CHAPTER ONE

Introduction

> In opening up to the outside world, we must actively make use of things from developed Western countries . . . but we must be careful not to take the decadent things for miracles, or ulcers for treasures.
>
> —Jiang Zemin, President of the PRC, 1997

How does an authoritarian state renegotiate its duties and obligations to society without sacrificing political control? One of the key explanations for the disintegration of socialism in the Soviet Union and Eastern Europe is that these states failed to keep up their end of the "social contract."[1] Whether through the effects of continual market reform (Hungary, Yugoslavia) or the effects of stagnation (Romania, Bulgaria), these societies were no longer willing to sacrifice autonomy and a liberalized political sphere for a dwindling supply of welfare benefits and job security. As scholars of the region point out, the fusion of economics and politics under socialism made the failure of the economy a moment of political opportunity.[2]

In the Chinese context, however, the state has extricated itself out of the "social contract" with the urban working class without losing its grip on political power. The sequencing of foreign direct investment (FDI) liberalization before significant reform of the state-owned enterprise (SOE) sector and development of domestic private industry has enhanced the staying power of the Chinese Communist Party (CCP) and delayed societal demands for political change. Early opening to FDI was an integral factor in China's success in breaking the "iron rice bowl"[3] and in spreading capitalist labor practices and new legal institutions out from the nonstate sector to the large state-owned sector of China's urban economy. In addition, the large influx of FDI and the new competitive pressures emanating from this sector helped to reformulate the ideological debate central to socialist reform: the debate over the importance of state-owned industry. This debate has been redirected from the public/private dichotomy toward a debate over the need for Chinese national industry amid ever-increasing foreign competition.

For the last ten years, the People's Republic of China has attracted more FDI than any other developing country in the world. In 2002 China surpassed the United States as the most favored destination for FDI. The policy of "reform and openness" of which FDI liberalization is a central part is widely seen as a great success—so successful, in fact, that by 2001, the Chinese leadership successfully negotiated membership in the World Trade Organization. Accession to the WTO marks China's full-fledged acceptance into the global economy and shows the leadership's determination to continue to pursue increased openness, increased foreign investment, and dramatically increased competition within the domestic economy.

There is great debate among economists and policy analysts on the economic effects of FDI.[4] An equally vigorous and perhaps more polarizing debate surrounds the political and social effects of China's FDI policy, in particular, and China's rapid integration into the global economy, in general. Advocates and supporters of "reform and openness" portray FDI as the bearer of all that is good, legal, and advanced.[5] Critics of the social consequences of FDI liberalization portray it as the Trojan horse of exploitative global capitalism.[6] This debate is unsatisfying because it often fails to acknowledge that both of these characteristics co-exist in time and space. One major reason for the polarization of this normative debate surrounding the benefits of FDI and economic integration is that these broad Manichaean conclusions are often drawn from research that is focused on particular regions or industrial sectors.[7]

FDI's political and social effects are highly complex and differ widely across different regions, firms, and individual workers. The behavior of foreign investors is also shaped by their respective home country practices and business cultures so that regions with a heavy concentration of overseas Chinese "foreign" capital look different from areas with more diverse sources of overseas funding. Normative conclusions are dependent on the region, industrial sector, and, if at the firm level, where the firm is placed within international production networks. A researcher studying foreign-invested enterprises in the footwear industry will usually come to different conclusions from a researcher examining labor practices in a multinational producing goods with its own brand name attached. Alternatively, research at greenfield development sites (where foreign and private factories are built from scratch and are often separate from local industry) will yield different insights from research at former state-owned enterprises that have been recently transformed into joint ventures. Finally, interviews with migrant workers employed at one of the many labor-intensive foreign-invested enterprises in China's coastal and southern regions will differ dramatically from interviews with the domestic managerial elite of foreign-invested enterprises in Shanghai and the north. These characteristics and China's large size make it difficult to make broad generalizations about the effects of FDI on the shape of China's developing capitalist economy and its effects on Chinese workers in particular.

Due to these constraints, the broad political consequences of FDI liberalization have either been simplified down to the good/bad dichotomy or have been overlooked. This does not mean, however, that broad, systemic effects of FDI liberalization do not exist but rather that these broad systemic effects impact regions, firms, and workers differently. These differences matter greatly. In China, the liberalization of FDI creates winners in some circles and losers in others. It has spawned competition and fragmentation, but slowly and only at the margins at first. The liberalization of FDI was dynamic and led to a contagion of capitalism across the economic and ideological boundary of public ownership. The power of FDI liberalization as a catalyst for social change is exactly here: It is its ability to create competition, to encourage the development of new institutions, both at the firm level and through the legal system, and to alter fundamentally the debate over socialist ownership by placing ownership in a more global and competitive context.

During my field research, these ideas of competition, fragmentation, and globalization came up repeatedly and among many different kinds of people. At the Beijing headquarters of the Chinese Enterprise Managers Association (CEMA), the official organization representing state enterprise managers, the representative complained bitterly that the unfair advantages granted to foreign firms made it impossible for state firms to compete. State firms needed the autonomy to hire workers, fire workers, raise salaries to retain skilled workers, and cut benefits to reduce the social welfare burden. How would Chinese industry survive without a level playing field against the foreign investors?[8]

At an SOE in Tangshan, Hebei Province, a manager made this general concern very specific. "After the Sino-Japanese joint venture opened in Qinhuangdao, we lost a large number of managers who were attracted by the higher salaries of foreign firms. . . . After that we began to pay attention to the problem of retaining talent."[9] This firm's solution was to open up the wage differentials, paying top managers wages that exceeded ten times the monthly wage of a production worker and guaranteeing housing even as it cut welfare benefits to the vast majority. Another manager in the same firm explained their staff reduