Union Competition Commission carefully reviewed the proposed acquisition of Elkem AS by China National Bluestar Group Co., Ltd and the joint venture agreement between Sinochem Group (Sinochem, China) and the Dutch pharmaceutical company DSM, before clearing it under the EU Merger Regulation, in 2011 (European Commission Press Release Database, 2011). The lessons learned by SOEs from acquisitions in developed economies have played an important role in bringing about a change in their national behaviour vis-à-vis competition as well.

4.3 THE ANTI-MONOPOLY LAW & SOES

During the early phases of SOEs reform in the 1980s, the political leaders and legal experts in China began viewing competition as an essential element for transforming SOEs into private

enterprises with the ability to compete effectively. China did not have a competition policy until the early 1980s, and the need to enact was felt during its transition from central planning to a market economy. The first of its kind, relating to competition and market power in China named as *Regulations on Development and Protection of Competition* was issued by the State Council on 17 October 1980 (Li & Du, 2007; Harris, 2006). Article 3 of the provision provided “in economic activities, with the exception of products exclusively managed by state-designated departments and organisations, monopolisation or the sole proprietary management of other products is not allowed”. Article 6 states: “Competition must be introduced by breaking down regional blockades and departmental barriers. No locality or department is allowed to block the market. No locality or department should impose any ban on the entry of goods made in other places. Localities should ensure that raw materials can be transferred out according to state plans and must not create any blockade. Departments in charge of industry, transport, finance and trade must revise any part or parts of their existing regulations and systems which impede competition so as to facilitate competition” (Li & Du, 2007). Following this provision, a series of government documents were issued to regulate monopolies from various perspectives. However, the progress happened in a piecemeal manner. In 1987, the former State Reform Committee and the State Economic and Trade Commission, jointly issued *Some Opinions on the Establishment and Development of Enterprise Groups and Regulation on Price Administration*, whose basic guideline promoted the principle of encouraging competition and preventing monopolies as a basis for the establishment of enterprise groups (Harris, 2006; Li & Du, 2007; Owen, Sun & Zheng, 2008). The Regulation prohibits enterprises and enterprise associations from colluding on monopolistic prices and further stipulates that the relevant supervision and inspection department may impose penalties, including returning illegal earnings to the purchaser or consumer; fines, and canceling the business licenses on the violators.

i) The Making of Anti-Monopoly Law in China

In 1992, a new wave of economic reform was initiated under Deng Xiaoping. The public opinion at that time favoured the enactment of a legal framework and lawyers considered incorporating ‘anti-trust’ principles as a legal provision which would regulate domestic enterprises in market oriented economies. An effort in this direction led to the enactment of the

Anti-Unfair Competition Law, in 1993 (UCL), which is considered as the Chinese Government's first serious effort to formulate a special competition law in order to address anti-competitive practices (Wen, 1994; Kong, 1999). Indeed, Articles 6 and 7 of the UCL expressly prohibit public and private monopolists from "forcing" purchases of commodities or "prohibiting competition from other enterprises (Li & Du, 2007)." Article 11 prohibits sales below cost with the purpose of driving competitors out of business (subject to certain exceptions). Article 12 prohibits tying and under Article 15, collusion in bidding is forbidden. Nevertheless, as enacted and enforced, the UCL was essentially limited in terms of regulating monopolies. The enactment process had met with intense opposition, which was followed by negotiations and the balancing of conflicting interests, thereby resulting in the drop of several legal provisions from the Act, on the pretext of legal inexperience and economic realities of China, during that time. Therefore, efforts to include any "core" antitrust content in the statute were deemed premature and unnecessary, leading to debates among the lawmakers involved in enacting and enforcing such laws (Owen, Sun & Zheng, 2008).

The Company Law, enacted in 1993 and made effective in 1994, sought to establish and harness property rights for enterprises to compete more effectively and efficiently, as well as prevent unfair trading practices, unauthorised use of trademarks and theft of commercial secrets. Work on the draft of Anti-Monopoly Law in China began in 1993, under the joint supervision of SAIC and the State Economic and Trade Commission (SETC) who studied antimonopoly laws of other jurisdictions and then compared them with the Chinese situation and realities (Wang, 2004). From the outset, the working group received comments and support from both antitrust agencies in major jurisdictions-including the US, Germany, Japan, Australia, and South Korea-and international organizations like the Organization for Economic Co-operation and Development (OECD), the Asia-Pacific Economic Cooperation (APEC), the United Nations Conference on Trade and Development (UNCTAD), and the World Bank (Wang, 2004). Reports of cartel activity within numerous industrial sectors in the late 1990s began distorting competitive markets which accelerated the need for antitrust legislation (China Daily, 1998). In 1995, the Commercial Banking Law was passed that prohibits banks from engaging in "improper competition" (People's Bank of China, 1995). Another important law enacted during the time with anti-monopoly implications was the *Price Law*, which became effective in 1998 and aimed to

establish a new pricing system “compatible with the requirements of a socialist market economy” by prohibiting anti-competitive prices (MOFCOM, 1997). In other words, the law regulates manipulation of market prices by the sellers, provides for price controls and direction by local agencies empowered towards effective implementation of the law to prevent monopolistic practices in China. While the *Price Law* came into force, the draft for the *Anti-Monopoly Law* was being “shelved” by the central government from the legislative agenda of the National People’s Congress (Li, 2006). Despite their emphasis on the development of a socialist market economy, the top party leadership during that time feared the negative impact on SOEs which are seen as the key engines of economic development. China’s WTO entry also added to the concerns for the SOEs and the consequent job losses that the Chinese economy would face after the closing down of enterprises.

Although these concerns acted as key factors in delay behind the framing of competition law in China, the accession had nevertheless intensified the debate among the academics and policymakers both in China as well as in the other countries about the possible effects of both market liberalisation on China’s SOEs, as well as effects from the implementation of its WTO obligations on the SOE monopolies (Wong, 2001; Zheng, 2002). Amidst concerns, the accession however fostered a belief, within and outside China, that such disruptions would be ameliorated by the benefits of market liberalization and free competition. As foreign investment began flowing into China in the post liberalisation years, the need for a comprehensive competition law became stronger. There were also pressures from other countries especially USA, EU and Canada who raised issues of discrimination and transparency vis-à-vis China’s domestic market and international trading agreements involving China (Lubman, 1999; Wilson & Purushothaman, 2003; Harris, 2006). The Chinese policymakers, on the other hand, became apprehensive of the foreign firms, their strong capital backup, superior technology and management skills and realized the importance of a competition law to prevent foreign enterprises from engaging in anti-competitive practices and becoming monopolies in China (Wang, 1999; Wang, 2003). Addressing the above concerns, both domestic and foreign, the NPC Standing Committee stated that China would draft an antitrust law as part of its preparation for entry into the WTO. Government officials also highlighted the need to address China's administrative monopolies and private restraints. However, there were more obstacles than support for enacting any such legal

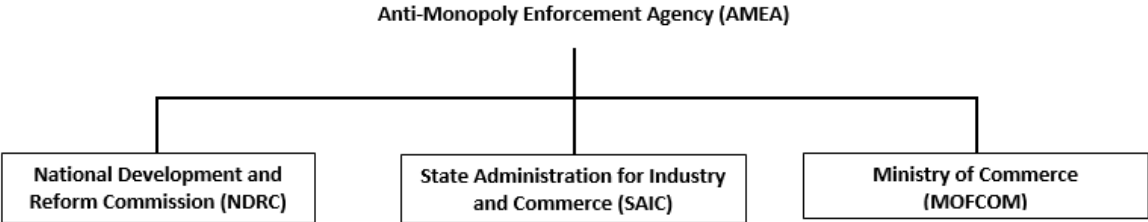
provision after China's WTO membership. As already mentioned, issues of job losses, bankruptcies, and social unrest caused the slowing down of the reform process and it took some time before the anti-monopoly law was enacted in China. Nevertheless, the persistent pressure from other WTO members compelled Chinese government to take steps toward enacting legislation, including antitrust legislation which forms a key component of WTO obligations that every member state is required to fulfill upon its accession. In addition, factors, such as a massive influx of foreign investment; the internationalization of Chinese markets; and the rapidly growing participation of Chinese entities, both state-owned and private, in the international market created the support base for propelling the Chinese government towards making a comprehensive, strongly enforced competition law (Zhu, 2002).

In 2002, the China Securities Regulatory Commission, Ministry of Finance (MOF) and SETC jointly released *Issues Related to Transferring State-Owned Shares and Institutional Shares of Listed Corporations to Foreign Investors (expired)*, which allows the transfer of state-owned shares and institutional shares of listed companies to foreign investors, subject to the requirements of the Guiding Catalogue (Gao & Jiang, 2014). In the same year, SETC, MOF, SAIC and the State Administration of Foreign Exchange jointly issued the *Interim Provisions on Introducing Foreign Investment to Reorganise State-Owned Enterprises*, which allows the introduction of foreign investment to “reorganise state-owned enterprises and corporate enterprises with state-owned equities (financial enterprises and listed corporations are excluded) or turn them into corporations with foreign investment” (Tao, Miao & Lijhin, 2008). The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) presently MOFCOM, at the same time, initiated the process of drafting rules based on the notice and approval process for concentrations involving foreign multinationals. Although these rules were meant for reviewing, evaluating and approving foreign investment projects and enterprise, they were, however, seen as a continuity of the previous restrictions to foreign investment in China and faced criticism for being discriminatory towards foreign companies (Gao & Jiang, 2014). In March 2003, the *Provisional Merger & Acquisitions Rules* were promulgated by MOFCOM and SAIC. Article 19 of the provisional rules stated if the MOFTEC-the predecessor of MOFCOM or SAIC believed that a merger transaction by a foreign investor involved “major factors which seriously impact market competition, the national economy, and people's livelihood, or state economic security,

etc.”, then the investor involved might be required to report the transaction to MOFTEC and SAIC (Li & Bian, 2016). Article 20 further stipulated that on receiving such reports, MOFTEC and other pertinent agencies would jointly organise a hearing to decide the approval or rejection of takeovers. In June 2003, the NDRC promulgated the *Provisional Rules on the Prohibition of Monopolistic Pricing Behaviours* (Owen, 2005). The Provisional Rules, which included antitrust provisions conducted merger reviews and purportedly prohibited price-monopolies, price-fixing, and predatory pricing, can be seen as a serious move toward the enactment of a comprehensive antitrust law (Shang, 2009). However, the Provisional Rules failed to generate any practical impact and its enforcement was abandoned.

The October 2002 Draft AML, prepared by the SETC, underwent several reviews by the State Council Legislative Affairs Office (LAO) in 2003. The provisions prohibited abuse of market dominance, collusion amongst businesses, abuse of administrative power by government units, and the creation of an Anti-Monopoly Management Body of the State Council.

Figure 4.2



Some foreign critics raised concerns with reference to the possible foreign-focused enforcement provisions in these early AML drafts that were partially based on certain foreign-only provisions in the Provisional Rules (Ross, 2003). In response, the views of the other countries and nongovernmental organizations (NGOs) were taken regarding the revised September 2003 Draft AML. The Anti-Monopoly Management Body of the State Council, as laid down in chapter 6 of that draft law would be charged with the investigation, prosecution, issuance of policies and rules, and resolution of all matters requiring its approval under the law (Harris, 2008). One of the reviewed drafts had authorized the following agencies for enforcement of the law: MOFCOM

(for merger review and administrative monopolies), SAIC (for monopoly agreements and abuses of dominant position), and the NDRC (for price collusion and bid rigging). The draft law was also discussed in a two-day conference hosted by MOFCOM outside Beijing in October 2003, which was attended by members from Chinese academia and a few practitioners from Japan, Germany, and the USA. The 2004 draft, issued in February, called for a “competent Anti-Monopoly Authority under the Ministry of Commerce,” a concept that was retained in the July 2004 draft promulgated by MOFCOM and listed on the legislative agenda of the Tenth National People's Congress, in 2008 (Yan, 2004). Concerns related to foreign firms increased in May 2004 with the release of the “SAIC Report,” prepared by the Fair Trade Bureau of SAIC that identified abuses by certain foreign firms, including Microsoft, Kodak, and TetraPak (Wang, 2004; Business Daily Update, 2004). These firms, however, denied any such allegations of abuse. There were also discussions and disagreements about the competence of agencies, which would have enforcement and policy-making authority under the law. This led to the setting up of own Anti-Monopoly Office in September 2004 by the MOFCOM. The draft completion process of the AML also intensified during the latter part of 2004. MOFCOM’s Anti-Monopoly Office submitted a “Submission Draft” of the law to the LAO in February 2004.

In April 2005, the State Council released a draft AML for comments and it provided for the establishment of an “Anti-Monopoly Authority” under the State Council, and the Authority was granted broad powers to implement and enforce the law (Harris & Yang, 2005). This became the subject of the International Seminar on Anti-Monopoly Legislation, held in Beijing in May 2005, organized by the LAO (Wang, 2005). The conference had participants from the leading academia and officials from antitrust agencies in the US, the European Community, Germany, Japan, Korea, and Russia as well as representatives of the ABA, the International Bar Association, and NGOs like UNCTAD and the OECD (BBC World Wide Monitoring, 2005). The discussion mainly revolved around the decision to allocate policy-making, implementation, and enforcement powers among the three host agencies, under the supervision of State Council. Among the inputs given by the international participants on the draft, the most substantive ones were related to changes required in for bringing it in conformity with the international standards. An amended draft of the AML was released on July 27, 2005, which was further discussed at a conference of Chinese scholars, officials, and counsels of multinational corporations, held in

Beijing on July 30, 2005 (Ren & Yang, 2005). During that conference, concerns pertaining to draft's compulsory access provision and its clause prohibiting undefined "abuses" of IP rights were expressed by the representatives of multinational corporations and other general concerns were highlighted by the American Bar Association (American Bar Association Joint Statement, 2005). It was then submitted to the Standing Committee of the NPC for revisions, before its enactment as a law in 2007. To assuage concerns of the foreigners, Chinese officials participated in an Industry Panel Discussion on China's Draft Anti-Monopoly Law in New York in 2005, which was co-sponsored by the US Council for International Business, the US-China Business Council, and the US Chamber of Commerce (Harris, 2006). The meeting was attended by the representatives from the NPC, MOFCOM, SIPO, US antitrust practitioners and in-house counsel members. Further revisions were undertaken by the Law Committee of the NPC, and the draft AML was deliberated at the 22nd Session of the Standing Committee of the 10th NPC in June 2006, the 28th Session in June 2007, and the 29th Session in August 2007, during which it was finally adopted.

The process of enactment of AML in China thus has gone through several stages of reforms and revisions interrupted by debates, discussions, and dissent. The enforcement of AML can, therefore, be understood as a result of debates among a group of Chinese policymakers who, despite their differing positions, were unified by a single objective of maximizing national interest in the era of economic reform (Zhang, 2014). They viewed China's entry into the WTO in 2001 as an opportunity to integrate with the world economy and the AML drafting was a response to the changing economic and foreign policy environment. Despite all the hostility that they faced in the process of AML drafting, there appeared to be a consensus at the time that China needed the AML to protect against the anticompetitive practices of multinational firms (Harris, 2006; Zhang, 2011). A study of this process, therefore, points to certain characteristics about China's antitrust legislation: first, in the early years of economic reform, in the absence of a unified anti-monopoly code, or an integrated antitrust system, the antitrust provisions were inserted in almost all types of laws, at various levels, in the form of regulations, administrative rules and regulatory documents. Secondly, the content of these antitrust laws or documents containing such provisions or regulations was relatively simple. They were general prohibitions, stating the regulations pertaining to monopolistic behaviour did not contain detailed rules or

guidelines. As a result, most of these rules hardly prevented such conducts both due to its fuzzy content and weak enforcement. Thirdly, the bureaucratic structure within which these regulations were implemented indicates, that in a country like China, the party and its various organs remain in charge of interpreting and enforcing the law and that their legal effects were less powerful, reduced in scope and sometimes ineffective (O'Brien & Li, 2005; Zheng,2010). Fourthly, the antitrust agencies within the ministries are sometimes understaffed and they end up competing against other for policy control, departing from their primary objective of regulating monopolistic conduct. With competition playing an ever increasing role in a market economy, the Chinese antitrust legislative efforts accelerated. After 13 years of continuous development, starting from 1994, China's AML was finally passed in August 2007.

ii) Case Study

This section investigates the interaction between the Chinese SOEs and the competition regime under transition. The interaction, to a large extent, had contributed to the shaping of competition policy in China, highlighting the role played by public opinion and political pressures. The story of the high profile merger deal of Carlyle group and Xugong forms an important case study. In October 2005, the U.S. private equity firm, the Carlyle Group intended to buy 85percent of Xugong Group Construction Machinery, by agreeing to pay \$375 million. This marked the biggest proposed foreign acquisition of a controlling stake in a leading SOE, during that time. Xugong is a leading enterprise in China's machinery sector, and an SOE wholly owned by the Xuzhou local government (Svietiev & Wang, 2016). However, Xugong at that time was not particularly profitable, with heavy pension burden for retired employees, and a large percentage of its assets in the form of bank loans. Despite being a leading SOE in the machinery sector, it faced competition from China's privately owned firms and foreign multinationals, such as Volvo and Caterpillar and was in clear need of more capital (Yong, 2012). The Carlyle Group, on the other hand, was a Washington, D.C.-based global asset management company, which specializes in private equity and has dominated foreign private equity investments in China since the early 2000s (Smith, 2003). However, the proposition by a foreign firm to acquire an SOE, led to a lot of public and political stir, infused with nationalist sentiments. The MOFCOM and NDRC approvals were required after the deal was submitted. The deal met a lot of opposition from both

Xugong's competitor as well as from the public. One of its principal competitors, Sany Corporation criticized local governments on the ground for selling premium state assets to foreign investors, while rejecting offers from Chinese domestic investors (Dyer, 2006; Wan, 2008). The central authorities in Beijing also declared that they were not even consulted either by Xugong or Carlyle before coming up with such proposition. While the proposal was under scrutiny by the NDRC and MOFCOM, the rumour was that Xugong was included on the NDRC's list of key equipment manufacturing companies whose restructuring or acquisition process would have to go through close scrutiny (Svetiev & Lei, 2016). An uncertainty regarding the decision making process between MOFCOM and NDRC also broke out, about which body would review the proposed acquisition and simultaneously highlighted the need for a merger approval instrument in China, particularly for dealing with foreign capital in Chinese enterprises. In fact, the case is regarded as a catalyst that accelerated the AML legislative process and raised questions about the legal instruments to deal with competition issues. Thus, in June 2006, during the Xugong acquisition discussions and after having prepared a draft text for two years, the State Council submitted its own version to the top legislator, the National People's Congress. This merger fuelled widespread public concerns that China was compromising in its national champions or strategic companies by selling them at a cheap price to the foreign investors, creating pressure for the Chinese central authorities to block the deal. The case, in fact, revealed the helplessness of the Chinese bureaucracy, split between overwhelming public sentiments and its broad commitments to the openness and rules of the market economy. It, therefore, maintained caution while sending signals to the foreign investors. In its bid to secure the deal, Carlyle itself lobbied MOFCOM and NDRC about the transactions through prominent members of its board, including founder David Rubinstein and former U.S. Secretary of State, Collin Powell (Xinhua, 2006). It had also made concessions and revised its offer on two different occasions, which resulted in a substantial reduction of Carlyle's proposed stake in Xugong to a minority of 45percent (Chen, 2008). It also agreed to give up its right to appoint the chairman of the board but nonetheless would be responsible for the appointment the vice-chairman and five of the ten board members.

The case of Xugong also reveals an important aspect of SOEs reform in China. It points to the continuity of the policies, related to the rigidity of public ownership. Although as part of the

reform agenda of the SOEs, the Chinese government, at both national and local levels, encouraged their restructuring through privatization by selling a share to external investors as a way of obtaining adequate capital for its revival. Foreign investors were often preferred over domestic ones for their relatively advanced management and possible technology transfers that could not only boost under-performing SOEs but also open new markets for them. Xugong was already among the candidates listed for restructuring by the Jiangsu Provincial government in 2002 (Svetiev & Lei, 2016). Its leading position in the market and the divestment that helped in reducing its debts attracted a lot of investors. Xugong refused to choose Chinese local investors, including an offer from Sany Corporation, a leading, privately owned equipment manufacturer in China. Caterpillar's offer was also rejected, apparently due to an unsuccessful earlier joint venture with Xugong in which only Caterpillar's brand was used and which suffered losses leading to substantial employee layoffs (Xinhua, 2006). Carlyle won after several rounds of bidding, both because it made the highest bid, and showed enough commitments to revive the SOE giant. Arguing its case, Carlyle also mentioned that its status as a financial entity made it a better buyer than foreign or local competitors precisely because it sought to maintain the existing local brand and know how. However, these assurances and gestures failed to sufficiently address the concerns which MOFCOM and other relevant ministries of the State Council raised, signaling less hope of approval. As a result, questions related to foreign investment, national security, strategic industries, cross-border mergers, competition, and discrimination against foreign as well as Chinese private companies became apparent during the process.

The domestic debate in China, on this issue, can be further grouped into two camps. Some scholars and policymakers were sceptical about Carlyle's motives behind acquiring Xugong and viewed it as a part of large foreign conspiracy to overthrow China's national champion and launder its strategic assets through exploitation of a Chinese company under the disguise of a regular merger and acquisition activity (Chen & Sun, 2009; Du, 2010). These groups, therefore, were very happy with the MOFCOM's response at protecting national economic security by blocking the sell-out of the strategic state assets. The others, who disagree on the national security concerns involved in the activity of Carlyle/Xugong case, argued that no such threats to state assets were imposed in this proposed deal since Xugong was merely a heavy machinery manufacturer with absolutely no sensitive or strategic significance (Tucker, Hill & Thornhill,

2008). MOFCOM, therefore, was merely acting in retaliation to a nationalistic backlash and its actions, in this case, could not be legally justified. Given the public fervour and nationalist upsurge in absence of an AML, the Chinese central authorities were under pressure not to leave the deal completely in the hands of the Xuzhou municipal government. Also, Carlyle/Xugong acquisition was not that linear or simple as it seemed to be. It was infact based on more nuanced considerations than would be suggested by a straightforward account of favouring “national champions” (Sokol, 2015). Stakeholder and public opinion pressures led to the realisation of building a legalised national security review framework in China and the authorities initiated procedures for the receipt of market input. In July 2006, MOFCOM, together with the SASAC, invited various stakeholders to Beijing for a three-day fact-finding hearing. One of these meetings involved Xugong, central government agencies, municipal and provincial government departments, and a member of the People’s Liberation Army (PLA) to confirm that Xugong did not produce any military equipment and posed no significant strategic considerations (Tucker, 2007). Another meeting was held with sectoral participants, which involved manufacturers, dealers, upstream firms, the engineering equipment association and the machinery industry association. Most participants in the second meeting were from the SOEs, and some private firms were also present. The meetings, first of its kind, was organised by the central authority to gather information as well as for deciding the fate of the business merger case. It, however, concluded that the acquisition plan by Carlyle needed revision and by 2008, the contract between Xugong and Carlyle eventually got expired.

The need for streamlining merger review was highlighted by doubts as to the responsible body and the basis for vetting the merger (Xinhua, 2006). The need to stipulate laws and regulations pertaining to cross-border M&A’s for an effective utilisation of FDI was also felt by the Chinese leadership as China’s interactions with world economy intensified. In 2005, Hu Jintao, the then president of China, indicated the importance and its promulgation of M& A laws at the Central Conference of Economic Affairs. Against this backdrop, MOFCOM and five other ministerial-level authorities jointly promulgated the *Provisions on the Takeover of Domestic Enterprises by Foreign Investors* in August 2006 (MOFCOM, 2006). Article 12 specifically provided, “ Where a foreign investor intends to obtain the actual controlling power of a domestic enterprise it plans to take over, and if any important industry is concerned, or if it has an impact on or may have an

impact on the national economic security, or it will lead to the transfer of the actual controlling power of a domestic enterprise which holds a famous trademark or China Time-honoured Brand, the parties concerned shall file an application with the MOFCOM". The State Council ultimately designated MOFCOM and NDRC as responsible authorities for drafting the AML. Special care was taken to include in the AML the necessary provisions/ criteria for the strategic SOEs with a national security layer of review in cases of a proposed foreign takeover of a domestic enterprise.

iii) The scope of AML.

In 2007, after a preparatory period of nearly 20 years, China adopted its first AML with a long term commitment to maintain a pro-competitive environment for its markets. One of the important and difficult tasks of the legislative process was to define the applicable scope of AML, which involves two main aspects: exemptions to the AML's application and its extraterritorial application. With the intensification of economic globalization and development of technology, the countries around the world have taken the anti-trust laws seriously, by reducing the scope of exemptions, i.e, public monopolies, public subsidies from the laws' application (Chakravorty & Dawar, 2011). For example, in the recent decades, countries have introduced competition to industries, traditionally viewed as public monopolies, and measures are also taken to introduce open competition in strategic sectors such as Telecommunications, Electricity Generation and Distribution, Airlines, Railway Transportation etc. However, in practice, various types of exemptions and exceptions are granted to monopoly industries for social, economic, and political reasons, which do not necessarily imply the weakening of competition law enforcement. Indeed, it may indicate, in some circumstances, necessary means for furthering the objectives of competition law policy (UNCTAD, 2002). One of the areas where the objectives of competition policy often face conflict of interest is the privatization of industries. In several countries, Governments have privatized SOEs with exclusive or monopoly rights so as to make profits as well as attract foreign investment. On the other hand, they place import controls or investment restrictions to prevent foreign entrants or investment into the domestic firms.

After the introduction of AML in China, its application has been well facilitated to monopoly industries. It is modeled in the lines of EU and German competition law and has an extensive

scope of application (Chen & Walley, 2014). The AML comprises of eight chapters and 57 articles. Chapter 1 (Articles 1–12) defines the “General Provisions”, which defines the broad purpose and the functions of the AML. It applies to all “undertakings”, covering any natural or legal person, or any other organization that produces or deals in goods or provides services (MOFCOM, 2008). It defines “Monopolistic conduct” as monopolistic agreements among business operators, abuse of dominant market position by business operators and concentration of business operators that eliminates or restricts competition or might be eliminating or restricting of competition. Chapter 2 (Articles 13–16), aims to prevent monopoly agreements. According to Article 13, it separates horizontal agreements, among competing business operators and Article 14 separates vertical agreements among business operators and their trading parties (MOFCOM, 2008). Chapter 3 (Articles 17–19) prohibits the abuse of the dominant market position. Article 17 defines abusive behaviour contrary to market rules (MOFCOM, 2008). Article 18 provides a list of factors which can be used to identify the existence of a dominant market position (MOFCOM, 2008). Article 19 states three conditions which indicate market dominant position for business operators based entirely on market share thresholds (MOFCOM, 2008). Chapter 4 (Articles 20–31) provides rules on M&A to control large mergers and acquisitions activity, and prevent any merger activity that restrict competition. Article 20 defines concentration of economic power and Articles 23 to 26 cover the procedural requirements which are concerned with lodging concentration declarations with the antimonopoly authorities (MOFCOM, 2008). Referring to the successful enforcement of AML in China, it can be noted that between 2008 and March 2013, MOFCOM had received 698 merger filings in total, within which 627 were registered and 588 were cleared and SAIC has investigated nearly 20 antitrust cases in cooperation with its counterparts at the provincial level since the AML came into effect (Wang & Emch, 2013). In the initial years, the companies that filed the notifications were mostly foreign companies, with fewer SOEs and private domestic enterprises.

Like in other countries, in China too, there are some exemptions and exceptions to AML’s exceptions. One of such provision which tends to reduce the scope of AML is Article 7. It states: “The State shall protect the lawful operations of the undertakings in industries vital to the national economy and national security and controlled by the state-owned economy, as well as in industries subject to exclusive operations and sales according to the law, and shall supervise,

adjust and control the operations of such undertakings and the prices of their products or services, in order to protect the interests of consumers and promote technical progress. The undertakings in the sectors mentioned in the preceding paragraph shall operate in accordance with the law, in good faith and in strict self-discipline, shall subject themselves to the supervision of the government and the public, and shall not use their controlling position or exclusive position to the detriment of consumer welfare” (MOFCOM, 2008). Article 56, similarly, refers to the exception made for the agricultural sector in China, according to which agriculture along with any rural activities such as production, processing, sales, transportation, storage and other operating activities of agricultural products entered into by agricultural producers and farmers’ economic organisations are exempted from the AML’s application (Chen & Walley, 2014). Article 55 fundamentally provides a general exemption from the application of the AML for intellectual property rights holders, who therefore are not subject to scrutiny for merely exercising their intellectual property rights consistent with the relevant laws and administration regulations (Murphy, 2016). The AML’s extra-territorial application is based on the effects doctrine, which means that its application depends on whether the monopolistic conduct carried outside the Chinese territory affects competition in the domestic market. Article 2 states, “This law is applicable to monopolistic conduct outside the territory of the People’s Republic of China which has an eliminative or restrictive impact on competition in the domestic market” (MOFCOM 2008).

iv) Application of the AML on China SOEs

As discussed above, the adoption of AML in China was preceded by a lot of foot-dragging and domestic debates. The debates could be grouped into two categories. First, at its very early stage, the debate centered on the necessity of having a competition law. Although the public and the policymakers felt the need of a competition law, a majority within and outside the party opposed it and deemed it as ‘not required’ in contemporary China. Second, at the later stages, during preparation and deliberations, there were intense debates over how to reconcile the conflicts between the forces of liberalisation (competition law, a part of it) directly affecting the supreme control of the government and the government’s desire to retain its existing power. In the early stages of China’s economic reform, monopoly as an economic concept was largely associated

with market power rather than with anti-competitive conduct (Svetiev & Wang, 2016). Such an understanding was prevalent because most private undertakings in China merely held significant market powers and therefore, the need to have a competitive law was inappropriate, something that was only meant for the foreign ventures. Also, China's market before its WTO entry, was characterised by a low degree of industrial concentration and productivity (Chen, 2002 & 2006). For example, in 1997 there were 17,831 plastic product manufacturers, 58,662 non-metal mineral product manufacturers, and 28,283 metal product manufacturers in China. In the automobile industry, 47percent of undertakings in 1996 produced less than 1,000 vehicles (Chen, 2006). Infact those who even advocated the necessity of an AML, was not sure about its potential impact on the Chinese domestic economy. In their opinion, with any such legislation, market competition would even be significantly restrained because undertakings would then become extremely careful in implementing their business strategies. Some even gave the example of Sherman Act in the US, which they argued was more of a legal justification for governmental interference in the economy, which would create more problems, if implemented in China (Jung & Hao, 2003). The increasing state control with the competition law is what the industrial owners and public in China was worried about. They did not want the law to become a tool for the Chinese government to better scrutinise private and foreign undertakings. It is this line of thinking in the pre-WTO years, which led many to regard competition law as unnecessary and unwelcome.

After China's accession to WTO regime, the debate took a new turn over the adoption of AML. Scholars and policymakers debated the content of AML, rather than questioning its necessity. This was primarily because of the irreversible pressure created by the international body to comply with the market norms and reform its legal system, particularly the ones directly impacting China's market practices. The discordant pace of economic and political reform created a developing dilemma in China where many issues from the past to be solved and too many interests to be balanced, an inherent contradiction between political ideology and social reality, which came to be characterised as a 'socialist market economy with Chinese characteristics' (Huang & Li, 2013). Consequently, the potential effect of the AML on the performance of a single undertaking as well as of a whole business sector required the drafters to take political consent from various interest groups which led to the significant curtailing of the

scope of AML's application on the Chinese economy. As a result, their only objective was to hold on to the most basic norms, which the legislation stands for. Article 1 of the AML represents this compromise and accommodates the interests of both pro-AML groups and literally every political faction by providing:

“This law is enacted for the purpose of preventing and restraining monopolistic conducts, protecting fair competition in the market, enhancing economic efficiency, safeguarding the interests of consumers and social public interest, promoting the healthy development of the socialist market economy (MOFCOM, 2008)”. Although many of the objectives stated in the final AML text, prevents monopolistic conducts, market abuses, and contributes to enhancing economic efficiency, and safeguarding the interests of consumers, some vague and abstract objectives, such the “enhancement of social public interest” and the “promotion of healthy development of the socialist market economy”, obfuscate the real objective of AML, and tries to accommodate a myriad of non-competition-related considerations. Due to the existing vagueness and fuzziness in the AML, the competition agencies easily fall prey to the parties they are supposed to regulate or get influenced by the political connections which tend to favour particular lobby/interests. In addition, the existence of these vague wording in the text, also lead to a situation where the competition agencies, in many instances, get mired in unrelated objectives, such as personal promotion or departmental prestige, rather than focussing on the details of the case (Mariniell, Neven & Padilla, 2015).

One of the groups which strongly resisted the AML was those belonging to the central ministries whose centralised authority over policy-making and allocation of resources might be seriously undermined if the AML was enacted (Lei, 2016). During the discussion of AML drafts, the then Ministry of Railways and the Civil Aviation Administration opined that since railways and airports were natural monopolies and formed strategic sectors, exemption from the AML should be granted to undertakings in these sectors (Williams, 2005; Lei,2016). Similar views were forwarded by the Ministry of Transport who wanted to retain the power to supervise competition issues within the transport industry. The main principle underlying China's SOE reform in the early phases was through wide scale consolidation, i.e., mergers between SOEs in the same industrial sector, as a fastest way for SOEs to increase their size and to be able to compete with

multinational companies which had then just begun to penetrate the Chinese market (Owen, Sun & Zheng, 2005). Therefore, the concern was that the enactment of the AML could very well clash with the reform objective and endanger the interests of a considerable amount of SOEs. Although a majority of these SOEs were running into losses, preserving their credibility became an utmost governmental concern during that time. This is because SOEs, as a provider of a wide range of social benefits to workers such as health care and pension funds, if failed to survive in the increasingly competitive market, the mounting job losses of the workers and their withdrawal from a social safety net might lead to a massive unrest and social upheaval on a national scale. The government, therefore, asked the drafters to take into consideration the issue of SOEs while designing the competition law so that the introduction of competition would not endanger the vested interests of SOEs in strategically important sectors. This resulted into the insertion of the most controversial provision in the AML, Article 7 (Chen & Walley, 2014). It was not included in the draft submitted to the Standing Committee for deliberation but was added later by the Standing Committee. As mentioned above, Article 7 concerns undertakings operating in strategically important sectors, which refers to the SOEs in China. The issue pertaining to the monopoly of SOEs became difficult for the competition policymakers to accommodate. On the one hand, AML's objective is likely to introduce more competition to the market and exert meaningful pressure on SOEs to promote their efficiency and productivity, as these SOEs continue to derive strong market power from state-subsidies and support, detrimental to the interests of the open market. On the other, the sudden exposure of SOEs, most of which are already accustomed to functioning in uncompetitive markets to excessive competition might make the least economically efficient vulnerable, thereby leading them to bankruptcy (Nolan, 2004; Chow 2007; Naughton, 2007). Given the need to preserve the vested interests in the most vital industrial sectors, strategic SOEs, the Standing Committee introduced the Article 7 as an anti-monopoly immunity to the SOEs in China by restricting private capital, especially foreign capital, from entering into these sectors.

Generally speaking, the competition between SOEs (normally the privileged one) and private enterprises is always a conspicuous problem for countries whose state-owned enterprises form the main pillar of the economy and accounts for a much larger proportion of its GDP. In most of the cases, the SOEs enjoy some privileges and conditions in the form of state support and special

subsidies rather depending on its own technology and management innovation, which unfairly reduces its costs and negatively hamper efficient resource allocation. Such a case was the fusion in 2008 between China Netcom and China Unicom, China Railway and China Mobile as well as China Unicom and China Telecom, by an arrangement that was highly criticised for neglecting any proper legal review before the merger was conducted (Fang, 2015). This is because it has involved several powerful SOEs and therefore, could easily bypass the decisions of the MOFCOM in carrying out the activity. The power of the MOFCOM to conduct investigation against the SOEs in China are limited when it comes to these giant enterprises or even monopoly enterprises in critical areas, which are sometimes controlled directly by administration on ministerial level. Additionally, opinions towards these cases contradict with each other. Whether the merger of two SOE enterprises should be considered as reconstruction of state-owned property or fusion under anti-monopoly law becomes a question. To provide some directions into these cases, MOFCOM published its administrative regulation in 2011. According to article 5 of the *Interim Measures for Investigating and Handling Undeclared Concentration of Business Operators*, “Where there is any preliminary fact or evidence showing the suspected failure to legally declare the concentration of business operators, the Ministry of Commerce shall file the case and notify the business operators under investigation in writing.” However, there has been an inclined protection of the SOEs in China. In 2013, the Zhejiang insurance industry was investigated and fined by the NDRC, but the AML agency considered the insurance industrial association as the leading organizer of price agreement and thus primarily liable, letting off the other insurance enterprises from any fines or punishment (NDRC Report, 2013). This was widely criticized as a strongly partisan decision in favour of the state-owned insurance enterprises.

The creation of competition culture is significant in creating competition awareness among market participants, enforcement of anti-monopoly law and realization of Competition Neutrality. It is true that the AML enforcement itself helps create competition culture and promote competition among all the market participators. According to the Article 10 of the AML, “the anti-monopoly law authorities under the State Council may, may, when needed, authorize the corresponding authorities in the people's governments of the provinces, autonomous regions and municipalities directly under the Central Government to take charge of

anti-monopoly law enforcement in accordance with this Law (AML Order No. 68, 2007). This forms the delegations of authority of anti-monopoly law enforcement at the local level. According to this, SAIC and NDRC issue administrative regulations to empower their respective local administrations. However, NDRC is more powerful when it comes to delegating responsibilities whereas, the actions of SAIC seem to be more cautious and conservative (Zhang, 2014). They delegate limited power to the local administrations to investigate specific cases, whereas NDRC has made a relatively abstract and broad delegation of authority. While the three central enforcement agencies enjoy the same ministerial rank, NDRC, in reality, stands out as the far more powerful and has the power to directly appoint the responsible agency, among which the department in State Council is in charge of the extreme cases.

4.4. SUBSIDIES TO CENTRAL SOES

Given the scope of AML's applicability in China, it is clear that SOEs enjoy exemptions from legal investigations despite their monopolistic and anti-competitive practices. However, what often becomes generalization is the failure to distinguish between the power of central and provincial/local SOEs in China. The CPSEs work like another organ of the state whereas the SOEs at the local level are more like private enterprises (Field Interview, 2017). Article 22 of the AML, points to this distinction. It allows a concentration to be exempted from filing with MOFCOM if one business operator that is not a party to the concentration owns more than half of the voting shares or assets of every business operator involved in the concentration. If a given merger involves two large SOEs that are owned by the central government and supervised by SASAC, it could, therefore, be argued that the SOEs should be treated as different affiliates within the same group of companies and would hence be exempted from the filing requirement. Also, no statistics are available which indicate that the AML is applied equally to all undertakings in China. For example, one such case was the 2009 investigation by the NDRC into suspected price-fixing by Travel Sky, an SOE provider of IT solutions to the tourism industry, which holds a 97 percent share of the Chinese domestic airline booking industry. In the suspension of the antitrust investigation in March 2009, nearly all domestic state-owned airline companies in China simultaneously increased prices, which compelled Travel Sky to adjust its

discounting policies and to increase the air ticket price for all the airlines in Travel Sky's network.

The NDRC had to drop its investigation with no prosecution of the case because soon after the investigation was set up, the Civil Aviation Administration of China, the regulator of the aviation industry, made a public statement that “such price increases were the result of independent adjustments by the airlines, and the airlines had not entered into any agreement to fix the price” (Zhang et al., 2014). The Travel Sky case indicated the limitations faced by the AML agencies while dealing with SOEs, especially those controlled by central authorities at the same rank, due to an excessive interference and control from the central ministries. On the other hand, another case which was against Wuchang Salt in 2010, points to the subsidies and power enjoyed by the central SOEs vis-à-vis the local SOEs (Blair & Sokol, 2014: 227). The NDRC's local Hubei bureau took action against state-owned salt companies for violating the AML's Article 17 (prohibition on abuse of dominance) and Article 7 (which prevents SOEs from using their exclusive operation rights to jeopardize consumers' interests). The investigation was successful and further revealed that the enactment of the AML against the SOEs at local levels or at the municipal or provincial levels is relatively easier as compared to the central SOEs. China also has an official policy of promoting “industrial concentration” in industries that it considers strategic, including steel, aluminum, agriculture, and others⁷. Keeping in line with this policy, several MOFCOM merger review decisions have restricted the expansion of foreign competitors in certain Chinese and international commodities markets. The primary reason behind this policy is to allow “national champions” and other central SOEs to grow and achieve a stronger, more dominant market position, including through acquisitions-contrary to the general purpose of competition law while inhibiting further such transactions by foreign companies (US Chamber of Commerce, 2014).

⁷ NDRC, the Ministry of Industry and Information Technology (MIIT), and other agencies have an official policy to achieve industrial concentrations for domestically-invested companies in the automobile, steel, cement, shipbuilding, electrolytic aluminium, rare earths, electronic information, pharmaceuticals, and agriculture industries. See Guiding Opinions on Accelerating the Promotion of Mergers and Reorganizations of Enterprises in Key Industries, issued by MIIT, NDRC, Ministry of Finance, Ministry of Human Resources and Social Security, Ministry of Land and Resources, MOFCOM, People's Bank of China (PBC), State-Owned Assets Supervision and Administration Commission (SASAC), State Administration of Taxation (SAT), SAIC, China Banking Regulatory Commission (CBRC), and China Securities Regulatory Commission (CSRC) (Jan. 22, 2013)

4.5 SOES AND WTO GPA NEGOTIATIONS

On December 28, 2007, China submitted its application for acceding to the Agreement on Government Procurement (GPA)⁸ to the WTO Secretariat after being an observer since 2002. The negotiation would define China's openness in an economically and politically significant market: the government procurement for consumption and investment (Chen & Walley, 2014). China made its initial offer in January 2008, followed which four revised offers were submitted on July 2010, November 2011, November 2012 and January 2014, respectively. Negotiation on coverage, i.e., the offers China is willing to make, forms the core of the GPA accession process. Prior to its WTO entry, China did not have a government procurement regime. However, the first relevant regulation in this direction was the *Interim Regulations on Government Procurement* promulgated by the Ministry of Finance (MOF) in April 1998 (Tu, 2011). Another procurement-related legislation is the *Tendering Law* adopted in August 1999, designed to deter corruption through public tendering rather than to promote value for money in procurement or give preference to domestic-sourced goods and services (NPC, 1999). Also, the Committee on Financial and Economic Affairs of the NPC established a drafting group of Government Procurement Law, in 1999. Following three years of deliberation, the *Government Procurement Law* (GPL) was enacted in June 2002. However, the implementation issues related to the GPL are still under discussion, and at present, contains abstract principles rather than concrete and applicable provisions. Another hurdle facing China's GPL is to include state enterprises procurement without further changes in the legal framework because under the jurisdiction of the MOF, it only covers procurement of government organizations and public institutions (such as public universities and hospitals).

Although China committed itself to initiating negotiations for membership in the GPA, there is no clear indication of the time period by which it will be completed. WTO GPA Appendix I commitments cover three levels of government procurement entities: central government departments; provincial government organs; and other public entities such as state enterprises (Ping, 2009). Concerning the procurement of SOEs, China agreed that "all laws, regulations,

⁸ As a plurilateral agreement under the WTO framework, the WTO GPA only regulates government procurement practices on a voluntary basis of those WTO members who choose to bind in the GPA.

and measures relating to the procurement by state-owned and state-invested enterprises of goods and services for commercial sale, production of goods or supply of services for commercial sale, or for non-governmental purposes would not be considered to be laws, regulations and measures relating to government procurement. Thus, such purchases or sales would be subject to the provisions of Articles II, XVI and XVII of the GATS and Article III of the GATT 1994” (Report of the Working Party on the Accession of China, paragraph 47). This indicates that SOEs need not be included in the GPA coverage since they are already meant for carrying out nation’ activities. However, the GPA parties are not convinced by China’s commitment and worry that SOEs will submit to governmental requirements in some cases to secretly give preference to domestic products. In such cases, with SOEs listed under the regulation of the GPA, foreign suppliers at least can challenge the act and resort to WTO DSB to address hidden discrimination from SOEs.

The NDRC and the MOF prepared a joint draft, *Opinions on Implementation of Government Procurement of Energy-efficient Products*, in 2004, which for the first time includes government procurement as a formal policy tool towards specific goals for the first time. The policy, however, was less controversial and did not attract much disagreement from foreign companies and other countries. In February 2006, the State Council issued the National Guideline on *Medium- and Long-Term Program for Science and Technology Development (2006-2020)* to implement government procurement policy with the objective of promoting indigenous innovation (Xinhua, 2006). To encourage innovation and to create incentives in the form of government policies, a document entitled *Trial Measures for the Administration of the Accreditation of National Indigenous Innovation Products*, was jointly issued by the science and finance ministries in China in 2006, which defines the products eligible for the status of indigenous innovation products and then for the preferable considerations in government procurement. The underlying objective is to encourage domestic innovation and to support “national champions” by providing financial incentives to reduce China’s technological dependence on foreign suppliers (Chow, 2013). The indigenous innovation policy, led to a flurry of protests, especially in the US. Foreign companies investing in China complain that because this policy discriminates against their products by imposing a requirement that the manufacturer of the product should have ownership of the trademark. U.S. businesses particularly claim that

these policies are designed to force them to transfer their advanced technologies to Chinese entities as a condition of being able to sell goods and services to the Chinese government (Morrison, 2013).

Evaluating China's offer of accession to GPA, it is the SOEs in the GPA coverage, which presents numerous challenges to the negotiation. First, Chinese SOEs are aggressively diversified in their operations than any other Chinese firms. The SOEs also differ in their degrees of market-orientation (Ping, 2009). The diversification is so huge that even when covered by the GPA, it is very difficult to distinguish between governmental and commercial procurement in an SOE. The next challenge pertains to the large size of Chinese SOEs' investment and consumption, which is much larger than that of any country. Since government procurement markets under GPA negotiation is based on strict reciprocity, it is almost impossible to find comparable sectors in incumbent parties as Chinese SOEs. Under the GPA, the MFN requirement is frequently set aside with respect to the parties' market access commitments in goods, services and construction services.

Thirdly, China's own government procurement regime is beset with several problems, often criticized for its inconsistency with international standards (Tu, 2011). The GPL in China is narrowly defined and in terms of procuring entities, it excludes all SOEs. These SOEs, who enjoy exemptions from many laws and provisions, would not prefer to be administered by the direct government control by joining GPA. In the case of China, the role of government is too large to be separated from the market and it forms the major investment and market entity in China. For example, the state sector including SOEs and governments accounts for almost one-third of the total fixed asset investment. For example, the Ministry of Railways (MOR) in China is almost the only constructor of railways, investing almost like \$220 billion on developing the high-speed railway network (OECD Report, 2013). Interestingly, in March 2011, the National Audit Office found that contracts worth more than 4 billion Yuan were awarded without tendering (Xinhua, 2011). Therefore, the role as an investor by the various levels of Chinese government poses a serious challenge to the current GPA system. It is also hard for the Chinese government to put its investment under the scrutiny of an international organization.

4.6 CONCLUSION

The chapter thus, explains the neo-liberal context of SOEs reform in China, the factors that impelled China to bring about certain economic and legal reforms and the challenges they pose for the SOEs. Even after 15 years since China joined the WTO, a considerable gap exists between its WTO commitments and practice. Two factors that acted as a lever to SOEs reform; first, WTO restrictions on industrial subsidies; and second, China's accession related commitment under the GATS to open its SOE sector to foreign competition. The idea of an external lever to advance economic reform was clearly in the minds of Chinese leadership when they sought out WTO accession. However, the tenor of reform gradually dissipated with aspects of policy continuity taking over in the functioning of China's economy, following years of accession. It is true that China has worked a lot towards economic liberalisation, yet there has been substantial wavering in the commitment to privatizing SOEs and limiting the state sector, a debate that continues to the present day.

In an interview with the experts from the leading financial institution in Beijing, they argue that SOEs reform in China is not an economic problem rather a political and social problem. In their view, there is a tight governmental control on the mother company of strategic SOEs in China, and they receive significant benefits vis-à-vis domestic private enterprises and foreign firms. A major benefit is that the SOEs need not be productive or profitable. Another study by the Unirule Institute, an independent Chinese economic think tank, points to the preferential financing that Chinese SOEs enjoy in the form of low-interest bank loans, free land and reveal that the return on equity was about half the rate of non-state-owned enterprises, a substantial "subsidy" in and of itself. Another interview with scholars, working on the WTO issues from the Chinese Academy of Social Sciences, Beijing views that SOEs should not be given low-cost credit by the government and instead emphasis to be put more on improving its operations, which in their opinion should be "market driven", instead of being "market based". Finally, in its Protocol of Accession with reference to SOEs, there is a lot of gaps in the language of the protocol, reflecting the unfortunate imbalance between the legislative and judicial functions of the WTO (Levy, 2017).

Although WTO accession has induced some amount of reduction in both direct and capital subsidies to SOEs, a number of large central SOEs continue to enjoy a lot of indirect subsidies like a preferential land rental as well as cheap loans and other forms of state support. Additionally, Beijing has devised the “Chinese way” of interpreting competition, transparency, accountability, etc. which protects its state sector from the direct influences of WTO accession as well as the burden of its commitments. The evidence drawn thus confirms the two hypotheses that it’s the state power structure, institutions and its leadership which directly influences China’s SOE reform more than anything else.

CHAPTER 5

CASE ANALYSIS I: TELECOMMUNICATION INDUSTRY

5.1 BACKGROUND

This chapter seeks to understand and analyse aspects of China's SOEs reform through a detailed study of the telecommunication sector in China. Evidence drawn from the sector's monopolistic behaviour, characterised by elements of change and continuity will be discussed based on the study of its leading SOEs firms. The study will evaluate its governance practices, organisational structures, nature of ownership and regulation and its relationship with the Chinese government. The rationale behind choosing China's telecommunication sector as the case study is due to its economic and political significance in China's economy and most importantly a majority of this sector's ownership is under the Chinese state. The study will be analysed within the institutional theory framework, where the complimentary political and economic logics discussed in the previous chapter will shed light on the reform pathway of this sector. Institutional arguments rely not on aggregations of individual action, or on patterned interaction games between individuals, but on "institutions that structure action" (Clemens and Cook, 1999: 442). The emphasis is to understand the sector reform-experience with the dynamics of politics and their effects on economic reform outcomes. While trying to focus on the politics of continuity, the study also illuminates upon the changes which came in during the 1990s with the participation of private and foreign investors in China's telecommunication sector. In the initial years of the sector's reform and opening up, the pace of initial reform was interrupted with the state objective of preserving the monopolistic character of the sector, once the networks were in place. The desire to create national champions was clearly evident in the way the reform in this sector had shaped up during the last two decades, when the major telecom firms, China Telecom, China Unicom and China Mobile became robust representatives of the state sector. The rounds of administrative restructuring in the face of WTO commitments was quite complex and puzzling. The instrumental market during the period was both weak and active, and when there were strong incentives to deepen the reform, firms faced serious restrictions under SASAC's tutelage, which reinforced the status of telecommunications basic services as an inviolable segment of the state-owned economy. The evidence also suggests that while the Chinese government's objective in securing the information flows is an important factor in shaping the degree of overall state

control in telecommunications, the political sensitivity of this field is just one of the several drivers in understanding the continuity in policies or the absolute state ownership of the sector (Eaton, 2015: 80).

To illustrate better the logic of the theoretical argument developed in chapter two, pathway of China's telecommunication reform is traced along three dimensions. The first section draws on the experiences of early years of reform, the emergence, evolution and the impact of an industrial policy regime which took shape in the early 1980s. The section also briefly outlines the state of China's telecom sector in the pre-reform period. The initial policy initiatives in the telecommunications sector, by the political leadership in China, paved the way for a slate of bold industrial policies in the 1980s which granted the sector considerable autonomy over the raising and disbursement of funds for network construction. Over time, the phases of reform, with its initial focus on building network lines, shifted its attention to developing the sector into large enterprises capable of competing in the global markets or at least in the face of foreign/private competition with the WTO entry. The second section examines the evolution of regulatory institutions in the telecommunications sector. The chapter involves a discussion of the transformation of the Ministry of Post & Telecommunications (MPT) from its role as rule-maker and sole authority in the telecom market to a more impartial regulatory authority since 1998 and also how the decision to create China Unicom was motivated by the need of having some competition in the sector, in order to make the sector more efficient. Despite these efforts, the governance of telecom remains highly contested and ad-hoc in nature. The third section examines the ownership and regulatory structure of the telecommunications sector and how the administration evolved across the reform phases. This section is also about the relationship between the state and the telecom sector, where the role played by the agencies will be analysed and how these roles resisted the forces of competition, market pricing and the corporatisation of the sector. The final section talks about the impact of WTO commitments on the reform of the telecommunications industry.

Telecommunications markets, traditionally speaking, had been natural monopolies all around the world (De Bijl & Peitz, 2003). The principle justification based on economies of scale was that the efficiency of a firm providing telecommunication services was higher than multiple firms

competing against each other. When the marginal cost of providing service to an additional customer is close to zero, such a business is a candidate for being considered as a single and natural monopoly (Ranade, 2017). The trend began to change with the coming in of liberalization and increased activities in foreign trade and investment, leading to the adoption of competition in telecommunication sector and in gradual opening up of the telecom markets. For example, in countries such as UK, USA along with other developing countries of the South Asian region, the telecom sector is the first sector to be opened up, and it gave tough time to the policy makers and the regulators to work on its modalities of liberalisation. However, it took China to join the league and the reform processes that the sector underwent were pretty complex and long-winding. For a long time after the opening up years, the telecommunications network in China, was viewed as part of the national infrastructure and a sovereign body and was under the absolute control of the state. The reform in this sector has been part of the large SOEs reform in China. Like the SOEs reform in general, the opening up of the telecommunication sector has been in phases. Although the sector has shifted from being a fully regulated and state controlled to a more liberalised one by introducing structural adjustment and institutional changes, the major telecom companies continue to be state-owned and there exist considerable restrictions on foreign and private sector engagement.

5.2 THE EARLY YEARS

Between 1949 and 1978, China adhered strictly to a socialist regime in which the economy functioned under the state control, excluding any possibility of competition. The SOEs ran the economy in all sectors. The management of the telecom sector between the 1950s and early 1980s was semi-military and highly centralised under the state command structure (Yang, 1991; Gao, 1991). Although telecom was considered a strategic sector of national importance, the sector was highly inefficient and non-productive. Thus, when Deng Xiaoping initiated the economic reform in 1978, the telecom sector among other sectors was accorded priority for reform. Following the historic Third Plenary Session of the Eleventh Central Committee of the CCP, a month later, Deng Xiaoping declared that “investment focus should fall on electricity, coal, petroleum, transportation and telecommunications” (Wang, 2001: 31). The ‘opening up’ phase, therefore, followed a gradualist path instead of carrying out an overall reform, by

introducing competition to the less-important sectors first, and later to the infrastructures. The small sized SOEs were open to competition first, followed by medium and large sized SOEs (Ma & Ling, 1998). During this period, Economics took precedence over politics and four modernizations, namely, modernization in agriculture, industry, national defense, and science and technology, were emphasized. Emphasis was also placed on identifying the errors made in the past and starting to devise policies that would lead to a fast-paced development (Wu et al., 2008: 15-17).

The 17th National Post and Telecommunications Work Meeting, held in April 1979, was a crucial first step. This meeting was attended by three vice-premiers-Yu Qiuli, Wang Zhen and Gu Mu (Eaton, 2015). Based on the report prepared by MPT at the end of this meeting, the State Council issued Document No. 165 in 1979 and telecommunication was made an official priority for the first time in the 1980s. Mentioning telecommunications in the sixth five-year plan, it stated: “Transportation, postal service and telecommunications are a conspicuously weak area in the current economy. In the Sixth Five-Year Plan period, a concerted effort should be made to reinforce the construction of these industries, to improve their management and to raise their capabilities and efficiency so that they can meet the needs for energy, drive, and stable economic growth” (Yang, 1990). The policy also directed the local governments to construct telephone networks and the city hotels were asked to have telephone lines and access to overseas dialing facilities. Other preferential policies included (Wei, 2002: 7): (1) preliminary telephone installation fee. Special approval was granted to the MPT to collect preliminary telephone installation fees as a major part of telephone user fees, ii) Preferential tax rates. Accordingly, a telecommunications department needed only to pay income tax at a 10 percent rate and was allowed to deliver only 10 percent of its foreign exchange income from non-business undertakings.

In this background, the official pronouncement on the telecom sector was clear in the 1980s. Publications in 1982, 1984 and 1987 consistently asserted Chinese state’s decision to protect this sector. However, the major push for liberalizing the telecommunications sector in China came with its desire to join the WTO (Mueller and Lovelock, 2000). In the early years, the monopolistic authority lay with the MPT, presently Ministry of Information Industries (MII) for

the telecom industries in China. As a department of MPT, the Directorate General of Telecommunications (DGT) was responsible for network operations. The China Telecom which was the subordinate department of MPT was too weak to withstand competition. The sector was based on preferential policies of the Chinese government. For example, the State Council authorised MPT to exact an installation fee from every subscriber that was equal to the construction cost of one line. In addition, MPT also enjoyed tax privileges (MPT, 1992) and its nature of asymmetric regulation favoured it politically to retain a dominant market position for the China Telecom (Gao & Lyytinen, 2000). Until 1994, more than half of the entire investment capital of MPT was derived from these preferential policies (MII, 1999).

Following such support measures, the sector developed quickly and entered into a rapid growth phase in the 1990s. During the Eighth Five-Year Plan (1991-1995) period, the aggregate investment in fixed assets in the province's P&T industries reached RMB 13 billion, which was a 19 fold increase over that of the Seventh Five-Year Plan (1986-1990) (Tang & Lee, 2003: 24). Thus, the growth level of the telecom sector equaled to the general growth level of the Chinese domestic economy during that period (Li et al., 1996: 2). The telecommunications market also shifted from a demand pull to a seller's push (Yang, 1997). Unlike the early years, the telecom sector shifted its goal from infrastructure development to improving service quality and making it cost effective, for the Chinese citizens, which could be achieved through competitive mechanisms. There was also an internal debate among the Chinese ministries such as ministry of energy, railways and electronics, brokered by the State Council, who advocated in favour of some domestic competition in the telecom sector. This led to the establishment of another telecom firm China Unicom, in 1994. Although one of the purposes behind its creation was to introduce some kind of local competition in the telecom sector, the two operators demonstrated huge differences in terms of their capital assets and market capture. Unicom's income was less than 1 percent as compared to China Telecom's (MII, 1999). During these phases of reform, China also lacked legal framework regulating monopoly and therefore, the concept of competition existed in reform text but in practice. China Telecom, which was directly under MPT's control, lacked independent oversight of finance, investment, and personnel. Hence, on the one hand, MPT was unable to regulate the market fearing discrimination toward China Telecom, owing to its close affiliation and on the other, MPT lacked enough power

to interfere and intervene in the functions of other ministries, such as MEI, which now participated in the telecommunications market (Zhang, 2002).

The Pre-WTO phase from 1998 onwards, witnessed major changes in the telecommunications market. Since, the telecommunications market formed one of the key points in negotiations between China and WTO members (see WTO, 2001), the Chinese government launched a new round of administrative reforms. As part of the administrative restructuring, the Ministry of Information Industry (MII) was formed in 1998 which replaced the MPT. In 1999, the China Telecom was divided into four independent groups by the MII: China Network Communication Corporation Ltd. (China Netcom), China Jitong Network Communication Corporation Ltd. (Jitong), China Satellite Communication Company, and China Mobile Communication Corporation Ltd. (China Mobil). The primary objective behind this administrative restructuring was to separate the regulatory responsibilities from the business management goals of the telecom industry (China Telecom, 2003). While the two SOEs maintained their dominance in the Chinese economy, the Chinese government as part of the accession led negotiations, welcomed competition and foreign participation into the telecom market (Mueller and Lovelock, 2000). Some measures such as absorbing private and foreign capital were also encouraged. The October 1997 listing of China Telecom in Hong Kong marked a new phase of China's SOEs in the global capital markets because it was central government-sponsored, massive privatisation through IPOs (Stanton, 1997). The example of China telecom served the model for the subsequent listing of oil and gas giants PetroChina and Sinopec in 2000 (Eaton: 2015). China's telecommunication sector, therefore, entered a new phase with advanced cross-country networks, which created the basis for market-based competition (MII, 1999).

5.3 REFORMS IN THE LIBERALISATION ERA

The telecommunication sector entered into new a stage of reform, after China became the official member of the WTO in 2001. As part of the restructuring efforts, the State Council promulgated *Regulations on the Administration of Foreign Invested Telecommunications Enterprises* in December 2001, detailing out rules for foreign investment in the Chinese market (State Council, 2002). According to the WTO commitments, China agreed to permit 49 percent foreign

ownership in mobile communications within 5 years, 49 percent in international and domestic services within 6 years, and 50 percent of value added services within 2 years. Also a foreign investment cap on basic telecommunications services operators was set at 25 percent in major cities and at 49 percent in semi-urban areas allowing the Chinese government to retain control of more than 50 percent of ownership. The regulatory system of the telecommunications was significantly improved and the Chinese government adopted the devolutionary approach followed by consolidation to correct the unbalanced telecommunications market.

Table 5.1 - Liberalization of Foreign Investment Limits in China's Telecoms Sector Post-WTO Accession

Sector	On 11 Dec. 2001 (%)	By 11 Dec. 2002 (%)	By 11 Dec. 2003 (%)	By 11 Dec. 2004 (%)	By 11 Dec. 2005 (%)	By 11 Dec. 2006 (%)	By 11 Dec. 2007 (%)
Mobile	25 (3 cities)	35 (17 cities)		49 (17 cities)		49 (nation-wide)	
Fixed-line				25 (3 cities)		35 (17 cities)	49 (nation-wide)
Value-added/paging	30 (3 cities)	49 (17 cities)	50 (nation-wide)				

Notes: The initial three cities are Beijing, Shanghai and Guangzhou. The 17 cities include the first three plus Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Taiyuan, Xiamen, Xi'an and Wuhan)

Source: Xu (2002)

During these years, the telecom sector in China, in fact, witnessed a virtual explosion of both fixed and mobile users shot up significantly in its post accession period. Data reveals that the number of wireless phone users in China had also reached 250 million by the end of 2003 (Statistical Year Book of China, 2005). China was not only regarded as a market for service providers but also as a manufacturing base for telecommunications equipment, which led to the expansion of domestic manufacturing industry. Although the telecom sector opened up domestically in a significant way and many major service providers like China Telecom, China Unicom, China Mobile, China Netcom, and China Jitong were competing with each other, fair competition in telecommunications markets was not yet a reality (Gao & Lyytinen, 2005). Both Unicom and China Netcom were too weak to effectively compete with China Telecom. Also,

unlike other countries such as the UK and the USA, the reforms in the telecommunication sector were carried out by government orders which lacked legal aspects and supervision.

Another major organisational restructuring happened following years of adjustments in the telecommunications sector in 2008. The State Council announced its Ministerial Reform Plan which led to the establishment of a Ministry of Industry and Information Technology (MIIT) to replace the previous telecommunications regulator MII (He, 2010). MIIT, the new regulator was established by merging the previous MII, the Commission of Science Technology and Industry for National Defense (COSTIND), the State Council Office of Developing Information Society, and some offices of the NDRC. A *Notice of Deepening Reform in Telecommunications Sector* was published by MII in conjunction with NDRC and National Treasury, describing a new market reform, which included a sale of China Unicom’s CDMA network to China Telecom, merging China Unicom to China Netcom, merging China Satellite basic telecommunication business to China Telecom, and merging China Railcom to China Mobile (MII, NDRC & Treasury, 2008). In other words, the restructuring was followed by the merger of previous six telecommunications SOEs into three super-SOEs. Popularly referred to as the “six to three” reform, the overhaul in the telecom sector indicates the shift in the organisational/operational structure of the sector is subjected to government directives in China, who view large SOEs as “quasi-governmental agencies” (Duan & Saich, 2013).

Table 5.2 - Comparison of the Telecom Regime

	Before Reform	1998–2008	After the 2008 reform
Operator	MPT	Six telecoms firms	Three telecoms firms
Regulator	MPT	MII, NDRC, SASAC	MIIT (Bureau of Telecoms Management), NDRC, SASAC
Owner	Government	SASAC and shareholders	SASAC and shareholders

Source: By Author

5.4 ORGANISATIONAL AND REGULATORY STRUCTURE

The telecom sector in China throws a great deal of light on the bureaucratic decision making, inter-departmental competition and the overall organisational and ownership structure, which is controlled by the government and represents a good case study which illustrates the continuity of

China's SOE policies in the post liberalisation era. At the helm of decision making is the State Council, which looks after the legislative issues in China, including those regarding telecommunications. The MII, an important wing of the State Council, is responsible for enacting telecom policy in China. Under the MII are 30 Post and Telecommunications Administrations (PTAs) that implement MII's telecom policy subject to MII regulation and approval (ITA Document, 2010). The PTAs play a key role in attracting domestic as well as foreign investment. Although the PTAs are subordinate to the MII and have limited influence on the formulation of regional development plans, in some parts of China, they operate fairly autonomously in terms of planning and developing networks (ibid).

The major telecom service operators in China are government owned. China Telecom and China Unicom are considered to be among the powerful SOEs in China. China Telecom, established as an administrative agency in 1958, was broken up in 1999, and reformed in 2002, with an annual revenue level of more than RMB 380 billion (China Telecom Website). With its 90.520 million subscribers, China Telecom has many subsidiary branches in 31 provinces. As one of the three leading telecom operators in China, China Telecom ranked 182nd in the 2013 Fortune 500 Companies, China Telecom provides integrated information service solutions including mobile services, broadband Internet access, information service applications and fixed-line telephone services (ibid). China Unicom, was established in 1994, is a consortium of 17 Chinese telecom organizations and operates two mobile services based on GSM and CDMA standards. It is the second largest mobile operator in China and was the official partner of the 2008 Beijing Olympic Games for fixed communications services (China Unicom Website).

The new regulatory institution, in the form of MII demonstrates Chinese state efforts toward regulatory reform. The MII is in charge of the entire information industry sector which encompasses not only the telecoms service but also the electronic, information technology manufacturing and software sectors. Yet its regulatory power is considerably constrained, and is subject to party directives and other supra-regulatory bodies (Yeo, 2008). This is primarily because MII despite being the formally designated regulatory body is governed and controlled by the party and two powerful comprehensive state institutions: the National Development and Reform Commission (NDRC) and the SASAC. One of its key responsibilities is to facilitate and

monitor service quality and fair competition among telecom service carriers. It has played important roles in proposing ideas to the policy-makers, top leadership, whose knowledge of telecom market and its operations are fairly limited. However, these proposals and regulations drafted by the MII are first reviewed by the NDRC before the State Council gives its final nod. As part of its basic service, the MII outlines industrial policies, sets service fees and technical standards, and issues licences and rules, but requires consultation with the Price Bureau (wujia ju) under the NDRC (Yeo, 2008).

NDRC, government's chief co-ordination agency, reviews all policy proposals and rules drafted by the MII and holds a discussion with the MII on price setting issues. For example, in February 2008, the NDRC and the MII jointly announced a price cut on mobile roaming service charges by between 54 percent and 73 percent depending on locality, after they held a public hearing on the issue (China Daily, 2008). The NDRC also announced that it would adopt a preferential policy for rural areas, relieving the burden on farmers who are paying a higher telecoms connection fee than urban residents (TechSecurityChina.com-Editor, 2007). In 2011, the NDRC also filed for investigation against China Unicom and China Telecom on charges of not letting private capital enter the telecom industry (Yeo, 2009). Previous research and studies show that government control over telecom charges is one of the major reasons for the imperfect competition in China's telecom market. Another attempt at centralization on the telecom sector is carried out by the SASAC. While the MII puts more emphasis on breaking up the old monopolies and develop a market guided telecommunications industrial structure in China, it has no substantial authority to direct the market players (Lan, 2014). In practice, the actual market structure determining competition among telecom services is designed by SASAC. It has its policy objective of creating national champions through merger and acquisitions and does not disturb the monopolized market structure as long as firms are globally competitive (Yeo, 2009). For example, while there are four major companies in China's telecom service sector, only two players, China Telecom and China Mobile, dominate each fixed-line and mobile service.

Unlike NDRC and SASAC, the Chinese Communist Party's involvement in the telecom business remains unaddressed in the public, despite holding the strongest influence in the bureaucratic decision making. The Party operates through three bodies; the Central Standing Committee of

the Political Bureau, the Department of Organisation (OD) and the Party Committee. The Central Standing Committee of the Political Bureau is the final decision maker in key policies of market restructuring (Liberthal, 2002) and senior officials of the MII are nominated by the Department of Organization of the CCP and the SASAC (Yeo, 2009). The OD implements the nomenklatura⁹ system which is a key instrument of Communist Party control over leadership selection in China and through this system; the top executives in telecom firms are appointed, removed and transferred by the OD. This is carried out with inputs from SASAC, since OD does not have sufficient knowledge of the candidates or the firms, and that is how the MII's authority is further fettered by the SASAC.

In addition to the OD, there is the Party Committee (Dangwei) inside the firms (Interview at RDCY, 2017). Its core task is not only to supervise the Party members of the firms but to ensure that the policy directives of the Party leadership are reflected in firms' business management. The key leadership positions are also held by the member of party committees, such as China's Telecom's CEO, Wang Xiaochu, is both the executive chair of the board of directors and the Party secretary. The CEO of the firm sometimes has the role of party secretary and they belong to the ministerial or vice-ministerial rank of the party. The former China Netcom Party secretary, Zhang Chunjiang, spearheaded the reform of corporate governance, creating a model for other large state firms by strengthening its board of directors and clarifying the roles of the firms' Party Committee in business management (Towns, 2006). This indicates that the SOEs reform in China does not mean a loosening of the Party's authority on the firms but it is a way to maintain party's hold and objective in corporate governance. For example, although China, with listings in overseas stock markets, has introduced a corporatisation in the key SOEs, most members of the board, however, belong to the Party Committee. They are party-state controlled but internationally listed telecoms operators. The party dominance is not restricted to the appointments as per the nomenklatura, but it also removes and reshuffles the CEOs or senior leaders of an SOE. For example, in 2004, due to concerns about the bosses of telecom sector

⁹ The nomenklatura system had its beginnings in the early 1950's, and by 1955 a system along Soviet lines had been established in China. The nomenklatura (zhiwu mingcheng biao) system² consists of lists of leading positions over which party committees exercise the power of appointment, lists of reserve cadre for the available positions, and the institutions and processes for making the appropriate personnel changes. The system is arguably the major instrument of Communist Party control over contemporary China's political, economic, social, and cultural institutions (Burns, 1987)

wielding excessive authority within the firms, the party reshuffled the CEOs of three major telecom industries (table 5.3 below)

Table 5.3 - List of CEOs Transferred Within the Telecom Sector In 2004

Name	Old Post	New Post
Wang Jianzhou	Chairman, General Manager, Party Secretary of China United telecom	General Manager, Party Secretary of China Mobile
Chang Xiaobin	Deputy General Manager of China Telecom	Chairman and Party Secretary of China United Telecom
Wang Xiaochu	Vice President of China Mobile	President, Chairman and Party Secretary of China Telecom
Shang Bin	President of China United Telecom	Party Secretary and Vice President of China Telecom
Zhang Chunjiang	President and Party Secretary of China Network Telecom	Party Secretary and Deputy General Manager of China Mobile

Source: Li (2014; 123)

5.4 IMPACT OF WTO AND TELECOMMUNICATIONS SERVICE SECTOR

As discussed in the previous sections, the WTO entry marked a very important phase in the reform of China’s telecommunications sector. In fact the WTO negotiations had unleashed a debate on the opening of telecommunications service sector to the foreign competition. In 1993, the ruling by the State Council, Policy No. 55, which stated flatly that “foreign businesses are not allowed to run or participate in the telecommunications service business in China” (State Council Document, 1993). In the view of Muller and Lovelock (2000), the ruling which had been drawn up based on the inputs from MPT was primarily intended to curtail Unicom’s development and to deprive the company of much-needed capital and cooperative opportunities with foreign telecom service providers. The rule was also consistent with the State Council’s interests to break MPT’s monopoly and to retain tight control in the development of telecommunications. They identify the domestic policy bargains within the political establishment that supported the FDI restriction. During the 15 years of its grueling negotiations for WTO membership, China resolutely resisted demands to undertake commitments on telecommunications as part of its

WTO compliance. The resistance came not only from the ministry responsible for telecommunications but also others in the government and the leading figures in the party leadership who were concerned that commitments in telecommunications could lead to a weakening of national security and leakage of sensitive information. The underlying objective of the concern was to protect the party's legitimacy from the Western interference.

However, during the course of negotiations, it became increasingly clear to the highest political leadership that it had no choice but to comply with the commitments for the larger economic interest of global integration. President Jiang Zemin and Premier Zhu Rongji understood that WTO commitments would give China a wider economic leverage to deal with the developed countries of the world. To this direction, Premier Zhu Rongji, said in his speech in 1999, that China was finally ready to offer huge opening of its markets, in telecommunications, banking, insurance and agriculture, in return for membership in the WTO (Washington Post, 1999). However, he did not make it clear the degree of openness that China would allow in its telecom sector, or the domestic reforms that the country would pursue to abide by the negotiation demands. With President Jiang Zemin in charge of managing the top-level political processes, Premier Zhu worked in seeking consensus among the domestic groups and various other lobbies (Roseman, 2005: 29). The absence of domestic consensus, in fact, delayed the date for China's accession and this raised more suspicion and debates about China's behaviour among the lobbies in the USA as well as other countries (Nakatsuji, 2001: 23). Therefore, it became imperative for the Chinese leadership to galvanize domestic support for the reform in the sector. During this time, MII Minister Wu Jichuan emerged as the strong opponent of Zhu's 1998 administrative reforms. Premier Zhu, said. "The Reforms must Go Forward, and Government must be Separated from Enterprises" in a high-level seminar organised for provincial level officials on March 31-April 11, 1998 (Zhu, 2015). Following the major reorganization of China's government after the 9th NPC, the MPT, MEI, and parts of the Ministry of Radio, Film, and Television were combined into a new organization: the MII. The former MPT head also remained the head of this new ministry along with senior staffs from MPT (Chetham, 1998). As head of the restructured telecom regulator, Minister Wu made it very difficult for Premier Zhu Rongji, to conclude the most difficult part of WTO negotiations, the US agreement. In April 1999, after a failed round of talks, Zhu came under intense pressure domestically and began

looking for external support and pressure in his battle with other members of the Chinese party-state elites (Breslin, 2003: 225). His position was quite clear on telecom reform and WTO entry. During a press conference organised by the State Council on 15 March 1999, the Chinese Premier in his reply to a Hong Kong journalist said “more competition is needed in the Chinese telecommunications market, and foreign operators should be encouraged to provide services in China”(Ming Pao Daily, 1999). This speech clearly signaled that the central government of China was determined to open the telecom sector to foreign operators, and thereby fulfill the commitments required for joining the WTO.

Thus, after lot of debates and discussions, the US agreement reached was a compromise of the first, which limited foreign equity investment in telecom basic services joint ventures to 49percent (after 2004 for mobile and after 2006 for fixed line) and 50percent in value-added services (refer to table 5.1) (Eaton, 2015). Accordingly, on 25 September 2000, the People’s Republic of China Telecommunications Decree, hereinafter referred to as the Telecommunications Decree, was promulgated and enforced under State Council Directive 291¹⁰. By 2001, under the joint efforts of Jiang Zemin and Zhu Rongji, China finally signed the WTO agreement, submitting schedules of commitments as part of their accession document. However, it was not clear both to the Chinese leadership as well as the Western world, how the trade-offs between economic growths and concerns over national security and control would be played out in the Chinese context.

5.5 CONCLUSION

From the evidences above, it can be concluded that the telecommunications in China remains firmly within the bounds of the state-owned economy. The industry’s experience with reforms in phases was characterised by its short stint with liberalisation followed by a heavy-handed control

¹⁰ The Telecommunications Decree sets out transitional administrative regulations prior to the establishment of a full-scale telecommunications law. In order to maximise the public benefit of full market competition, the Decree must first regulate the market power of China Telecom by enhancing interconnection policy. Although the Decree emphasises the importance of interconnection, it does so at the basic level with no reference to unbundling. To stimulate competition in the market, regulations concerning equal access, carrier selection, and a more specific methodology to decide interconnection charges should be either established. Furthermore, with a fixed-line telephony penetration rate of only 12percent, the universal service obligation is of key importance and needs to be introduced in the future telecommunications law (DSTI/ICCP(2002)6/FINAL, 2003).

by the Chinese state. The MPT's protectionist stance became a major obstacle in the path of development of the telecommunications sector. In the context of WTO negotiations, telecom proved to be a difficult deal to be reckoned with. The Chinese domestic consensus was sharply divided and the central leadership came under severe criticism, for agreeing to open the telecom sector to the foreign investors. The fight between Premier Zhu Rongji and MPT Minister Wu Jiachun was so severe that the premier even thought of resigning from the leadership. Thus, the nature and pace of the reform became subject to the clash of political egos. This also reflected the instrumentalist approach adopted by the Chinese leaders from time to time in favour or in opposition to the reform.

Thus, the evidence drawn from the study prove the hypotheses drawn in the beginning of the chapter. It suggests that the interests of the political leadership served as the crucial factor in protecting the telecommunications sector. The interest was motivated by both economic as well as power considerations. The study reveals that to fulfill such interests, the national security card is often played by the Chinese state in favour of retaining state control in the sector.

CHAPTER 6

CASE ANALYSIS II: BANKING SECTOR

6.1 BACKGROUND

China's banking system remains an indispensable part of the SOEs reform. It is the bank loans and the interest rates that redefine the relation between the Chinese state and the SOEs. The State Owned Banks, (SOBs) not only form a key pillar of Chinese state capitalism but itself acts as a conglomeration of enterprises which are highly regulated. Also, the institutional and regulatory arrangements for banking in China have been different from the banking systems of other countries. After the liberalisation, the single central bank was replaced with a diversified portfolio of partially or fully state or publicly owned financial institutions. Although these financial institutions operate under distinct institutional incentives and constraints, they are however dominated by the SOBs, which account for more than half of the banking industry assets in China. The four large SOBs are Industrial & Commercial Bank of China (ICBC); China Construction Bank (CCB); Agricultural Bank of China (ABC) and Bank of China (BOC). These banks, which form the focus of this case study, were created in the 1980s to grant credit to key sectors and are now commercial banks concentrating in corporate lending. The other types of banks include the policy banks, joint stock banks, and foreign banks.

The modernisation of the Chinese banking system began in 1978. Prior to the late 1970s, the Chinese banking system consisted of a centralised bank - the People's Bank of China (PBC), which was under the Ministry of Finance (Turner & Tan, 2012: 54). Its role in China's planned economy was fairly limited to the collection of revenues from SOEs and allocating investment funds approved through the budget. As part of the reform, the mono-bank system was replaced with four SOBs and further three policy banks were created in the mid-1990s to separate the commercial functions from the policy ones. The policy banks are China Development Bank, Import and Export Bank of China, and Agricultural Development Bank of China. Under the Commercial Banking Law of 1995¹¹, the four SOBs were reclassified as commercial banks (refer to Table 5.4). One of the reasons behind its restructuring of the four SOBs is the

¹¹ The Commercial Banking Law (1995) holds all lenders responsible to lend "in accordance with the needs of the national economic and social development and under the guidance of the industrial policies of the State" (Art 34)

undercapitalised nature of these banks that was reeling under a large amount of non-performing loans (NPLs) (Huang, 2006; Lardy, 1998). The Chinese government injected a total of US\$33 billion of capital into them and four asset management companies (AMCs) were then established in 1999, one for each bank (Turner & Tan, 2012: 53). The role of these AMCs is to deal with the bank's NPLs by purchasing, resolving and selling them. China's WTO membership also came along with additional commitments for the banking sector. From 2002, foreign banks were allowed to conduct business in foreign currency and By 2006, geographic and customer restrictions on foreign banks were lifted and they were granted which offer them licence in terms of registered capital, branch opening rights, required operating capital and regulatory standards (Li, et.al, 2015: 73). In 2003, the China Banking Regulatory Commission (CBRC) was established to regulate and supervise the administrative functions of the banking sector, separating this from the functions of monetary policy and financial system stability that continued to reside with the PBC (Xu, 2011:54).

Table 6.1 - Restructuring of the Four Largest State-owned Chinese Commercial Banks

	Bank of China	China Construction Bank	Industrial & Commercial Bank of China	Agricultural Bank of China	Total	Share of Bank's Assets (percent)
Initial capital injection	1998	1998	1998	1998		
In (US\$ Billions)	5	6	10	11	33	3.5
Initial NPL disposal	1999-2000	1999-2000	1999-2000	1999-2000		
In (US\$ Billions)	32	45	49	42	168	15.5
Subsequent capital injection (US\$ Billions)	2003	2003	2005	2008		
In (US\$ Billions)	23	23	17	19	81	3.5
Subsequent NPL disposal	2004	2004	2005	2008		
In (US\$ Billions)	33	15	86	117	252	8
Establish shareholding company	2004	2004	2005	2009		
In (US\$ Billions)	-	-	-	-	-	-
IPO	2006	2005	2006	2010		
In (US\$ Billions)	13	17	22	22	74	2

Source: Based on Annual Reports of the Banks & Turner, Tan, and Sadeghian (2012)

6.2 OWNERSHIP AND REGULATORY STRUCTURE

The Chinese banking sector is characterised by a diversified portfolio of institutions with different degrees of state and public ownership. The top four banks in China are state-owned enterprises administered by the CBRC. The organizational structure is similar to the administrative mechanism of the centralised SOEs and represents a parallel corporate and Communist Party hierarchy (Bejkovsky, 2016: 6). The three policy banks are also state regulated and they carry out assigned tasks without being profit-oriented. Each of them has a specific scope, set by the government. They are similar to the ones in the developed countries but in a much larger scale. The Joint-stock commercial banks, in the beginning, were provincial in nature and could not operate nationwide. However, with the adoption of the Law on Commercial banking since 1995, they were allowed to fully compete with large national banks. Although the name suggests private banking sector, in these government entities, have a significant share, with the presence of other shares which can be Chinese private entities or foreign holdings banks which complement the state ownership (Goodhart & Zeng; 2007; Yin, Yang, & Mehran, 2013). Besides, there are also “local” banks which operate both in urban and rural areas, and it is the local government that retains the dominant share by the government (Huang, 2008). These local banks had its origins as rural credit cooperatives, which played an important role during the early years of China’s economic reform. They are thus, not so significant in terms of their assets and may have ownership by other entities.

Like other SOEs in China, the vast majority of assets in the banking sector are under the state ownership (table 6.4). The four large SOBs which provide the majority of commercial loans in China are subjected to greater state intervention which is ad-hocist in nature (Cull and Xu, 2003). Any single foreign entity cannot hold more than 20 percent of Chinese banking institutions and their aggregate share of the ownership cannot exceed 25 percent (China Banking Regulatory Commission, 2016). Even after years since China's entry into WTO, foreign securities agencies are still not permitted to establish a full-fledged branch in China. In fact, they are subjected to various regulatory measures and require complying with several categories if they wish to enter the Chinese banking market (Banking & Securities Position Paper, 2015). As a result, they fail to attract foreign funds and the share of foreign entities has remained low even in the joint

commercial banking sector. Although state ownership is dominant in most of these banks, these organisational structures, however, function under different institutional incentives and constraints, depending on their geographic location and their distance from the centre. The role of the local government, local investors and county unions becomes essential in that case. For example, the local banks, mostly in the rural areas of China are subject to relatively lower state interference and enjoy greater administrative autonomy than their urban counterparts (Ong, 2006; Yan & Gao, 2012).

Table 6.2 Gradual Opening of China’s Banking Sector to Foreign Entities/Shares

Geographical Regions	Foreign Companies & Foreign Individuals	Chinese Domestic Companies	Chinese Individuals
Open Shanghai, Shenzhen	1996	2003	2006
Open Tianjin, Dalian	2001	2003	2006
Open Guangzho, Qingdao, Nanjing, Wuhan	2002	2003	2006
Open Jinan, Fuzhou, Chengdu, Chongqing	2003	2003	2006
Open Kunming, Zhuhai, Beijing, Amoy	2004	2004	2006
Open Swatow, Ningbo, Shenyang, Xian	2005	2005	2006
Lift all geographical restrictions	2006	2006	2006

Source: Garcia, Herrero & Santabarbara (2004)

The Chinese centralised SOEs and the four large state owned banks in China exert direct influence on each other. The management of the state-owned banks in China usually carry a political rank comparable to government officials, and they participate in political activities from time to time, so the political influence on SOEs is virtually unavoidable. Sometimes general managers of SOEs are politically more senior than those of banks in the system, making it very difficult for banks to say no to borrowing requests from these SOEs. Senior officials at large SOE’s favour bank officials through their party influence, other government channels and also through a web of social relationships (see table 6.3). It is through these relations, the SOEs officials, mostly the influential ones convince the banks to issue a loan essentially circumventing normal credit procedures. Although this was common in early years of reform, but such practices do exist in the present and is difficult to quantify. One of the reasons why it is hard to measure is

because of the legal limits which constrain the extent to which a loan officer can be pushed for sanctioning a certain amount. Also, the smaller SOEs, private sector and also the informal ones cannot compete with large SOEs in acquiring loans from the banks. This has become a serious problem in China in the recent years, especially after the 2008 financial crisis and the government and party leaders have taken adequate note of it. They have taken steps to encourage the banking sector to lend more to smaller firms and by opening avenues of credit provision.

Table 6.3 - Number of Legal Entities and Staff of Banking Institutions at the End Of 2012

Institutions / Items	Number of staff	Number of banks
Large commercial banks	1,665,973	5
Policy banks & the CDB	62,231	3
Joint-stock commercial banks	315,585	12
City commercial banks	259,261	144
Rural credit cooperatives	502,829	1,927
Rural commercial banks	220,042	337
Rural cooperative banks	55,822	147
Finance companies of corporate groups	7,571	150
Trust companies	11,710	67
Financial leasing companies	1,855	20
Auto financing companies	4,477	16
Money brokerage firms	447	5
Consumer finance companies	716	4
New-type rural financial institutions & Postal savings bank	200,769	864
Banking asset management companies	8,240	4
Foreign financial institutions	44,560	42
Banking institutions in total	3,362,088	3,747

Source: CBRC Annual Report 2012

Despite the ability of the Chinese leaders to carry out a major reform in simplifying the procedure of loan disbursement for the smaller SOEs, private firms and the informal ones, it is not clear, whether the incentive structure practised over the years favouring the large SOEs are going to change soon or that the resistance will be too strong to handle. Also, the big banks in China lack the organisational culture and institutional support necessary to lend successfully to small, private firms. Chinese officials are currently trying their best to tap the potential of the informal sector by giving them loans/ funding support while avoiding predatory behaviour and excessive risk-taking by institutions and individuals that are less regulated (Prasad, 2016; 9).

**Table 6.4: Assets of Individual Types of Banking Institutions in China in 2014;
100 Million Yuan RMB and Percent**

Types Of Banks & Institutions	Assets In 2014; Unit: RMB 100 Million	Share On The Total Assets In The Banking Sector
Large State-owned (commercial) banks	710140	41.21percent
State policy banks	156140	9.06percent
Joint-stock commercial banks	313801	18.21percent
Local banking institutions (rural and urban)	296115	17.18percent
Local cooperative banking institutions	138435	8.03percent
Postal Savings Bank and other local institutions of a new kind	70981	4.12percent
Foreign banks	27921	1.62percent
Other financial institutions (consumer loans, trusts, leasing companies and others)	50123	2.91percent
Total	1723355	100.00percent

Source: Based on CRBC's Annual Report 2015

6.3 LENDING DECISIONS

The interdependent relationship between China's banking sector and the SOEs, thus make it clear that profit maximization is not what drives the lending decisions in banks (Bejvosky, 2006; 6). This often blurs the distinction between China's banking system and the SOEs, and that banks are run as SOEs and the government influences affect both their operations to a large extent. One of its main functions which are subject to direct party-state influence is the lending decisions by the SOBs in China. Since the pre-reform years, the banking system has played little role in allocating capital, and state-owned banks extended loans required to finance plan allocations. They had given enough fiscal subsidies to the loss-making SOEs. Even after the liberalization of the Chinese economy, the trend continued and there was less concern related to the loans losses or the risk related to non-performing loans (NPLs). Given the difficulties and disadvantages, within China of raising additional tax revenues to take over the remaining social functions from SOEs, the local governments have used the commercial banks as informal fiscal piggy-banks which enormously raise the problem of NPLs (Goodhart & Zeng, 2007; 4).

The reform in the banking sector in China is lagging behind as compared to reforms in other economic sectors. Since SOBs are the primary official channels for financing the SOEs, many loss making SOEs continue to be in the soft-budget constraint. This was the case in the pre-reform era and it continued with some changes carried out in the form of closures/ mergers of loss making small SOEs into the big ones. The large SOEs (not-so-profitable) can still carry out the expansion in China in the form of franchises because they have the support from the SOBs in the form of easy loans at relatively lower interest rates. According to the statistics, SOEs had an average interest rate of 1.6percent in 2010, while the average interest rate for private firms was 4.7 percent (Du, 2014; 4). They have special obligations when it comes to financing a national goal. These banks also pay an important role in financing large projects with international implications, One-Belt-One Road (OBOR) project in the current case. If the investment is successful, the SOEs managers retain the profits and other benefits, whereas the losses and failure can be largely passed on to the banking system. These projects often fail to comply with the market criteria but get full financial support from the SOBs. These negotiations are just formalities between the SOE authorities and the bank managers and they are primarily driven by local interests, often detrimental to the market principles (Li, 2009). Also, the local government makes no attempt to keep the prices of these projects down because of the easy availability in obtaining loans from the banks. Additionally, the lack of transparency owing to local government's fiscal position leads to uncertainty related to credit risks both for the banks and the local SOEs.

Since, banks and rating agencies do not have easy access to local governments' overall fiscal position, which includes not only budgeted revenue and expenditure but also extra-budgetary revenue and expenditure (Lu & Sun, 2013; 14). Thus, all such tendencies to favour the SOEs have created a market environment which promotes state-capitalism in China (refer to table 6.5). As discussed in the earlier section, the SOBs in China being the primary financier of the SOEs, have accumulated a large volume of NPLs, which could very well threaten the solvency of the main commercial banks in China. This meant that SOBs too have been on a soft budget basis. From time to time the Chinese authorities have tried to 'clean up' the banks by transferring old NPLs to asset management companies (AMCs) (and shifting strategic investment financing onto

the policy banks and injecting new assets, recently in the form of US Treasury bonds – into the banks in the place of the transferred NPLs.

Table 6.5 - Financial Summary in RMB Million

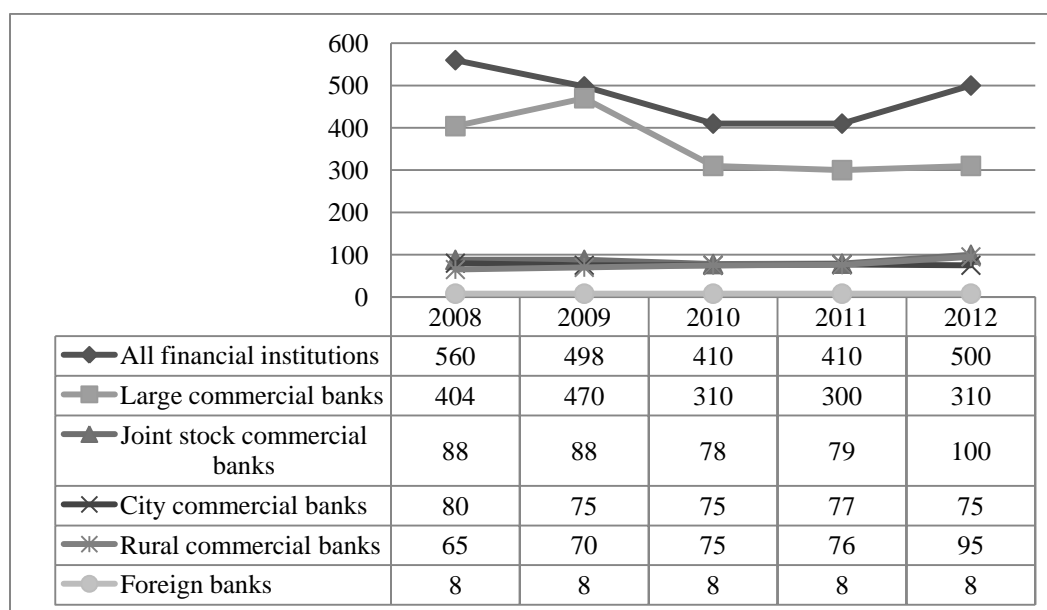
		Total assets	Net assets attributable to equity holders of the parent company	Net assets per share attributable to equity holders of the parent company (RMB)	Total loans and advances to customers
No	Name of bank	2012	2012	2012	2012
1	Industrial And Commercial Bank Of China Limited	17,542,217	1,124,997	3.22	8,803,692
2	China Construction Bank Corporation	13,972,828	941,668	3.77	7,309,879
3	Agricultural Bank Of China Limited	13,244,342	749,815	2.31	6,433,399
4	Bank Of China Limited	12,680,615	824,677	2.95	6,710,040
5	Bank Of Communications Co., Ltd	5,273,379	379,918	5.12	2,879,628

Source: KPMG Annual Report 2014

This has been partially successful because the banks in China have only in practice be able to transfer a proportion of their existing NPLs to the Asset Management Corporations (AMCs). The problem of NPLs has not been new to China. There was a huge amount of NPLs accumulated in China’s financial system in the 1980s and 1990s. As per the official statistics, the ratio of NPLs to total outstanding loans at the big four state commercial banks was officially recognized to be 25 percent (Montagnon & Harding, 1999). This was however considered to be a much-deflated figure by the international classifications and the Goldman Sachs showed that the ratio of NPLs ranged between 30percent and 60percent (Wang, 1999). There have been several factors which contribute to NPLs since the pre-reform period. First and the most important is the bank-directed finance which the Chinese government primarily depends on financing industrial development and infrastructure (Lou, 2000; 1159). In that case, the role played by capital markets is very small. Second, the banks lack appropriate risk-control procedures and suffer from poor management skills which lead to a lower quality of loans originated. Third, the absence of a transparent credit-rating system makes it difficult for banks to evaluate the credit risks when making lending decisions. Lastly, China’s NPL problems are further exacerbated by

the state-party influences on bank lending which are directed towards favouring inefficient and loss-making SOEs. In the post-crisis years, along with the injection of stimulus program in 2008, the Chinese government also resorted to credit expansion and lowered interest rates to stimulate growth and employment in industries (see fig. 6.1 and table 6.6).

Figure 6.1 - NPL Balance of Commercial Banks (RMB Billion)



Source: KPMG Annual Report 2014

**Table 6.6 - Total Deposits & Loans of Banking Institutions (2003-2012)
(RMB Million Yuan)**

Items / Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total deposits	220,364	253,188	300,209	348,016	401,051	478,444	612,006	733,382	826,701	943,102
Saving deposits	110,695	126,196	147,054	166,616	176,213	221,503	264,761	307,166	347,401	403,704
Total loans	169,771	188,566	206,839	238,280	277,747	320,129	425,597	509,226	581,893	672,875
Short-term loans	87,398	90,808	91,158	101,698	118,898	128,609	151,353	171,237	217,480	268,152
Medium- & long-term loans	67,252	81,010	92,941	113,010	138,581	164,195	235,579	305,128	333,747	363,894
Bill financing	9,234	11,618	16,319	17,333	12,884	19,314	23,879	14,845	15,154	20,447

Source: CBRC Annual Report 2012

Table 6.7 - A Summary of NPL & Provisioning Rules

	Western Banking “Norm”	China
NPL when:	<ul style="list-style-type: none"> ✓ Loans are more than 90 days past due ✓ Loans are 90 days past due that there are other warning signs ✓ Loss given default is not a factor in the assessment 	<ul style="list-style-type: none"> ✓ The borrower cannot even repay the loan and (even after considering the collateral value) there may be a loss ✓ Loans more than 3 months past due are usually an NPL when the bank expects loss
The minimum provision on NPL:	<ul style="list-style-type: none"> ✓ No minimum ✓ Provision based on bank’s best guess of the expected loss given a default 	<ul style="list-style-type: none"> ✓ Provisions at the portfolio level must be at least 150percent of the aggregate NPL balance and at least 2.5 of the total loan book.

Source: CBRC Provisioning Rules

These measures not only cushioned China’s economy from the negative effects of crisis but also helped it to recover quickly from the crisis and maintain its high growth rates. However, these recovery measures, on the other hand, have exacerbated the already existing problem of NPLs in the banks. The low profits by the Chinese SOEs add to the increasing difficulties in servicing interest payments of the current flood of bank lending. The threat of mounting non-performing loans therefore, puts China at risk of revisiting the 1990s non-performing-loan problem. In the event of a bankruptcy, or closure, a bank ranks low amongst creditors in China. They are also known as ‘passive creditors’ with taxpayers and depositors subsidising both SOBs and SOEs (Goodhart & Zeng, 2007). China has its own unique way to recognise NPLs. The banks in China consider several aspects in assessing its credit risk situation of an SOE. For example, when a Chinese SOE suffers loss due to fall in commodity prices, low cash reserves and is now more than 90 days past due on a scheduled repayment of a loan, the lending bank takes a legal charge over the firm’s head office as security (PWC Report, 2015; 3). As one of its factors, it considers the market value of this prime real estate which is much greater than the loan, and that makes the bank confident that it won’t suffer a loss and therefore, would not make any specific provision against the loan and it would not be classified as an NPL. As per the western norm, when the debt of a company is more than 90 days past due, banks would generally acknowledge the exposure to as a NPL (ECB, 2017; 12). Unlike western banks, when assessing whether a loan is

an NPL, Chinese banks are allowed to consider whether they expect to suffer a loss should a company default. So the loss making SOEs in China is unlikely to be recognised as an NPL, despite it showing obvious signs of stress.

6.4 BAILOUTS AND GOVERNMENT CONTROL

In the previous section, the lending decisions of China's SOBs are discussed, which brought in for the problem of NPLs in China. This section will, therefore, highlight the reform measures taken by the Chinese government to clear its NPLs. In 1990, when there were only 32 cases of bankruptcy, the number rose to several thousands of SOEs, in the second half of the 1990s, who were declared bankrupt and 126.1 billion yuan in bank loans were written off with funds provided by central government (Yusuf et al. 2006: 103). Thus, clearing NPLs from the balance sheets is seen as an important step towards banks' modernisation in China (Ma, 2006). The first step taken in this direction was in 1998 when the Ministry of Finance issued 270 billion yuan (\$32.6 billion) of 30 years in special bonds acquired by the banks themselves and then converted into equity, thereby doubling the capital base of the Big Four banks (Dobson & Kashyap, 2006). In 1996, PBC arranged a debt equity swap of RMB5 billion to protect some of its biggest creditors like the oil firms from going bankrupt (Shirai, 2002: 26). In 1999, the major step was the creation of four AMCs to be associated with the four pillar commercial banks.

They are Cinda associated with CBC, Huarong with ICBC, Orient with BOC and Great Wall with ABC. Each received RMB10 billion from the state budget as registration capital to cover current operating expenses. AMCs established with a time period of 10 years to clear off the NPLs are primarily tasked to restructure SOE debts and to recover the fallen assets. This arrangement of creating AMCs with each SOB was different from the ones that exist in other countries. Since, a time of 10 years was initially allotted to AMCs to deal with NPLs, analysts often compare its creation with that of US Resolution Trust Company (RTC), which was a temporary rapid asset disposal agency, established to resolve the financing issues of distressed financial institutions in the US (Klingebiel, 1999; Lardy, 1998; Sheng, 1996). However, the primary difference between the RTC and AMC is that the former relied on private sector contractors to evaluate, manage and sell many of the assets, where the latter was a central

government directed agency, operating at its instructions. The mechanism by which the AMCs manage NPLs is through debt equity swaps, auctions, and bids (Kossof, 2014: 11).

Beginning with Cinda, NPLs from the CCB and CDB were transferred to it for workout and recovery. Most of these bank losses from the policy lending predated 1996. Subsequently, the other three AMCs secured NPLs from the other Big Four banks by issuing bonds backed by MOF. A large amount of NPLs were purchased at auction by the foreign buyers, who were contracted by AMCs. The first of these auctions conducted by Huarong who contracted Ernst & Young in 2001 with respect to the bidding process for NPLs transferred from the ICBC. Afterwards, Huarong established a joint venture with a Morgan Stanley-led consortium which acquired an NPL portfolio valued at 1.5 billion USD (Liu, 2002). The other AMCs then held subsequently held auctions with foreign investors. Another example is Cinda establishing a joint venture with Goldman the Sachs to dispose of bad assets. These large auctions had come to a halt in the mid-2000s after the AMC had disposed of most of their NPLs (Burroughs, 2012). By 2000, the four major banks initially transferred approximately \$168.2 billion to Chinese AMCs (Wu, 2000). The primary reason why the Chinese banking authorities chose the AMC model to dispose of NPLs outside of the four commercial banks is due to the Commercial Bank Law provision which bars commercial banks from engaging in investment banking activities (NPC Order No. 47, 1995). Also by swapping the debts of a troubled SOE for equities, it gives AMC an opportunity to can become a new shareholder with representation on the SOE's board of directors, which also helps in restructuring SOEs.

As far as the organisational structure of AMCs is centralized state-owned financial organisations, under the oversight and control of China's government agencies. First, the MOF injected RMB 10 billion in equity capital into each AMC, thereby providing a total of RMB 40 billion to the financing of the four AMCs (refer to table 6.8). This was however very little as compared to the policy purchase of the AMC. In case of any AMC failing to dispose of all transferred NPLs, the MOF take over the nominal equity or write off the bad debts directly. Therefore, in absence of implicit state backing for the AMC bonds, any improvement of the big four banks' combined balance sheet from the policy-based NPL transfer would not be possible (Ma & Fung, 2002: 7). Second, PBC was in charge of AMCs' financial business transactions, such as setting forth the

fees AMC's can pay to NPL servicing companies¹². Third, for other financial transactions outside the scope of PBC, supervisory authorities such as CSRC were responsible for the supervision of AMC's. Fourthly, the SETC determines the allowable debt/equity swaps for AMC's so that the government may pursue its industrial policy through the AMC's (Bartel & Huang, 2000). Finally, the Financial Working Committee of the Central Committee of the CCP was responsible for the supervision of AMC's' relationship with Communist Party and human resources¹³. Since there was no clear division of duties laid by the State Council executive order, among the aforementioned institutions, the agencies in charge of AMC's often conflicted with each other's objectives.

Table 6.8 Transfer of NPLs to AMC's

AMC	NPL acquired from	Amount of NPL acquired (RMB bn)	Total Assets of Selling Banks (RMB bn)	NPL acquired as percent of assets
Huarong	ICBC	408	3540	11.5
Cinda	CCB	350	2201	15.9
Orient	BOC	246	2904	9.2
Great Wall	ABC	357	2276	15.2
Total		1371	10,921	12.6

Source: Deutsche Bank Research, 2001

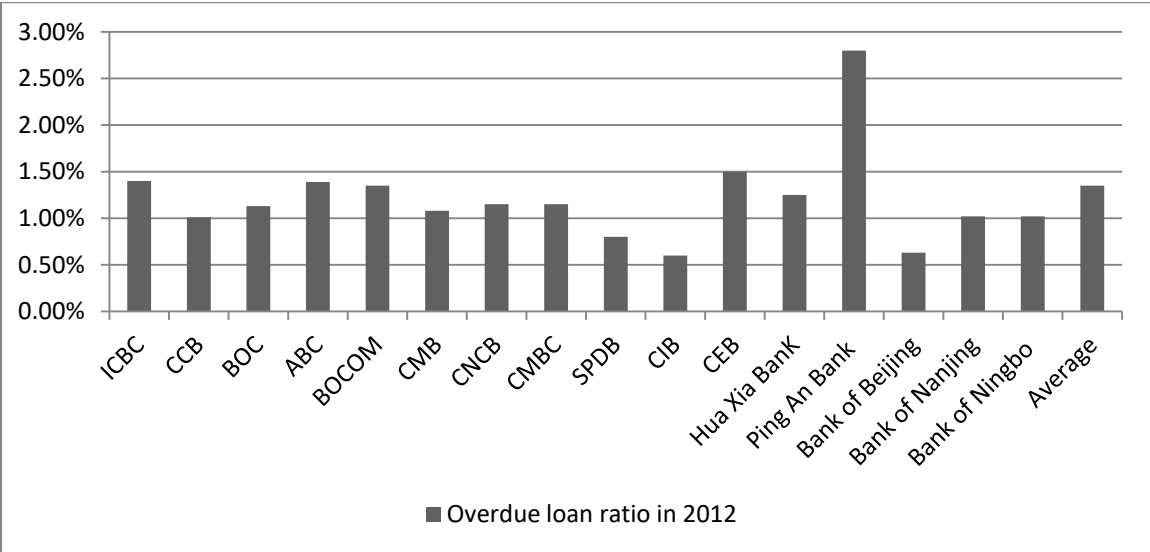
AMC's as a vehicle for modernising banks, suffer from various shortcomings. First they are structured organizationally as SOE's. Although some AMC's have devised incentive schemes to stimulate employees' efforts, it is unclear how these will be sufficient to overcome the regulations. Since there is no strategy for redeploying staff at the end of the process and no rewards for the employees, it affects their performance and they become "insolvency themselves" (Rodman, 2005) Also, they suffer from the traditional problems associated with SOE's in China i.e., corruption, which has raised considerable doubts about the efficiency of AMC's. Also, there is lack of transparency between the AMC's and the bank relationship owing to

¹² Decision of the Standing Committee of the National People's Congress on CBRC's Performance of the Regulatory Functions that Used to be Performed by PBC, (promulgated by the Standing Comm. National People's Congress, effective from April. 26, 2003).

¹³ Notice of State Council Office on Circulating the Opinion of PBC, MoF and CSRC to Establish Huarong Asset Management Company, Orient Asset Management Company and Great Wall Asset Management Company (promulgated by the St. Council, effective July 21, 1999).

problems of information-sharing about the borrowers. The second problem is that, although the AMC's are expected to engage in a broad range of financial activities, e.g., loan recovery, venture capital activities, strategic consulting and investment banking, their employees lack the skills for doing so. They also lack the option of hiring from any specialised agencies to solve the labour problem. John Bonin, a professor from Wesleyan University, mentioned in his working paper "after five months of operation, Cinda already suffers from two labour problems, redundant workers and the lack of necessary skills in its labour force". Finally, there can be major challenges if SOEs start behaving in a strategic way when the central government fails to commit credibly to a once-off policy. The concerns arise from the widespread loan defaulting because of the new instrument of debt-equity swaps available to AMC's and that the new instrument may actually encourage even profitable SOEs to stop paying interests on the bank loans so that they too qualify for debt relief. With reference to SOE restructuring, AMC's performance has been quite poor (see fig 6.2 & 6.3). As the debt-for-equity swaps serve a key model for Chinese AMC's to clear NPL's of SOEs and increase their commercial viability, the policy has failed to show results due to the bureaucratic system and management mechanism, in charge of supervising AMC's.

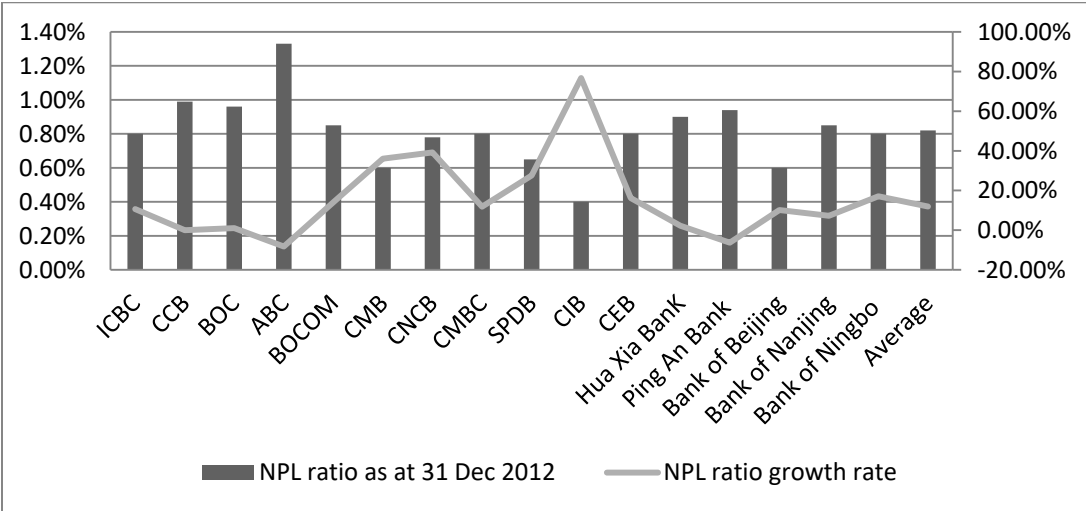
Fig. 6.2 Overdue Loan Ratio In 2012



Source: KPMG Annual Report 2014

In 2004, banking authorities ordered four AMC's to sell their equities and exit SOEs as soon as possible (Chen 2006: 257). As already mentioned about the problem of information asymmetry between the AMC and bank, AMC's due to lack of personnel and professional know-how about SOEs' various businesses in mining, textile, and handicraft manufacturing, were unable to adequately monitor SOE operations. Additionally, the organisational structure of the AMC has reduced it to serving narrow interests, with no clear reform agenda. The influential position of some SOEs has often been an obstacle for carrying out reform and AMC's have faced political resistance in those cases. AMC's on the other hand, due to a complex, zero-incentive governance structure, have sold NPL's at an unreasonably low price to improve their short-term performance in a system that view performance by the yardsticks of speed and quantity of NPL disposal, rather than by the actual returns from NPL disposal.

Figure - 6.3 NPL Ratios & Their Growth Rate



Source: KPMG Annual Report 2014

6.5 CONCLUSION

The experiences of China's state-owned banking sector clearly point to the absence of a mature capital market in China, for efficient capital allocation, strengthening industries as well as for solving NPL issues. This is one of the reasons why AMC's fail to utilize the capital market to solve the NPL problem, either through IPOs of SOEs or through securitization of NPLs. Also, the regulatory structure of the banking sector and its lending decisions, hardly motivated by

profits, hamper their efficiency and effectiveness. As a result, they are over-burdened with NPLs, which can again be understood as a by-product of the transitioning economy trapped in complex web of SOEs, SOBs and the fiscal policy. Although there is no clear picture of the real amount of China's NPLs, it has, however, become one of the bottlenecks for China's further reform in the banking sector. Also, there has been a rise in the non-viable investment projects since 2008. It is therefore not clear, how the central government will tamp down debt risks without throttling the economy.

Thus, while there are evidences of decentralisation of China's banking sector, Yifu Lin, Tao and Liu (2006), points out "without deregulation or more fundamentally, without the change of distorted development strategy, decentralization may not facilitate the economic development and may even lead to adverse economic consequences". It is quite clear that the Chinese party-state is quite determined to maintain control over SOBs, and the banking sector serve their objective of steering money into its favourable projects or SOEs and in the process cultivate political support and legitimacy for the Chinese state. The SOB governing institutions, as well as the bureaucracy running it, are the two key drivers who have led the cycle of decentralisation-decentralisation in China's banking reform. This further bolsters the hypotheses of the study and provides empirical support for explaining the theoretical puzzle of continuity in China's reform policies in the post-liberalisation era.

CHAPTER 7

CASE ANALYSIS III: OIL INDUSTRY

7.1 BACKGROUND

Oil being an important pillar of the Chinese energy industry, is dominated by three large state-owned oil companies who have been developing the country's domestic reserves, building and operating pipelines and filling its strategic petroleum reserves (SPR). China's national oil companies (NOCs) are China National Offshore Oil Corporation (CNOOC), China National Petroleum Corporation (CNPC), and China Petroleum and Chemical Corporation (Sinopec). Each of the three companies has a subsidiary which is listed on the Hong Kong and New York stock exchanges. The majority of the shareholding is owned by the parent company while the others include individual and institutional investors. The popularity of China's oil industry not only lies in its contribution to the oil output but also due to the importance oil bureaucracy among other bureaucracies and its proximity to the top leadership in China (Meidan, 2016; 3). Oil industry for that matter is more closely controlled and its operations guided by the Chinese party-state than any other non-strategic sectors of the economy. Thus, the development of China's oil industry was significant for a number of reasons: first, the notion of self-sufficiency for energy in the post revolutionary period marked by a shift from dependency on imports; second, the rise of new political elite known as 'the petroleum faction' which grew through the party ranks to become Mao's trusted economic advisors (Liao, 2014; 3&4). For example, Daqing oilfield became a political model of revolutionary spirit, which was committed to the ideals of CCP.

By the end of the Maoist era, China had become the world's third largest energy consumer, although per capita consumption remained low. In the era of economic reforms under Deng Xiaoping, China's oilfields were becoming increasingly unpredictable. The leaders from the oil sector, who suffered setbacks during the Cultural Revolution, regained their former political clout during these years (Meidan 2016; 7). The attempt underlying the reform was decentralization to increase the oil output and as a result, oil production, almost as unexpectedly, showed signs of growth since 1980s. The contract system was the first step in moving away from central planning in the energy sector and an initial contact was established with the international

energy markets, prices, and practices, albeit in a controlled and limited manner. Unlike the re-reform years where fixed prices varied between RMB 100 and 200 per tonne, the government set the price for the contracted oil, but all excess output destined for export was sold at international market prices (Jin 2004; 230).

The emergence of the Chinese NOCs in the 1980s was a result of the government reforms. They were created to replace industry's line ministries (Yao and Zhang 2013). In February 1982, the government created its first state corporation, CNOOC, charged with offshore exploration and production and offshore cooperation with foreign companies (Chen 2007; 49). The first stage of restructuring witnessed dismantling of the Ministry of Petroleum Industry (MPI) and its transformation into two corporate entities: Sinopec created in 1983 and CNPC, a wholly state-owned oil company formed after the disintegration of MPI, with the political ranking of a ministry, to manage the assets of the former MPI (Liao,2014). Each of the NOCs is marked by their functional specialisations - CNOOC in offshore development, Sinopec in oil refining and CNPC specialises in onshore exploration and production. Each of these companies is dominant in their original segment of the oil market and the Chinese government remains the majority of a shareholder in these firms.

Table 7.1 Major Share Ownership of NOCs (In 2012)

Company	Major Shareholder	percent of shares owned	Share Type
China Petroleum and Chemical Corporation (Sinopec Ltd.)	China Petrochemical Corp. (Sinopec Group)	70.84	State-Owned
PetroChina Company Ltd	China National Petroleum Corporation (CNPC group)	86.07	State-Owned
CNOOC Ltd	China National Offshore Oil Corporation (CNOOC)	64.41	State-Owned

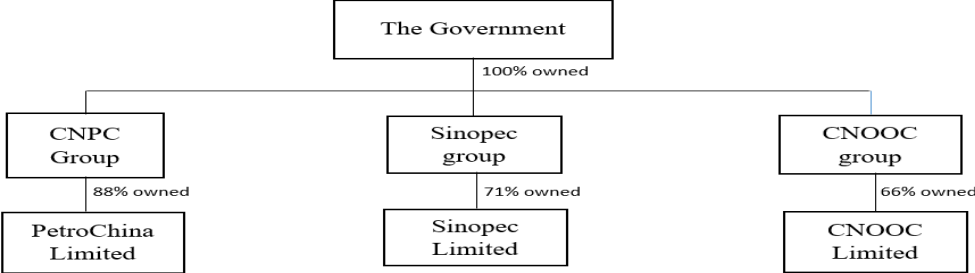
Source: Xu, (2012: 79)

7.2 OWNERSHIP & REGULATORY STRUCTURE

While China's NOCs possess operational autonomy after reform and restructuring of the sector, the Chinese government maintains strategic control of these companies through various means,

from ownership to finance and to determine the management of the companies. Amongst all, the key mechanism that ensures government control is the state ownership, where the mother SOEs is in charge of subsidiaries and is under the direct control of the government (refer to Fig. 7.1). Therefore, the attempts to reform the sector and establish a corporate governance structure have been limited and mostly superficial, especially in the strategic SOEs. China’s NOCs are under the supervision of central SASAC, which reduces corporate transparency by minimizing the scope of an independent audit to a large extent (Mc Nally 2002; 109).

Figure 7.1 - Ownership Structure of Three NOCs



Source: By Author

The NOCs are meant to fulfill the national interests in certain ways, even at the cost of profit and efficiency. The primary interest they are tasked with is to ensure stable energy supplies, crucial to the economic development of the country. Jiang Jemin, Chairman of PetroChina in 2008, stated that his company was forced to bear the burden of losses due to social responsibilities (Xu, 2012; 82). The SOBs are the main financier of the NOCs and they are also paid monthly state subsidies to cover up their losses. The domestic market within which the NOCs operate is an oligopoly, where three major oil firms participate in the limited competition. The oligopolistic structure was created in the reform years to break the monopolies and inject some competition and prepare them for the international markets while maintaining profitability. Thus has made them less reliable on markets to improve their performance and continue to function under a top-down regulatory system of the CCP.

The top management structure of the NOCs is determined by the party through nomenklatura system. The board of directors in the listed subsidiaries of the respective NOCs generally comprise of executive and non-executive directors who also happen to be executive or senior managers in the parent companies. Scholars like Xinting Jia and Roman Tomasic (2010), suggest that this pattern indicates that the management of a listed company was very much dependent on the management of its mother company, which in turn is guided by the party-state in China. While independent directors comprise 30-50percent of the boards of the NOCs, they are typically drawn from the government and party elite, except in the case of CNOOC Ltd. (Jia and Tomasic, 2010; 115). For instance, Sinopec’s independent non-executive directors worked for the government and party members. CNOOC, on the other hand, is considered to be one of the best managed and most profitable Chinese companies, both for its corporate culture induced by its western trained head, and its experience in dealing with international firms. The company’s former chairman and CEO, Fu Chengyu, has played an important role in company’s success by encouraging transparency, and corporate governance approach (The Economist, 2005). However, the corporate governance model met with partial success. Despite having independent directors, CNOOC was not able to cushion political interference of China’s party-leaders in the decision making and top rank appointments. Evidence of party-state interference in Chinese NOCs can also be noticed in the way Central Organisation Department (COD) tends to treat the heads of the SOEs and manage their appointment transfer and even dismissal.

Table 7.2 - Composition of the Board of Directors in China’s NOCs

Company	Board Members	Executive Directors	Non-Executive Directors	Independent Directors
Sinopec Ltd	15	10	0	5
PetroChina Ltd	14	3	6	5
CNOOC Ltd.	11	3	3	5

Source: Xu (2012, 86)

As part of the SOE reform process, the NOCs underwent restructuring to improve their performance by transforming into modern enterprises. The core assets which are relatively more efficient were carved out of the state holding companies and restructured into joint stock limited companies for initial public offering financing (Taylor, 2012). This phase of restructuring involved separating the core from the non-core business, leading to the corporatisation of the

core assets. In the final stage of restructuring, the NOCs transfer their assets to subsidiary branches, which are listed on international stock exchanges. The government also carried out split equity structure reform in a gradualist basis to integrate the tradable and non-tradable shares and to convert the non-market shareholdings into liquid assets (Xu, 2012; 81). However, these reforms have not proven sufficient for these NOCs to become modern enterprises. Despite the split equity structure reform and the decentralization attempts to separate the core, the government possesses the majority of the ownership in the NOCs, directly influence the decision-making process of the mother firm and is characterised by heavy burdens of debt and low quality personnel and assets.

7.3 PRICING

China's oil pricing system has undergone transitions since 1949. Between 1949 and 1980, under the centrally planned economic structure, the prices of oil were directly controlled by the Chinese government. Since supply and demand were determined by quotas, this gave them very little incentive to produce more, and as a result, oil production rate declined in these years. With the beginning of economic reform in the 1980s, the oil industry was exposed for the first time to the market-based prices under the dual track system (*shuanggui zhi*). Under this policy, the then Ministry of Petroleum could export a certain amount of oil or sell it at the market price (*gao jia*) as long as it first supplied the state quota at the planned price (*ping jia*). The dual track price system also known as "the big contract system", in case of oil industry, marked the first step for the oil industry to move away from central planning and establish some initial contact with the international energy markets, prices, and practices (Zhang, 2002). In the pre-reform years, fixed prices varied between 100RMB and 200RMB per ton, but exported oil was sold at around 600RMB per ton (Jin, 2004). In June 1998, the State Planning Commission issued the Oil and Oil Product Price Reform Plan (OOPPRP). Despite the pricing reform leading to an initial surge in production and revenues, the government was, however, unable to offset the stagnation of the older oilfields. As a result, the government also ordered exploration of the new fields to increase the oil production during the period. As the reforms proceeded towards decentralization, further reform of the pricing mechanism was experimented with (Wang, 1995). The 1998 reform is considered a major step towards market-based pricing of oil where the domestic crude price was

aligned with international oil market, to meet the WTO obligations (Yang, 2003). The mechanism was outlined in the *Crude and Oil Products Pricing Reform Package* initiated by the State Development Planning Commission (SDPC), in May, 1998. Under this system, the SDPC was responsible for monitoring the fluctuations of International Oil Prices, and based on it, the baseline price for oil and its products were set in China. However, the reform could not affect the monopoly by CNPC and Sinopec in crude oil production and imports, and in wholesale of refined oil. In fact they enjoyed more freedom to manage the whole spectrum of the business chain-from crude production to oil products marketing and their dominance was rather strengthened by two State Council Circulars in 1999¹⁴ and 2001¹⁵. The two major NOCs CNPC and Sinopec used to monitor the price movements at the Singapore market, and based on published price assessments, they submitted a report to SDPC on the 27th of every month. SDPC, in turn, worked out a marker price for the month by averaging the month's strike price plus the premium (Oil & Gas Journal, 1998). The intervention of SDPC was so much, that oil prices were set, domestic crude price failed to be in line with the foreign crudes as the SDPC made it clear that domestic crude should be priced a bit lower than that of foreign crude in order to encourage refineries to buy domestic crude. Over time, this pricing mechanism has undergone many changes, which also includes the choice of particular international oil price targets and, more importantly, the conditions triggering the adjustment of Domestic oil prices.

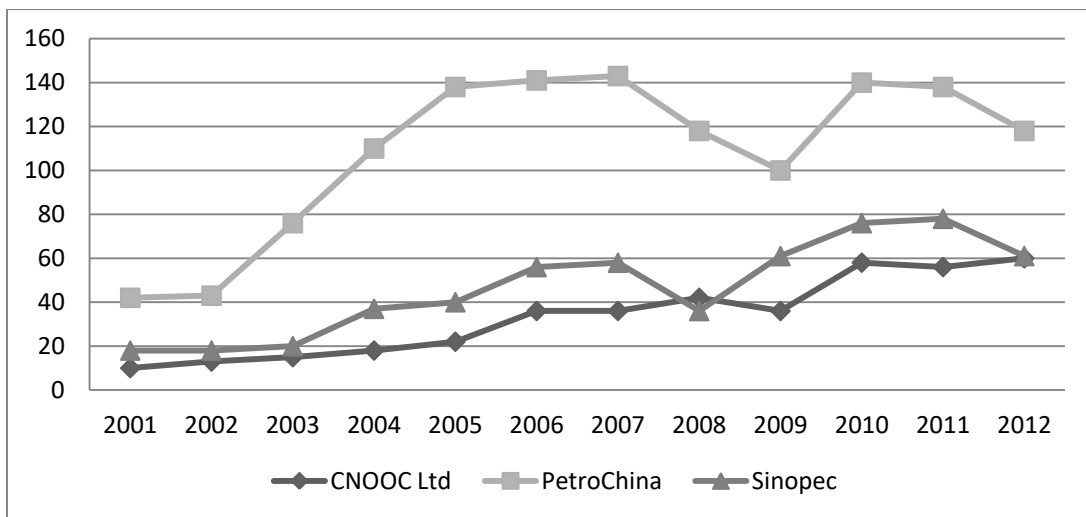
Given the market monopoly by the NOCs, the Chinese government had a dilemma in fuel price setting (Liao, 2015: 53). On the one hand, the central government came under pressure for raising the petrol price constantly in order to offset their costs triggered by record high international crude price and on the other, the government wanted to minimize the inflation risk to retain social stability. As a result, NOCs were given subsidies and tax rebate to offset their claimed losses and to ensure an uninterrupted petrol supply (Liao, 2015; Chen, 2009) (also refer to fig.7.2). The Vice Premier Zeng Peiyan urged NOCs in this direction in 2008, asking them to

¹⁴ According to Article 3 of the 1999 Circular, all the crude oil (domestically produced and imported) must be 'allocated by the state', which would actually be handled by the NOCs. Article 4.1 of the same document stipulated that oil products from ALL refineries should be passed to the enterprises affiliated with CNPC or Sinopec, and only they had exclusive rights for wholesale of oil products (State Council Circular, 1999).

¹⁵ Article 2.1 of the 2001 Circular stated that no new fuel retailing stations outside CNPC and Sinopec control would be allowed to operate; and new applications for wholesale business should be submitted, via the two NOCs, to the SETC for approval (State Council Circular, 2002).

increase energy outputs to ensure supply. He said, “Oil and gas, petrochemical and power industries are the basic sectors and lifeline of the national economy and bear upon the economic and social stability” (Xinhua 2008). This move came after the government had ordered that prices of refined oil, natural gas and electricity should not be adjusted “in the near future” in order to lighten inflationary pressure over common people ahead of the upcoming Spring Festival (ibid). Assuring the domestic price drop, Xu Kunlin, vice head of the pricing department at the NDRC told that there was room to lower the country’s current fuel prices. the NDRC, along with three other government agencies, the Ministry of Finance, Ministry of Transport and State Administration of Taxation, issued a draft that held that “pricing of domestic fuel prices should not only reflect fluctuations of international oil prices and production cost but should also take into account of domestic oil supply and demand” (China Daily 2008). The underlying message of the draft was that the Chinese government would retain “an appropriate control” over the fuel price. Another NDRC Circular was issued on the *Measures for Oil Price Administration*, which launched a new refined oil price reform program allowing it to adjust domestic refined oil prices accordingly when the moving average of international crude prices fluctuated outside 4percent around the established price within 22 consecutive working days (NDRC 2009). This reform initiative was not immune to criticism and what the market participants and experts complained of was China’s long price-adjustment period and for manipulating domestic prices instead of setting it as per international market.

Figure 7.2 - NOC Net Profits from 2001-2012 (in billions of RMB)



Source: Based on the annual reports of the companies

Thus, despite the pricing reforms, the NOCs continue their monopoly in the Chinese economy. Since 2004, CNPC and Sinopec have received government subsidies and forced many private refineries and retailers out of the market (Liao, 2015; Chen, 2009). Many also argue that NOCs face little competition from private refineries and therefore, there is hardly any incentive for them to reduce the cost (Liao, 2015: 54). Thus, chaos and disorder characterise the oil pricing system in China. Since Oil pricing has a direct bearing on China's national economy, the government has from time and again, employed price control, resorting to market distortions. The NOCs efficiency is often put to the question, due to lack of competition from other market players.

7.4 THE GOVERNMENT - NOCs RELATIONSHIP

The key to the understanding of China's NOCs behaviour is the relationship that these firms share with the central government. The relation has been the subject of considerable interest both in the academic and policy circles, not only due to its strategic importance but also the weight that the energy bureaucracy exerts amongst other bureaucracies in China. The "energy bureau" as popularly known, comprised of a powerful interest lobby in Chinese politics, which influences political elites and shapes the oil industry development in China. The two giant NOCs, CNPC and Sinopec are as powerful as the ministries and their general managers hold the rank of vice-minister. Thus, there is constant government interference in the managerial processes. After the MPI was disbanded and the creation of CNPC, many subordinate units still retained their ministerial denominations and functions (Meidan, 2016: 18). The old management methods continued and they took the time to evolve into new institutions (refer to table 7.3). In fact, the characteristics of the old left their mark on the new institutions and its practices. In May 1999, the General Office of the State Council issued the *Opinions Concerning the Cleaning up and Rectification of Small Oil Refineries and the Standardization of the Circulation Orders of the Crude Oil and Product Oil* (Sheng & Zhao, 2013; 137). The document ordered that all domestic oil refineries should be dealt with by the wholesale enterprises of PetroChina or Sinopec and that no other enterprises are permitted to engage in wholesale businesses or self-marketing. The order further monopolized the already existing monopolies of these NOCs.

Table 7.3 - Governing Bodies and Industry Players in China's Oil Sector

Year	Governing Bodies	Industry Players
1949	Ministry of Fuel Industry (for oil, coal, and power)	
1955	Ministry of Oil	
1970	Ministry of Fuel and Chemical Industry	
1975	Ministry of Oil and Chemical Industry	
1975	Ministry of Oil	
1980	Ministry of Oil reporting to National Energy Commission which also oversees ministries of coal and power	
1982	Ministry of Oil reporting directly to the State Council. (National Energy Commission was abolished)	Creation of China National Offshore Oil Corp (CNOOC)
1983	Ministry of Oil	Creation of China National PetroChemical and Chemicals Corp (SINOPEC)
1988	Ministry of Energy (Ministry of Oil abolished)	Creation of China National Oil and Natural Gas Corp (CNPC)
1992	State Council via the State Planning Commission (Ministry of Energy was abolished, functions transferred to the SPC)	
1993	State Council via the State Planning Commission (State Economic and Trade Commission was established)	i) Creation of China Oil, a jv trading company between CNPC and SINOCEM (China National Chemicals Import and Export Corp) · ii) Creation of UNIPEC, a jv trading company between SINOPEC and SINOCEM
1996	State Council via the State Planning Commission	Creation of China National Star Petroleum Corp (CNSPC) by the Ministry of Geology and Mineral Industry
1998	State Administration for Petroleum and Chemical Industries (SAPCI) under the State Economic and Trade Commission (SETC)	Regrouping CNPC and SINOPEC according to geographical partition to form CNPC group and SINOPEC group
1999-2000	SETC, with involvement of State Development Planning Commission (SAPCI was abolished in October 2000)	i) Creation in 1999 of CNOOC Ltd by CNOOC · ii) Creation in 1999 and public listing in 2000 of PetroChina by CNPC group · iii) Creation and public listing of SINOPEC Ltd by SINOPEC group iv) Acquisition of CNSPC by SINOPEC group in 2000
2001	SETC, with involvement of SDPC	Public listing of CNOOC Ltd
2003	NDRC (National Development and Reform Commission), regrouped from SDPC and SETC (both were abolished)	

Source: Based on IEA (2000 & 2002) & Chatham House Report (2004)

In 2003, Beijing established an Energy Bureau within the NDRC to control the energy industry by examining industrial projects and supervise energy-affiliated activities (China Daily, 2005).

In the beginning, the Energy Bureau clearly lacked authority, mandate and capacity to exercise its power. It was much lower in the hierarchy among other bureaucracies which made it difficult for the energy department to administer effectively. The energy bureau underwent major reform, after extensive consultations, led by the State Council (Zhao, 2007). The National Energy Leading Group was established involving 13 other government ministers in 2005. In 2010, the National Energy Commission (NEC) was established, headed by Premier Wen Jiabao and Vice Premier Li Keqiang, involving 21 additional ministers (Liao, 2012). The 2008 creation of the National Energy Administration was followed by the 2010 establishment of the National Energy Commission headed by the Premier. The various centralization efforts in the form of NEC demonstrated the importance assigned by central leaders to the issue of energy. The NEC also had members from China's National Security Council and the military establishment (BBC Energy Monitor, 2010).

As far as the relations between CNPC and Sinopec were concerned, it was a tensed one and the two lacked coordination. CNPC followed its own business development strategies and preferred allocating oil to Sinopec's refineries from the Tarim basin but Sinopec's refineries preferred purchasing oil from nearby fields in the Bohai oil region (Wang, 1997; Zhang, 2002). As CNPC began developing its own refining activities in the 1990s, it led to distortions in the allocation plans as it prioritized supplies to its own refineries over those of Sinopec. Sinopec, on the other hand, was keen to purchase oil from the international markets (when the international price was low as compared to domestic prices), irrespective of the import quotas and the allocations set by the State Planning Commission (SPC) (Andrews-Speed, 2004). This was followed by frequent negotiations between the two NOCs and as a result of state-controlled nature of the oil industry (where the prices set by the state), CNPC's profits were higher than the Sinopec. The two even clashed abroad, overrunning the SASAC guidelines. For example, in 2003, Sinopec outbid its domestic rival CNPC for a pipeline project in Sudan (Liou, 2011: 679 & 683). CNPC, which had long dominated the oil industry in Sudan, was surprised by this and appealed to the Chinese Embassy in Sudan for adjudication. The embassy notified the higher authorities in Beijing to negotiate an agreement between the two oil giants. Sinopec, however, defended its strategy based on commercial reasons and instead of withdrawing its bid; Sinopec went ahead and completed the pipeline project.

Thus, the interaction between the government and NOCs in China is marked by overlapping degree of centralization and decentralization and also exhibit a great level of convergence with the government policies. The relation faces challenges from time to time in the internationalization of oil industry, when the commercial interests of the oil industry clash with the statist considerations (Meckling, Bo & Madan, 2015). The state, in this case, acts as resource supplier as China officially formulated its ‘going out strategy’ in the 2000s. The Chinese government increasingly felt the need when the country’s dependence on oil imports surged in the late 1990s. As a result, NOCs have been given autonomy to determine its investments abroad, and the transformation of China’s energy ministries into corporations, with some China’s analysts describing the energy sector as “strong firms and weak government,” with “strong” and “weak” referring to capacity, not authority (Downs, 2005; 77).

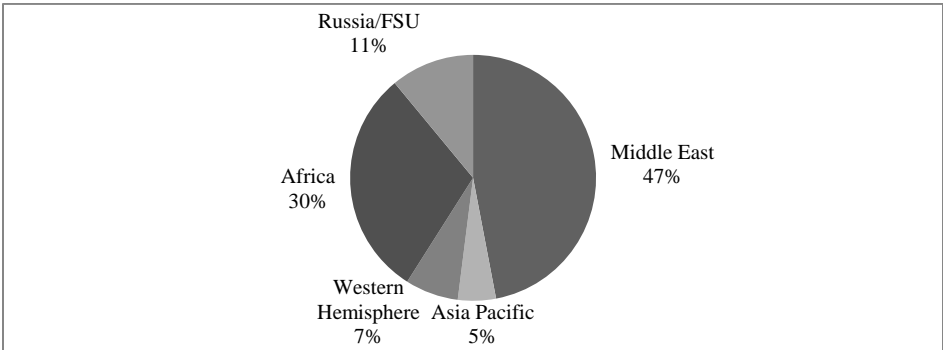
7.5 GOING-OUT STRATEGY

As China’s dependence over imported oil gradually increased, owing to the rising demand, shortage of domestic supply and increasing dependence on foreign imports, China came under increasing pressure to secure reliable supplies. This led to the formulation of ‘go out, go global’ (*zou chu qu*) policy by President Jiang Zemin at the 16th Party Congress in 2002. President remarked, by “bringing in” and “going out” a number of strong multinational enterprises and brand names, China should take an active part in regional economic exchanges and cooperation while paying great attention to safeguarding its national economic security” (People’s Daily, 2002). The objective of this strategy was two-fold: first to diversify sources and reduce dependence on imports and second to promote internationalisation of NOCs, with the aim of raising China’s global economic profile. Under the government instructions, the NOCs as well as domestic oil companies and banks become closely involved in the activity of investing abroad, mainly in oil exploration projects (Mol, 2010: 10).

China also acquired vast foreign reserve assets in the early 2000s, which acted as a support for the going out policy. SASAC who directly administers NOCs through State Council was in charge of this new economic venture. By the end of 2005, the operations of CNOOC, CNPC and Sinopec had been expanded to around 35 countries through bidding, farm-ins and corporate acquisitions. In 2005 CNOOC withdrew its \$18.4 billion bid for Unocal Corp., which was taken

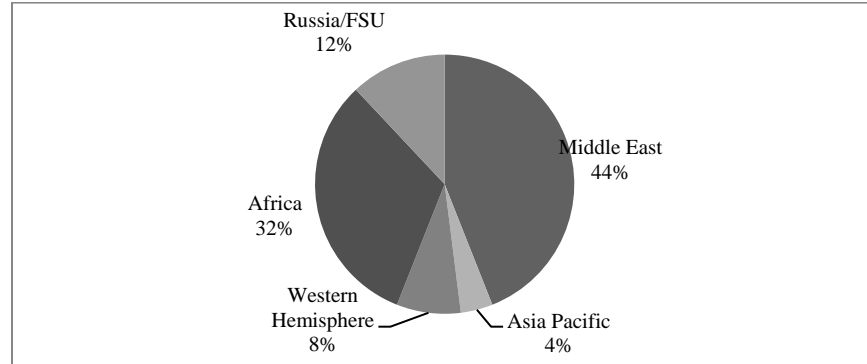
by Chevron Texaco, as a result of strong political opposition from U.S. lawmakers (Associated Press, 2005). In the same year CNPC secured its purchase of Petro-Kazakhstan, which was the largest overseas takeover transaction of a Chinese company. CNOOC Limited, together with its subsidiaries, signed an agreement with South Atlantic Petroleum Limited (SAPETRO) in Nigeria (CNOOC Ltd., 2006). This “going-out” strategy was not an entirely new strategy. In 1993, CNPC, under its president Wang Tao (formerly the minister of MPI), spearheaded the strategy of attracting foreign investments, technology, and expertise as well as resource exploration and development through investing abroad (Kong, 2010). In this way, the major NOCs in absence of extensive government support and financing, devised their own strategies for their overseas campaign (refer to figures 7.3 & 7.4). In 1994, CNOOC embarked on its first investment project abroad, acquiring 32.58percent of ARCO’s rights in the Malacca Strait, Indonesia making CNOOC the largest shareholder of the oil field (Chang, 2004). Consequently, Sinopec also initiated its international expansion by strengthening ties with Iran in the oil sector in a bid to secure more oil supplies from the Middle East and also signed a production sharing contract with National Iranian Oil Corp. to jointly explore and develop an oil and gas block in Zavareh-Kanshan region (Kemp, 2012).

Figure 7.3 - China’s Crude Import by Region, 2009



Source: Xinhua News Agency (2010).

Figure 7.4 - China's Crude Imports by Region in First Half Of 2010



Source: Xinhua News Agency (2010).

The financial crisis in 2008 invigorated the need for China to expedite going out a strategy of its oil industry. After the financial crisis in mid-2008, China was one of the few countries that reacted quickly, injecting its domestic economy with stimulus money, which created a massive drive to push its energy companies overseas. Loans, which dried up for many global energy companies, were in abundance for NOCs (James, 2007). These companies who initially faced international criticism for its pricing policy and met with resistance while trying to secure a deal, the crisis, however, opened up new doors during the crisis, acquiring assets across the globe through various investment strategies. When the global oil companies were badly hit by the crisis, China's NOCs saw an opportunity to guarantee its international investments and to create an international image for itself. This was further reinforced by the President Hu Jintao and Premier Wen Jiabao in the 17th Party Congress who carried forward the legacy instituted by the Zemin administration. To support and accelerate the overseas expansion further, Wen Jiabao, in 2009, said, "we should hasten the implementation of our 'going out' strategy and combine the utilization of foreign exchange reserves with the 'going out' of our enterprises" (The Economist, 2009).

In NOCs overseas expansion, the role of Chinese SOBs, especially the policy banks cannot be ignored. They have been a major supporting mechanism for the NOCs investments abroad. After the policy became official in 2003, the banks formulated their own developing strategies to allocate funds to the NOCs. In 2004, China Exim Bank along with NDRC published the "Circular on Supportive Credit Policy on Key Overseas Investment Projects Encouraged by the

State”, outlining support key overseas investment projects encouraged by the State. It declared that preferential export credit interest rates as provided by Exim bank shall apply to the special loans for NOC’s overseas investments. However, application for use of special loans for overseas investments was subject to approval in accordance with the *Decision of the State Council on Investment System Reform* and the *Interim Administrative Measures for Ratification of Overseas Investment Projects*. Following Exim bank’s move, CDB also declared its support to NOC’s international expansion during that period. What these policy banks tried to secure was loans-for-oil deals, which meant long-term oil supplies by issuing credits to oil-rich countries. China’s policy banks issued a total of US\$37 billion of loan commitments to Latin American countries, which was higher than that of the loans allotted by the World Bank, Inter-American Development Bank and the US Export-Import Bank combined (Zhang, 2012). These loan-for-oil deals also helped China to acquire entry to previously inaccessible resource-rich countries by using its financial leverage which gave them more bargaining power. Consequently, this was followed by more oil deals between Angola and Chinese NOCs that accounted for multibillion dollar loans in connection with infrastructure projects. In 2009, CNOOC and Sinopec purchased a 20 percent stake from Marathon Oil Corp for US\$1.3 billion (Zhao, 2011). Besides, securing long-term oil supply chains and gaining access to petroleum-rich countries, they also created new export markets for Chinese goods and services. The overseas expansion of NOCs, gave opportunities to other SOEs to enter into their borrowers’ market for trading in goods and services. Thus, the expansion brought in diversified gains to the Chinese government, benefitting its economy directly and also its foreign policy.

Like opportunities, there are also challenges involved in the overseas expansion of NOCs. Firstly, it is not easy for the NOCs, with no prior experience, to operating in mature and stable markets, which requires detailed knowledge of the local markets, including the related political, economic, legal, and cultural environments of that region. The managerial problems which arise due to the inter-cultural differences become a real obstacle for the NOCs to gain frontier technical experience and expand their business. There always remains the fear of getting misunderstood by the local communities who might consider these NOC led projects as an attempt to colonise them, especially in the African regions. It is generally believed that the overseas expansion of NOCs involves a social welfare responsibility on the part of these

enterprises. However, in reality, NOCs act more autonomously in their overseas projects and prioritize profits over the national mandate and misuse their monopolistic power, which is often subject to criticisms from the Chinese media and public (Kong, 2010; Downs, 2011). They also choose to sell the majority of their overseas equity productions in international markets rather than sending them back for domestic use, which is regarded by many Chinese as a deviation from national responsibility (Xu, 2013).

The overseas crowding of the NOCs is also not viewed positively by the Western powers. Most of their bilateral negotiations happen behind closed doors and away from the public (Andrews-Speed and Dannreuther, 2011). They suffer from an element of transparency which raises skepticism about the means by which the deal is secured. This clearly indicates that these bilateral negotiations entailed explicit state support from the Chinese state and might have included preferential credit offers like infrastructure-for-oil (Zhang 2012: 14). Countries like Iran, Sudan, Kazakhstan, Russia, Brazil, Syria and Angola are case examples of this extensive political assistance by the Chinese government to its NOCs. Also, these kinds of deals are secured in inaccessible areas, where the other oil companies hesitate to venture. Thus, ranging from preferential credits to development aid, loans-for-oil and infrastructure-for-oil, offered by the Chinese policy banks, the Chinese state has devised an attractive system to accelerate its NOC's expansion, and to secure oil supplies of the world.

Although there are evidence of decentralization of the NOCs, leading them to acquire a corporate character, the core aspects of their operations, however, remain subject to central control. For instance, the institutional structure of approval of NOCs in any international transactions is controlled by the Chinese government. Any significant investment of NOCs requires the approval of the NDRC, which designing has a strong influence in directing NOC policies and pursuing state interests (Huang and Wilkes, 2011). The policy banks also can't issue loans to any overseas projects without NDRC's approval, especially if the investments are above US\$200 million (Andrews-Speed and Dannreuther, 2011). Moreover, the Ministry of Commerce (MOFCOM) is another government body that plays a significant role in the implementation and supervision of Chinese OFDI. MOFCOM also plays a significant role in the implementation and supervision of Chinese OFDI. It represents the Chinese state in bilateral and multilateral

investment and trade negotiations and holds the key in issuing investment licenses to the NOCs. The State Council, who is the head of these ministries and agencies, directs and regulates the economic strategy and its implementation. Thus, the policy direction of NOCs are still by far largely influenced by the central government with the State Council being in charge of the policy decision-making process, the coordination and implementation through NDRC and MOFCOM, the diplomatic relations and its alignment with the economic strategy through the MOFA, the financing through the policy banks and the ownership through the SASAC.

7.6 CONCLUSION

China's oil demand doubled between 1995 and 2005, reaching 6.8 million barrels per day. China also became the world's second biggest consumer surpassing Japan in 2003 (Bustelo, 2005: 1). This leap in China's energy demand happened over very few years after China became the oil importer for the first time in 1993. The rise in China's oil consumption points to the importance of oil in China's economic development. Along with its economic significance, the oil also has its political significance in the context of China. The Chinese leadership not only considers oil as one of its strategic SOEs but also views it as a key to social stability and party legitimacy. The major NOCs, albeit their corporate interests, feel comfortable to be within the purview of the Chinese state. They are not interested in inviting a fierce competition by recommending NDRC to take steps for liberalization of China's gas market. Thus, they enjoy their monopoly statuses, CNPC for its onshore and CNOOC for its offshore gas expansion business respectively. Thus, the review and discussion in the previous sections prove the hypotheses derived in the introductory chapter. Two explanatory variables: administrative monopoly and price regulation by the government are most helpful in accounting for explaining the continuity in SOE policies by the Chinese state. They have prevented the development of China's energy market along the lines of market principles and free competition. The Chinese political leadership has been quite instrumental in bringing about reforms in the oil sector. While some aspects of NOC reform have seen the withdrawal of the state, in most cases, it has influenced the institutions to resist changes.

CHAPTER 8

CONCLUSION: EXPLAINING REFORM POLICIES & PROCESSES

8.1 INTRODUCTION

This chapter returns to the six questions that have shaped this study: i) what are the major changes in China's state-owned enterprises in the post-liberalisation era? How have central government policies shaped these changes? ii) What have been the stipulated objectives of the reform vis-à-vis SOEs? To what extent are the objectives fulfilled? iii) How has the WTO membership affected SOE reforms in China? iv) What explains the continuity in China's industrial policies towards SOEs across the various phases of reform? v) How continuity and change in the policies towards SOEs are shaping the discourse on the role of the Chinese state in industrial enterprises? The first section summarizes the answers to these questions provided in the preceding chapters. It then goes on to discuss how the study contributes to the literature, how it adds to the contemporary debate on China's economic reform in general and SOEs in particular, following which the directions for future research will be outlined.

8.2 REVIEW OF KEY FINDINGS

In view of what has been said in the earlier chapters, the general direction of SOE reform in China has focussed on increasing the autonomy of the SOEs, improving their management to the level of private corporations, with the aim of transforming them into modern enterprises (Sheng & Zhao, 2013). Although this reform has achieved considerable public support in China, it puts the government and policy makers in a complex dilemma. For instance, SOEs on the one hand, who emphasize their status as the "national champions" of the economy, seek privileges and preferential treatment from the government vis-à-vis the private and foreign enterprises. On the other hand, with the reform measures, they tend to assert their independent and autonomous behaviour as market subjects to avoid governmental interference, public welfare responsibility and other restraints. As a result, over the years, the SOEs, especially the CPSEs have turned into interest groups/lobbies, which under the mask of state ownership and public interests, exploit public resources, deny public benefits and suffer from huge debt which the government banks

are left to deal with in China. This nature and direction of reform has resulted into various anomalies of Chinese SOEs, making it one of the biggest socio-economic and political problems of the country.

It is however important to note that China has been quite successful in carrying out its integration with the global economy. An effort in this direction was the decentralization of SOEs in the second half of 1990s. The decentralization was marked by a full transfer of both cash flow and control rights, which likely reduced the extent of agency costs. Like a decentralized western corporation, the decision-making authority in China's state sector also moved down the hierarchy after decentralization of SOEs. The delegation of various rights is documented in State Council (1998): "after decentralization, all rights regarding the SOE's finance, labour, wage, social welfare, and personnel are transferred to the local government; also transferred include state asset, liability, equity...further transferred are the loss and subsidy quotas; after decentralization, all income taxes are ... turned to local public finance" (Huang et al. 2005). Decentralization, however, failed to change the objectives and responsibilities of the central government. SOEs with strategic concerns in China, affects the shaping of decentralization decisions in China. Scholars like Liu and Tan (2006), Lin & Liu (2000), argue that in a transitional economy like China, reforms happen in a cycle of centralization and decentralization and that the process of decentralization is bound to create changes in policies and take the development in a new path. However, they also argue that such reforms are not possible without deregulation and decentralization enough is not possible to bring economic changes. In 2006, the State Council's document on the reorganization of SOEs (State Council, 2006) stated, "the state should maintain absolute control over important industries that are related to national security and national economic growth." These features make strategic objectives more salient for the central rather than for the local governments. Also the existing institutional framework and the legal system in China do not fully support the corporate governance mechanism for the centralised SOEs.

The phase from 1978 to 1986 marked the gradual opening of China to the global economy. Since then, the Chinese domestic political economy has undergone changes as part of the

modernisation drive. The process of re-engagement¹⁶ with the global economy took off only during the 1990's. One of the primary objectives of this reform process was to establish economic connections with the globe and as a result formally become a part of the international political economy. China's application to join GATT/WTO needs to be understood in that context. It was therefore, in its best interest to embrace rules of international political economy, in order to fit into the world economic system. This indeed had taken a lot of compromises and concessions on the part of Chinese state amidst a situation back home where the wisdom of WTO membership was largely debated (Li, 2009). However, with the economic benefits and double digit growth trickling into the domestic economy, the debate took a back seat for few years after China's entry. However, problems surfaced as a result of incomplete reform and compliance related commitments became difficult to be reckoned with. At the domestic level, increased attention to marketization and WTO compliance related commitments have created pressures over the SOE employees subjecting them to harsher conditions of working terms, thereby leading to discontent and dissent of various kinds. Besides, the bureaucracy was divided on the issue of opening the monopolies to the foreign competition. There were legal issues too. The Chinese law was not equipped enough to deal with issues of transparency, competition and procurement which directly impacted the entry of foreign investors as well as the reform of SOEs. The problems exacerbated after the global financial crisis. The stimulus package injected by the Chinese government into the economy, albeit spurring growth momentarily, led to over-production, excesses and accumulation of NPLs. In fact, during 2011-12, the Chinese economy looked more "commanded" than it was before the crisis, with less room for manoeuvre for private sector activities. Thus, the highly centralised organisational and regulatory structure, lack of political willingness on the part of political leadership as well as the firm actors, have made it incompatible for the corporatisation of SOEs, reform of the legal sector, and the full development of market economy and its institutions.

¹⁶ The opening of China into the outside world from relative autarky and isolation happened twice in the gap of a century and half. On the first occasion, this engagement was the consequence of imperial powers that split China into treaty ports by forceful means. The second engagement, ie., re-engagement happened in the post Mao era as a result of deliberate domestic reforms undertaken in China's national interest. Although the international forces played role in 'opening up' China for the second time, but the final call was taken by the Chinese elites (Breslin 2007; 82).

A national asset manager, SASAC, created in 2003, plays an important role in exercising state control over SOEs. They do not only focus on managing the state ownership and supervising the functions of SOEs but also assumes regulatory responsibilities which directly impact the business operations of SOEs (Naughton, 2006 & 2011). This makes SASAC's mandate different from that prescribed in OECD (2005) "Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries", which encourages regulatory independence and does not allow combining ownership functions with the regulatory responsibilities. This behaviour of SASAC prevents SOEs to become real market players in the SASAC system, which fails to weaken the government characteristics of SOEs. Under the SASAC system, SOEs enjoy low credits to manage their losses and enjoy monopolistic powers using their state-party influence. Thus, even in the years post WTO entry, SOEs in China gained substantial privileges which are growing over time. This forms a major obstacle to the growth of market economy in China, despite the government's liberalization rhetoric. The three case studies of industrial reform pathways, probed the question? What explains the continuity of SOE reform policies in the post-liberalisation era? The cases together highlight the importance of governmental interventions in the various phases of reform that led to the formation of rules and practices which determined the respective degrees of state, private and foreign ownership in these three strategic sectors. The case studies also lend support to the institutional framework derived at the beginning of the study in chapter one and two. They bolster the hypotheses about the significance of state ownership and the role played by political leadership in explaining the dynamics of SOE reform. The relationship between economic institutions and political leadership also helps to explain the persistence of majority state ownership in these key sectors and account for the changes and continuity in SOE policies in the years following China's liberalisation.

In the three case studies under review, telecommunications, banking and oil industry, the approach to liberalisation adopted at the outset of the reform period shaped emergent norms on the appropriate level of state ownership. Each industry has their own experiences of transition from the Mao era, and their degrees of backwardness varied which subsequently determined their nature of reform in the liberalisation period. Thus the path to transition from early years to later stages, cannot be understood as a straight line construction and in fact was characterised by degrees of decentralisation and centralized control. In the telecommunications sector, the MPT

acted as the biggest obstacle to reform. They not only wanted to retain monopoly of the sector but also desired reform as per their term and conditions. While this approach led to the reform of the telecommunications services, it had the unintended consequence of positioning the MPT as a formidable opponent to market liberalization measures that threatened its exclusive claim to short-term winnings. In fact they also played the national security card to win the domestic debate against opening the sector to the foreign investors. In the banking sector, the control was of a very different kind. Despite having a similar organisational and regulatory structure, the SOBs, from the early years of reform were leaned towards corporatisation of the sector. However, the problem of NPLs as a result of policy-lending, stymie the growth of the banking sector as efficient financial institutions. The state-directed lending decisions also reduce incentives among the employees in the sector, to increase the performance of the sector. The scope for AMCs is also limited in cleaning off the bad debts of the SOBs. They also face the challenges related to transparency in operations, information sharing, corruption, red-tapism and lack of incentives to perform better. The state-owned oil industries in contrast have an interesting reform experience and share a puzzling relationship with the central government. After the pricing reform and the going out strategy of the sector, the industries have actually been profit-oriented in their approach, especially in its overseas operations. It also gave opportunities to other SOEs to enter into their borrowers' market for trading in goods and services. Thus, the expansion brought in diversified gains to the Chinese government, benefitting its economy directly and also its foreign policy. However, their dependence on Chinese policy banks, tie them to the state governance mechanism, and the oil bureaucracy, one of the most powerful bureaucracies of China, found it in their interest to retain the monopoly status and resisted competition at home.

The political logic behind the regulation of these sectors is found in the incomplete separation of government and enterprise in the late 1990s. The economic logic was provided by the SOE industrial policy drive which trumpeted the importance of the development of large SOEs in key industries. These sectors, being national champions, were prioritised in the large enterprise strategy, leading to their consolidation in the midst of reform. The case studies also lend insight into what factors are driving changes in the state-owned economy, yet the empirical limitations arising out of conducting research in China preclude a definitive answer to the question of what

accounts for the continuity of policies in SOE reform. The cases together, therefore, attest to the fact that SOEs are naturally regarded as the ruling foundations of the CCP. The reforms may result in corporatization of SOEs, and separation of the functions of government and enterprise, upon closer inspection, however, it appears that regulatory mechanism is affected by a variety of forces, including institutions and political willingness. Under the current arrangements in China, the government acts as both the owner and the keeper of the state firms.

8.3 CONTRIBUTION TO LITERATURE

The relationship between political institutions and economic reform has been the focus of much recent research in political economy, but the results have been equivocal at best (Nooruddin, 2011: 169). Both economists and political scientists have made considerable headway in studying how political institutions affect policy decisions and economic outcomes (Przeworski et al., 1999; Atkinson and Stiglitz, 1980). The scholarship on the subject dates back to 1930s when Oscar Lange was challenged by Friedrich Hayek and Ludwig Mises on his theory of market socialism (Lavoie, 1985). The debate has however evolved with time and scholars have tried to examine it from different perspectives as well as added varied nuances to it. It in fact gained currency in the 1970s when market- oriented reforms began dominating the social and economic change in state socialist countries. What the extant scholarship still lacks is a cogent organisation and a unified approach, as it shed light on the nature of reform, and in particular on the institutional drivers of policy changes.

Defining the concept of “markets” in state socialism has often received little attention in theoretical literature. Most of the studies tend to assume the ideal kind of market as understood in classical economics, as the point of reference to begin with. They situate the debate often in binary lines, where if the patterns of organisational behaviour and decision making do not point to the characteristics of ideal market, they understand it as bureaucratic allocation (Brus & Laski, 1989; Kornai, 1990). Part of these problems arises because the “state”, which is key driver in socialist transition/transformation, has received relatively little attention in contemporary political science or political economy studies. The overwhelming emphasis in comparative politics has been on the qualities of governance, democracy, prevalence of elections and the like

(De Mesquita et al., 2003; Mulligan et al., 2004; Lindert, 2004). While works by Atul Kohli (2004), Vivek Chibber (2003) have placed the state power and its direction as the key to explaining economic development, the emphasis on the agency of political leadership and the importance of political will remain silent in explaining why and when they decide to use power for changes or resisting changes. The present study is a contribution to address this theoretical gap which also helps to overcome the weakness of agency based explanations, by focussing on the changes in the state's power structure and the impact of such changes on economic relations.¹⁷

Agency-based explanations are used by scholars who tend to take a historical-sociological approach and those who are interested in national-institutional context (Quinn & Woolley, 2001; Varshney, 1998 & 2002; Bates, 1981). Such approaches seek to identify critical junctures in policy making that explain the adoption of economic reform policies, or that derail positive economic growth (Nooruddin, 2011: 23). They also pin down particular actors involved in critical decisions in explaining the conditions under which the policies were implemented and what enabled them to do so. The role of “political will” is central to such explanations, which also forms a key variable in this thesis. It then becomes imminent to delve into the political costs involved in the reform process, the importance of gaining domestic consensus or societal consensus before carrying out a reform. Another aspect which this study also brings out is the set of policies which determine the direction of changes and continuity in economic reform. Thus, the thesis also adds to the theory of state sector reform by demonstrating the importance of agency in policy-making. The analysis uses institutionalist explanations not contrary to the sociological/agency based explanations described in the previous chapters, but rather argue that they are potentially complementary if used to identify the relationship between political institutions, leadership and their interests in carrying out economic reform.

The thesis also brings out the limitations of studying China's economic transition based on either decentralization theory or the factional struggle theory. This study takes the perspective of

¹⁷ Scholarly efforts have been made to probe into the “black box” of bureaucratic decision making and bring to light the structural configurations of the state. The majority of them find a relatively high degree of fragmentation in the Chinese polity. However, for most part their focus of analysis is centered on identifying the lasting characteristics of such a polity rather than on structural changes over time and their sources and impact. See Victor Nee and David Mozingo eds (1983), David M. Lampton, (1987); and Kenneth Lieberthal and Michel Oksenberg, (1988).

institutionalism to explore the drivers and actors in the institutional change, and also identify the dynamics that resist such changes by forming the alliance, the base and the strategies in retaining the legitimacy by permitting reforms within the existing institutional logic. In terms of the theoretic implications of the interplay between the state and the market, this study shows how the incentives for various forces from within and without make use of the state apparatus to advance their agendas through accesses and avenues opened by structural changes. The findings, therefore, reject a static understanding of the state-market relations. It is true that the pre-reform political economic system of China was based on a highly centralised command structure with no scope for incentives or uncertainties in decision-making. What has been changed in the post reform years is the break-down of many such old institutional buffers that were set up against uncertainties, instrumental political incentives and based on ideological indoctrination, but the debates have multiplied and the cycles of liberalisation is complemented by a cycle of re-centralization in economic reform as the evidences from this study suggests that the Chinese state's economic power can also be sustained in an incoherent power structure. This study has further shown that while the market forces have entered China in the post WTO years, weakening the instrumental market for some time, it has however not been able to weaken the monopoly of SOEs in China; in fact their strengths have increased over the years.

WHERE ARE THE REFORMS HEADED?

The 18th Party Congress at the end of 2012 had already set the momentum for another phase of SOE reform in China. The new leadership under Xi Jinping had set out to determine the topics for discussion at the third plenary session of the 18th CPC Central Committee (Xi, 2014: 76). SOE reforms featured as one of the key issues for discussion, and in this direction, a new set of comprehensive reforms were announced, to deepen the reform. Although this marks the beginning of a new and fifth phase of SOE reform in China, the official blueprint was introduced after two years from its announcement, in 2015 as a “Guiding Opinions of the Communist Party of China Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises” in the guideline to deepen reform of SOEs issued by the State Council in September 2015 (The State Council, 2015). The document highlights four changes for SOEs: mixed ownership reform, new supervisory rules for state assets, a modern enterprise system, and Party

leadership (Asia Pacific Foundation of Canada Research Series, 2016). Setting 2020 as the timeline for the reform, the document further notes, “SOEs are expected to be more robust and influential and have greater ability to avoid risks”, (Xinhua 2015). Although the move signifies a transformative role of SOEs in Chinese economy, it is however not clear the means by which it will be achieved. In fact the guidelines throw very little light on the details of the reform, except reiterating the need to carry out the reform on a priority.

As already discussed in the previous chapters, the importance of market in allocating resources as the basic to any enterprise reform, it is not clear from the current policy documents following the guideline (Xinhua, 2016), the role that market forces would play in opening the large and key SOEs to competition, how the elements of plan and market will be reconciled, and the extent to which the corporatisation of SOEs would take place. The Chinese leadership, amidst its pronouncements and rhetoric of SOE reforms, has reminded the enterprises time and again, that it is the party which has the ultimate decision making power in case of SOEs. To this direction, President Xi Jinping recently remarked, “Party leadership and building the role of the party are the root and soul for state-owned enterprises”.....and “that principle must be insisted on” (Feng, 2016). These reminders therefore can be understood as a caution to the management of the enterprises against the “leaching away of state-assets” (Jefferson, 2017: 15). The new leadership under Xi had also witnessed a reshuffling of the government departments and transfers of various political leaders within the party ranks. One of them which hold a direct implication on SOE reforms, is that the new leadership has diluted the power of the Central Leading Group for Financial and Economic Affairs by including the agencies from state council into the key decision making process.¹⁸ Thus, the creation of new political institutions and agencies into the decision making indicates an attempt to recentralize power by the new leadership (Economy, 2014). This also brings into fore the factional struggle which often impedes the progress of any economic reform in China to a great extent. The new set of reforms also does not infuse much credibility about the regime into the foreign investors who are hesitant to make investments in China. Instead SOEs will serve as one of the major financiers in the Silk Road initiative (Sze & Wu, 2016). Therefore, the direction of this new phase of reform, also seem to toe the line of policy continuity, leaning towards a hard-line approach to carry out the reform.

¹⁸ It served as the link connecting supreme Party leaders and bureaucrats.

8.5 FUTURE RESEARCH

A promising aspect of future research in this area would be the analysis of the considerable local/regional variation in regulating and liberalizing the key SOE sectors. While this study has focused on developments in the portion of the state sector under the central government, there is much to learn from studying the reforms which developed at the local level. It would be indeed interesting to understand the role played by local level SASACs and their relationships with the central SASAC. Under China's present system, the local SASACs implement state asset management policies largely independently of the central authorities. Contrasting analyses between the major cities' approaches to redraw the boundaries of the state sector is especially striking and invite in-depth comparative analysis. The study about different approaches taken by the SEZs and the large cities like Shanghai and Shenzhen, who have brought about their own regional modifications to the state asset management system, would be particularly helpful in accounting for the decentralisation phenomenon based on center-periphery theory. While these two cities have similar systems of state asset management, almost similar levels of economic development and a shared legacy of state sector profitability, they have adopted very different approaches to implementation of the SOE reforms.

Shenzhen has become the centre of attention in China as the Chinese authorities, especially the neo-liberals within the party, hold it up as a role model of economic transformation and wealth accumulation that defies the economic headwinds that have slowed growth in most other parts of the mainland. The Shenzhen model has in fact unleashed a debate among the city government's think tanks and its citizens, over whether Shenzhen's recent reinvention should be a model for China's future. The city, which is only a third the size of Shanghai, and one eighth that of Beijing, could very possibly overtake Shanghai as China's global financial centre in the next decade if it cooperated with Hong Kong. While the Shanghai market is dominated by large state-owned enterprises, Shenzhen is more representative of smaller, younger, privately owned companies, and is headquarters for a number of property developers (South China Morning Post, 2016). Shanghai's experience, on the other hand, shows that a mixed economy with hybrid of private and state-owned enterprises might be better for China's economic development to reap the benefits of globalisation.

This thesis has highlighted the complex, contested and contradictory character of China's SOE reform. The study has pointed flaws to the image of China's state-owned economy as the domain controlled by few politically influential leaders, instead it can be understood as a complex phenomenon that has been driven forward by disparate factors including leadership behaviour, administrative reforms as well as the power dynamics at the industry level bureaucracy. Among the role of external forces, the neo-liberal context for SOEs reform was also provided by China's desire for WTO membership. It in fact unleashed an array of intense debates among the various factions of political leadership, which majorly shaped the nature and course of SOE reform in China. As expected by the Western world, China's WTO accession, has failed to sustain the tenor of SOE reform, pushing it backward into the path of state-directed development. The resistance to change by the political leadership was particularly important in planting the normative seeds and institutional shoots of a now-robust SOE industrial policy regime. Finally, the study has also drawn attention to the problems ailing the SOE sector in China for decades. News of corruption by top executives of some large SOEs has drawn severe public criticism about the misuse of SOEs as monopolies in the economy. The chief of Asia economist at Mizuho Securities Asia, Jianguang Shen commented "SOE reform, debt, overcapacity and 'zombie companies' are all deeply connected issues. For private companies in overcapacity industries, after several years of losses there's no way to continue. The owner will shut them down or sell them off, but at SOEs they can keep getting bank loans or government support" (Wildau, 2016). In sum, the extant scholarship indicates that, although the economic environment has become slack, there is still the persistence of the socialist legacy, which competed and struggled with the new practice, even in the post liberalisation years. Thus, it can be convincingly argued that in reforming state socialist economies the relationship between organizational decision-making and the price system has been shaped by two major structural variables, namely, ownership based control of economic organizations by the state and the logic of state's power structure.

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National Bureau of Statistics of China

National Development Reform Commission <http://en.ndrc.gov.cn/>

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OECD China <http://www.oecd.org/china/>

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United States Trade Representative <https://www.wto.org/>

WTO <https://www.wto.org/>

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APPENDICES

Annexure 1 - List Of Central SOEs Controlled By SASAC

Name	
1	China National Nuclear Corporation (CNNC)
2	China Nuclear Engineering Group Corporation (CNEC)
3	China Aerospace Science and Technology Corporation (CASC)
4	China Aerospace Science & Industry Corporation (CASIC)
5	Aviation Industry Corporation of China (AVIC)
6	China State Shipbuilding Corporation (CSSC)
7	China Shipbuilding Industry Corporation (CSIC)
8	China North Industries Group Corporation (NORINCO GROUP)
9	China South Industries Group Corporation (CSGC)
10	China Electronics Technology Group Corporation (CETC)
11	China National Petroleum Corporation (CNPC)
12	China Petrochemical Corporation (Sinopec Group)
13	China National Offshore Oil Corp (CNOOC)
14	State Grid Corporation of China (SGCC)
15	China Southern Power Grid Corporation (CSG)
16	China Huaneng Group (CNHG)
17	China Datang Corporation (CDT)
18	China Huadian Corporation (CHD)
19	9 China Guodian Group
20	China Power Investment Corporation (CPI)
21	China Three Gorges Corporation (CTG)
22	Shenhua Group Corporation Limited
23	China Telecommunications Corporation (China Telecom)
24	China United Network Communications Group Co., Ltd. (China Unicom)
25	China Mobile Communication Group Co. (China Mobile)
26	China Electronics Corporation (CEC)
27	China FAW Group Corporation (FAW)
28	Dongfeng Motor Corporation (DFM)
29	China First Heavy Industries Group (CFHI)
30	China National Erzhong Group Co. (China Erzhong)
31	Harbin Electric Corporation (HE)
32	Dongfang Electric Corporation (DEC)
33	Anshan Iron and Steel Group Corporation (Ansteel)
34	Baosteel Group Corporation (Baosteel)
35	Wuhan Iron and Steel (Group) Corporation (WISCO)
36	Aluminum Corporation of China (CHINALCO)

37	China Ocean Shipping (Group) Company (COSCO)
38	China Shipping (Group) Company (China Shipping)
39	China National Aviation Holding Group (CNAH)
40	China Eastern Air Holding Company (CEAH)
41	China Southern Air Holding Company (CSAH)
42	Sinochem Group Corporation (Sinochem)
43	China National Cereals, Oils & Foodstuffs Corp. (COFCO)
44	China Minmetals Corporation
45	China General Technology (Group) Holding, Limited (Genertec)
46	China State Construction Engineering Corporation (CSCEC)
47	China Grain Reserves Corporation (Sinograin)
48	State Development & Investment Corporation (SDIC)
49	China Merchants Group
50	China Resources (Holdings) Company, Ltd.
51	China Travel Service (HK) Group Corporation (HKCTS)
52	State Nuclear Power Technology Corporation Ltd. (SNPTC)
53	Commercial Aircraft Corporation of China, Ltd. (COMAC)
54	China Energy Conservation and Environmental Protection Group (CECEP)
55	China International Engineering Consulting Corporation (CIECC)
56	China Huafu Trade & Development Group Corp
57	China Chengtong Holdings Group Ltd.
58	China National Coal Group Corp. (ChinaCoal)
59	China Coal Technology & Engineering Group Corp. (CCTEG)
60	China National Machinery Industry Corporation (SINOMACH)
61	China Academy of Machinery Science & Technology
62	Sinosteel Corporation (Sinosteel)
63	China Metallurgical Group Corporation (MCC)
64	China Iron and Steel Research Institute Group (CISRI)
65	China National Chemical Corporation (ChemChina)
66	China National Chemical Engineering Group Corporation (CNCEC)
67	Sinolight Corporation (Sinolight)
68	China National Arts & Crafts (Group) Corporation (CNACGC)
69	China National Salt Industry Corporation (CNSIC)
70	Huacheng Investment & Management Co., Ltd.
71	China Hi-Tech Group Corporation Ltd.
72	China National Materials Group Corporation Ltd. (SINOMA)
73	China National Building Materials Group Corporation (CNBM)
74	China Nonferrous Metal Mining (Group) Co. Ltd. (CNMC)
75	General Research Institute for Nonferrous Metals (GRINM)
76	Beijing General Research Institute of Mining & Metallurgy (BGRIMM)

77	China International Intellectech Corporation (CIIC)
78	China Academy of Building Research (CABR)
79	China CNR Corporation Ltd. (CNR)
80	CSR Corporation (CSR)
81	China Railway Signal & Communication Corporation (CRSC)
82	China Railway Engineering Corporation Group (CRECG)
83	China Railway Construction Corporation Group (CRCCG)
84	China Communications Construction Company Ltd. (CCCC)
85	Potevio Company Ltd. (Potevio)
86	Datang Telecom Technology & Industry Group
87	China National Agricultural Development Group Corporation (CNADC)
88	Chinatex Corporation Limited
89	Sinotrans& CSC Holdings, Co., Ltd. (SINOTRANS Group)
90	China Silk Corporation
91	China Forestry Group Corporation
92	China National Pharmaceutical Group Corporation (SINOPHARM)
93	CITS Group Corporation
94	China Poly Group Corporation
95	Zhuhai Zhen Rong Company
96	China Architecture Design & Research Group (CAG)
97	China Metallurgical Geology Bureau (CMGB)
98	China National Administration of Coal Geology (CNACG)
99	Xinxing Cathay International Group Co., Ltd.
100	China TravelSky Holding Company (TravelSky)
101	China National Aviation Fuel Group Corporation (CNAF)
102	China Aviation Supplies Holding Company (CAS)
103	Power Construction Corporation of China
104	China Energy Engineering Group Co., Ltd
105	China National Gold Group Corporation
106	China National Cotton Reserves Corporation
107	China Guangdong Nuclear Power Holding Co., Ltd. (CGNPC)
108	China Hualu Group Co., Ltd
109	Alcatel-Lucent Corporation Limited
110	FiberHome Technologies Group
111	OCT Group
112	Nam Kwong (Group) Company Limited
113	China XD Group
114	China Railway Materials Commercial Corporation (CRMCC)
115	China Reform Holdings Corporation Limited

Source: SASAC Website 2013

Annexure 2 - Top 50 Non-Financial Enterprises with ODI Stock

Enterprise	Rank 2012
China Petrochemical Corporation	1
China National Petroleum Corporation	2
China National Offshore Oil Corporation	3
China Mobile Communications Corporation	4
China Resources (Holdings) Co., Ltd.	5
China Ocean Shipping (Group) Company	6
Sinochem Corporation	10
China State Construction Engineering Corporation	13
China Merchants Group	8
Aluminum Corporation of China	9
China Unicom Corporation	11
Huawei Technologies Co., Ltd.	27
China National Chemical Corporation	14
China Minmetals Corporation	7
CITIC Group	12
China Communication Construction Company Ltd.	28
China National Cereals, Oils & Food stuffs Corp.	15
China National Aviation Holding Corporation	16
China Three Gorges Corporation	42
State Grid Corporation of China	24
China Shipping (Group) Company	19
Sino Steel Corporation	17
GDH Limited	22
SINOTRANS Changjiang National Shipping (Group) Corporation	18
China North Industries Group Corporation	21
China Huaneng Group	20
HNA Group	34
Yanzhou Coal Mining Company Limited	30
Power Construction Corporation of China	N/A
China Nonferrous Metal Mining & Construction (group) Co., Ltd.	29
Wuhan Iron & Steel (Group) Corporation	35
Shanghai Geely Zhao Yuan Investments International Ltd.	N/A
Jinchuan Group Ltd.	52
Shanghai Baosteel Group Corporation	43
Aviation Industry Corporation of China	41
China Metallurgical Group Corp.	23

Legend Holdings Ltd.	25
China Railway Construction Corporation	N/A
China Power Investment Corporation	26
Shenhua Group Corporation Ltd.	51
Guangzhou Yuexiu Holdings Limited	45
Anhui Foreign Economic Construction (Group) Co., Ltd.	N/A
Midea Group Co., Ltd.	N/A
China National Travel Service (HK) Group Corporation	33
Dalian Wanda Group Co., Ltd.	N/A
China General Nuclear Power Group	47
Anshan Iron & Steel Group Corporation	37
Shanghai Pharmaceuticals Holdings Co., Ltd.	N/A
China Datang Corporation	N/A
China National Heavy Duty Truck Group Co., Ltd.	N/A

Source: MOFCOM and BBVA Research

Annexure 3 - Comprehensive Monopoly of Power (percent)

Primary Indicators	Secondary Indicators		Telecom	Oil	Gas	Railway	Banking	Tobacco	Electricity
Economic Monopoly	Trade barriers		100	75	75	84	75	100	75
	Price regulation		75	75	100	100	100	100	75
	Market structure	Concentration of property rights	95.68	75	100	95	95	95	95
		Proportion of industry nationalization	55.53	75	100	96	95	95	95
	Structure of property rights	Market concentration	98	100	100	86	75	86	86
		Industrial integration	98	75	75	100	90	100	75
Power Monopoly	Laws and regulations	Number of legal and regulatory limitations and exclusions of competition	75	75	100	75	75	100	50
		Extent of limiting and excluding legal and regulatory competition	87.5	75	100	100	75	100	50
	Administrative powers	Setting for the industry department in charge	75	50	75	100	100	100	100
		Management authority in charge of the industry department for the industry	75	50	75	100	100	100	100
		Management mode for the industry by the industry department in charge	75	50	75	75	75	100	50
	Personnel authority		75	75	75	88	75	75	75
	Ideology		60	75	75	70	70	70	75
	Effect of Corporate behavior	Profit-making behavior using monopoly		75	75	75	85	85	75
Operational autonomy of enterprises			75	75	75	75	75	75	75
Allocative efficiency		Investment	62.5	75	75	100	75	100	50
		Demand and supply	75	75	75	100	75	100	100
		Ratio of worker's income and average income	28.8	75	75	100	90	100	100
	Labor productivity		61.30	75	75	82	75	82	75
	Quality of services		75	75	75	75	75	75	100

Annexure 4 - Innovation Efficiency in the Private and State-Owned Sectors

Ownership	Year	R & D Expenditures (in billion Chinese yuan)	Patents	R & D Expenditures per 10,000 Firms	Patents per 10,000 Firms
SOE	2003	11.3	730	3.3	213
	2004	12.6	683	3.5	192
	2005	16.2	961	5.9	350
	2006	16.5	1488	6.6	596
	2007	18.2	1921	8.8	929
	2008	26.9	3757	12.6	1763
	2009	32.2	4285	15.7	2089
	2010	39.2	5280	19.4	2607
Private	2003	2.2	412	0.3	61
	2004	4.1	1058	0.3	89
	2005	6.4	1351	0.5	109
	2006	10.5	1885	0.7	126
	2007	14.8	2312	0.8	131
	2008	23.4	4177	1	170
	2009	32.2	6343	1.3	248
	2010	41.4	8659	1.5	317

Sources: Based on National Statistical Bureau, China Science and Technology Statistical Yearbook, Luo, Li & Duan, (2012) & Duan & Saich, (2014).

Annexure 5 - Total Assets of Banking Institutions (2003-2012) RMB Million

Institutions	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Banking institutions	276,584	315,990	374,697	439,500	531,160	631,515	795,146	953,053	1,132,873	1,336,224
Policy banks & the CDB	21,247	24,123	29,283	34,732	42,781	56,454	69,456	76,521	93,133	112,174
Large commercial banks	160,512	179,817	210,050	242,364	285,000	325,751	407,998	468,943	536,336	600,401
Joint-stock commercial banks	29,599	36,476	44,655	54,446	72,742	88,337	118,181	149,037	183,794	235,271
City commercial banks	14,622	17,056	20,367	25,938	33,405	41,320	56,800	78,526	99,845	123,469
Rural commercial banks	385	565	3,029	5,038	6,097	9,291	18,661	27,670	42,527	62,751
Rural cooperative banks			2,750	4,654	6,460	10,033	12,791	15,002	14,025	12,835
Urban credit cooperatives	1,468	1,787	2,033	1,831	1,312	804	272	22	30	
Rural credit cooperatives	26,509	30,767	31,427	34,503	43,434	52,113	54,945	63,911	72,047	79,535
Non-bank financial institutions	9,100	8,727	10,162	10,594	9,717	11,802	15,504	20,896	26,067	32,299
Foreign banks	4,160	5,823	7,155	9,279	12,525	13,448	13,492	17,423	21,535	23,804
New-type rural financial institutions & Postal savings bank	8,984	10,850	13,787	16,122	17,687	22,163	27,045	35,101	43,536	53,511

Source: CBRC Annual Report 2012

Annexure 6 - Total Liabilities of Banking Institutions (2003-2012) Rmb Million

Institutions	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Banking institutions	265,945	303,253	358,070	417,106	500,763	593,614	750,706	894,731	1,060,779	1,249,515
Policy banks & the CDB	20,291	23,005	27,760	33,006	39,203	52,648	65,393	72,159	88,231	106,647
Large commercial banks	154,002	172,180	200,453	228,824	269,176	306,142	386,036	440,332	502,591	560,879
Joint-stock commercial banks	28,621	35,333	43,320	52,542	69,350	83,924	112,541	140,872	173,000	222,130
City commercial banks	14,123	16,473	19,540	24,723	31,521	38,651	53,213	73,703	93,203	115,395
Rural commercial banks	380	538	2,873	4,789	5,767	8,756	17,546	25,643	39,208	57,841
Rural cooperative banks	-	-	2,574	4,359	6,050	9,381	11,940	13,887	12,959	11,796
Urban credit cooperatives	1,464	1,766	2,001	1,781	1,247	757	255	21	24	-
Rural credit cooperatives	26,646	30,035	30,106	33,005	41,567	49,893	52,601	61,118	68,575	75,521
Non-bank financial institutions	7,683	7,745	9,126	9,424	7,961	9,492	12,649	17,063	21,310	26,194
Foreign banks	3,751	5,329	6,530	8,532	11,353	12,028	11,818	15,569	19,431	21,249
New-type rural financial institutions & Postal savings bank	8,984	10,850	13,787	16,122	17,568	21,942	26,713	34,365	42,247	51,712

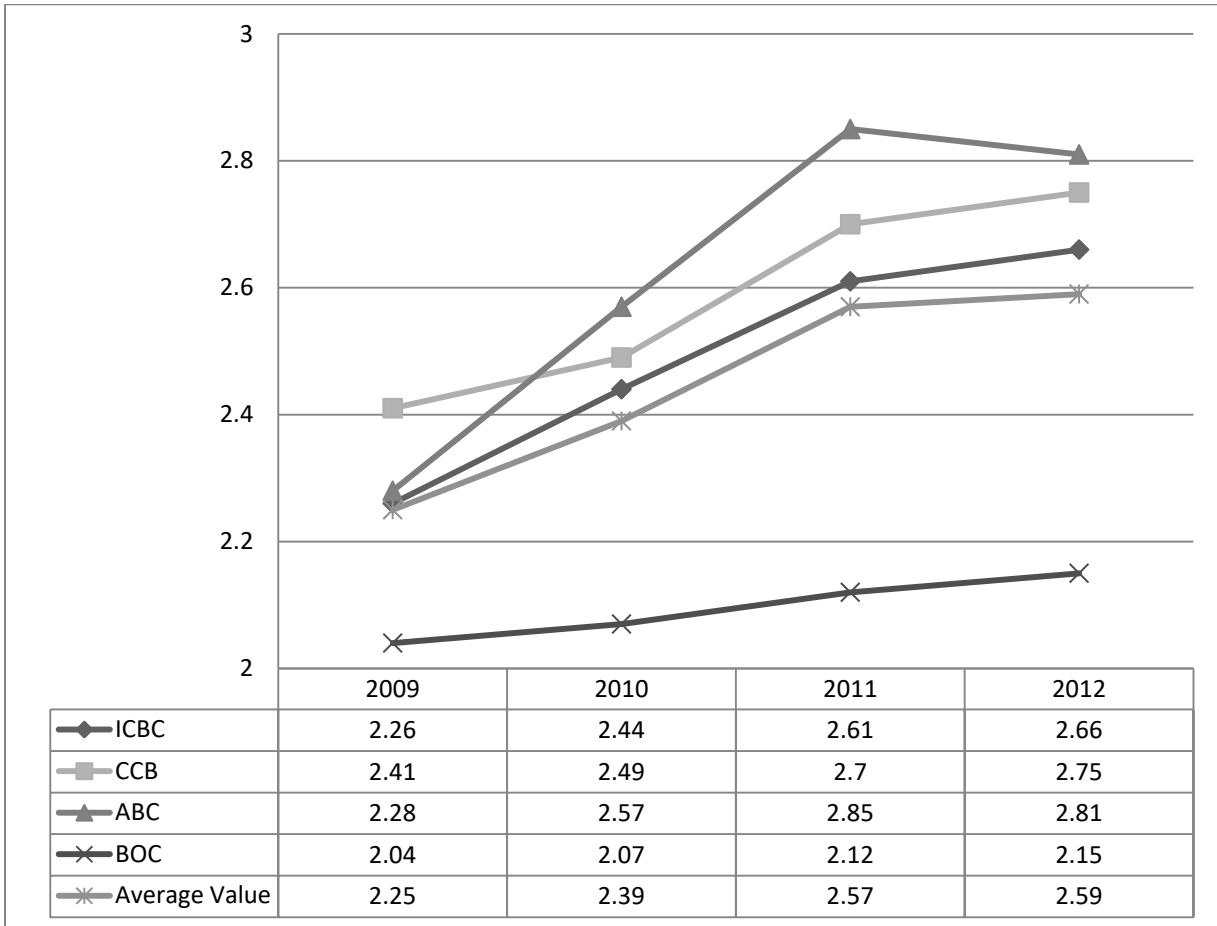
Source: CBRC Annual Report 2012

Annexure 7 - Income and Profit of China's Banking Financial Institutions

RMB 1 trillion	2011		2012	
	Amount	Increase	Amount	Increase
Net profit income	2.15	29.30percent	2.54	17.90percent
Non-interest Income	0.51	46.30percent	0.63	21.80percent
Net profit	1.04	36.30percent	1.24	18.90percent

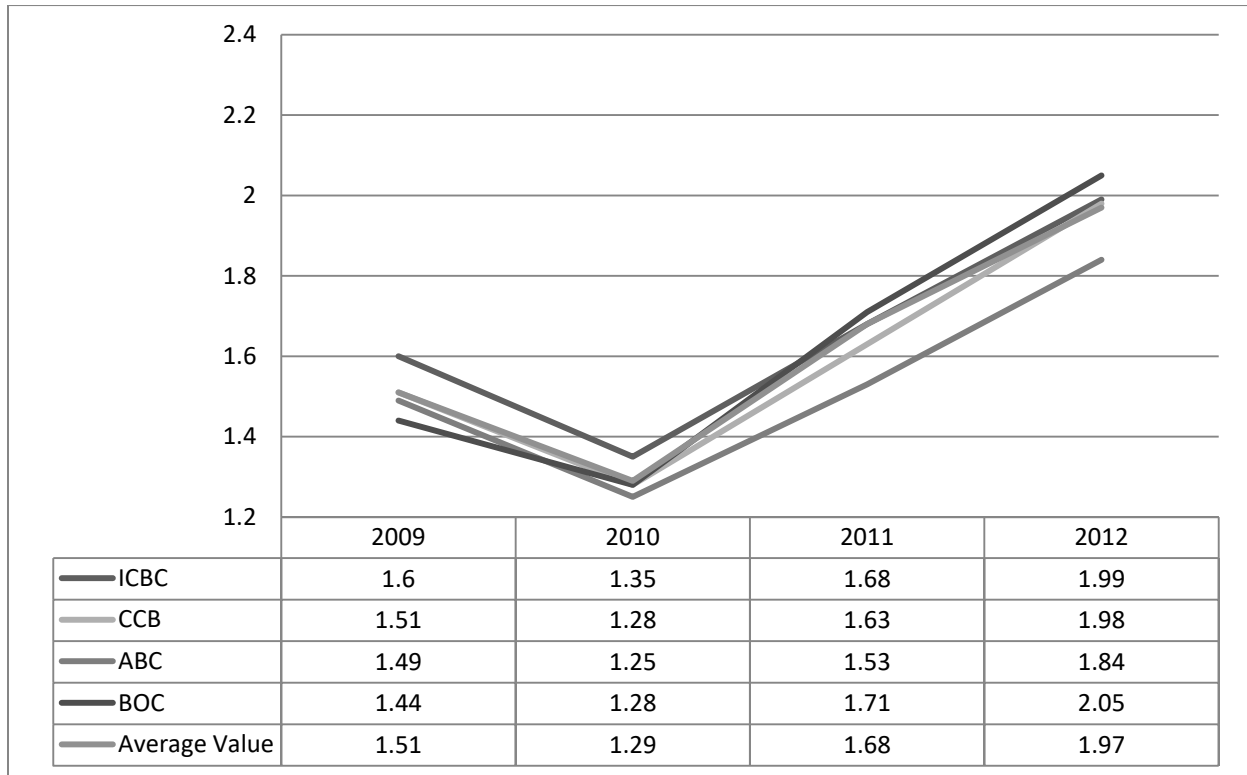
Source: KPMG Annual Report 2014

**Annexure 8 –
Net Interest Rate Margin of the Four State-Owned Commercial Banks from 2009 To 2012**



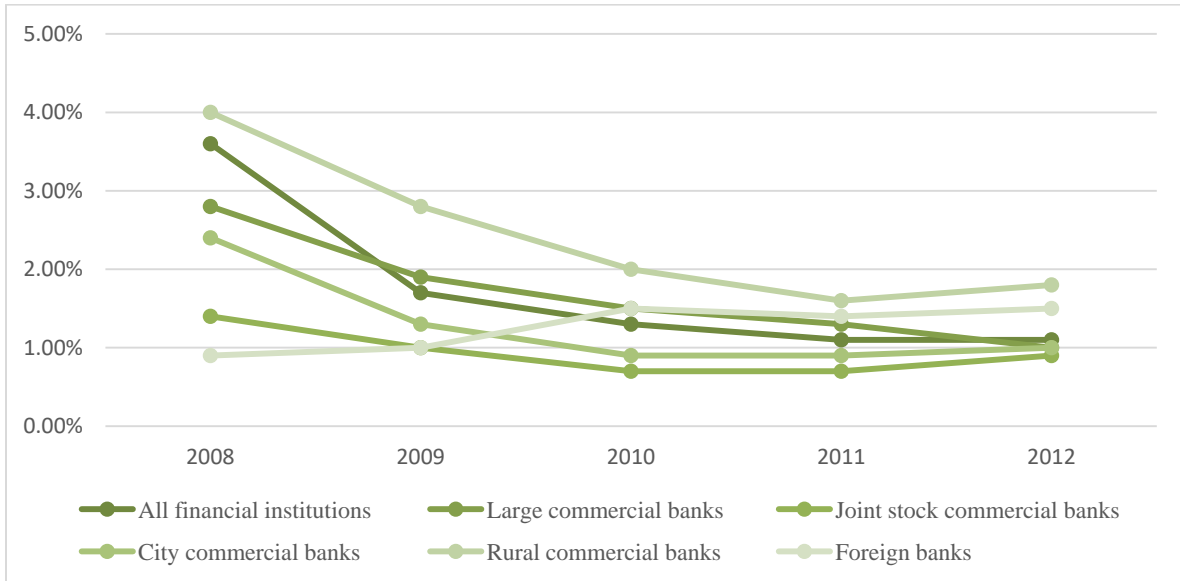
Source: KPMG Annual Report 2014

**Annexure 9 –
Cost of interest-bearing deposits from customers of the four state-owned commercial banks
from 2009 to 2012**



Source: KPMG Annual Report 2014

Annexure 10 - NPL Ratio of Commercial Banks (percent)



Source: KPMG Annual Report 2014

Annexure 11-
Degree of Concentration of Chinese Oil Companies in the Crude Oil Production Market,
1989–2012 (Unit: 10,000 tons)

Year	National Total output	CNPC	Sinopec Group	CNOOC	Yanchang Petroleum	Sinopec Star Petro. Co.	Shanghai Branch of the Sinopec Group	Others	CR1	CR2	CR4
1989	13764	13597	--		--	--	--	--	98.79percent	--	--
1990	13831	13614.5	--	126.5	--	--	--	--	98.43percent	99.35percent	--
1991	14099	13647.2	--	241.4	--	--	--	--	96.80percent	98.51percent	--
1992	14210	13725.7	--	387.4	--	--	--	--	96.59percent	99.32percent	--
1993	14400.4	13912.4	--	463.5	--	--	--	24.5	96.61percent	99.83percent	--
1994	14607.2	13837	--	647.7	63.2	--	--	59.3	94.73percent	99.16percent	99.59percent
1995	14879.2	13907.7	--	841.6	73.5	--	--	56.4	93.47percent	99.13percent	99.62percent
1996	15729.1	14053.3	--	1501	88	--	--	86.6	89.35percent	98.89percent	99.45percent
1997	16034.4	14215	--	1620	107.3	62	--	30.1	88.65percent	98.76percent	99.81percent
1998	16025.6	10583.4	3531.7	1631.9	162.6	62.8	--	--	66.04percent	88.08percent	99.28percent
1999	15878.6	10494.8	3456.5	1617.4	211.9	98	--	--	66.09percent	87.86percent	99.38percent
2000	16086	10359	3724	1757	246	240	--	--	64.40percent	87.55percent	100.00percent
2001	16317.2	10339.2	3783.9	1822	316.4	294.2	58.9	--	63.36percent	86.55percent	99.66percent
2002	16886.6	10366.2	3789.1	2098.6	380.2	293	47.3	205.2	61.39percent	83.83percent	98.50percent
2003	16983.1	10401.5	3804.8	2185.9	552.9	--	38	--	61.25percent	83.65percent	99.78percent
2004	17499.2	10455.1	3851.6	2439.7	720.9	--	31.9	--	59.75percent	81.76percent	99.82percent
2005	18142.2	10595.4	3919.5	2763.8	838.2	--	25.3	--	58.40percent	80.01percent	99.86percent
2006	18382.8	10663.6	4010.6	2760.3	926	--	24.7	--	57.71percent	79.45percent	99.52percent
2007	18596.2	10764.6	4102.5	2697.5	1031.7	--	21.6	--	57.89percent	79.95percent	99.88percent
2008	19022	10825.2	4174.8	2906.3	1089.7	--	21.6	--	56.91percent	79.00percent	99.86percent
2009	18990.2	10313.2	7239.1	3177.4	1130	--	--	--	54.31percent	76.63percent	99.31percent
2010	20301.4	10541.4	4253.6	4167.7	1200	--	--	--	51.92percent	72.88percent	99.32percent
2011	20364.6	10707.2	4270.4	3894.3	1232	--	--	--	52.58percent	73.55percent	98.72percent
2012	20747.1	11033.3	4315.6	3857.2	1254.8	--	--	--	53.18percent	73.98percent	98.62percent

Source: Based on National Statistical Bureau, China Statistical Yearbook & annual reports of CNPC, Sinopec Group, CNOOC

Annexure 12-

List of Members of the National Energy Commission and their Position (End of 2010)

Name	State Energy Commission	17th CC	Current Position
Wen Jiabao	Chairman	PBSC	Premier
Li Keqiang	Vice Chairman	PBSC	Executive Vice Premier
You Quan	Member	Alternate	Deputy Secretary General of the State Council
Zhu Zhixin	Member	Full	Director of Central Finance General Office
Yang Jiechi	Member	Full	Minister of Foreign Affairs
Zhang Ping	Member Director of the General Office	Full	Chairman of National Development and Reform Commission
Wan Gang	Member	Non-CC	Minister of Science and Technology
Li Yizhong	Member	Full	Minister of Industry and Information
Geng Huichang	Member	Full	Minister of State Security
Xie Xuren	Member	Full	Minister of Finance
Xu Shaoshi	Member	Full	Minister of Land and Resources
Zhou Shengxian	Member	Full	Minister of Environmental Protection
Li Shenglin	Member	Full	Minister of Communication and Transport
Chen Lei	Member	Full	Minister of Water Resources
Chen Deming	Member	Alternate	Minister of Commerce
Zhou Xiaochuan	Member	Full	Governor of People's Bank of China
Li Rongrong	Member	Full	Chairman of State-Owned Assets Supervision and Administration Commission
Xiao Jie	Member	Full	Chief of State Administration of Taxation
Luo Lin	Member	Alternate	State Administration of Work Safety
Liu Mingkang	Member	Full	Chairman of China Banking Regulatory Commission
Wang Xudong	Member	Full	Chairman of National Electricity Regulatory Commission
Zhang Qinsheng	Member	Full	Deputy Chief of the General Staff Department
Zhang Guobao	Member and Deputy Director of the General Office	Non-CC	Vice Chairman of National Development and Reform Commission and Director of the State Energy Administration

Source: State council of PRC (2012)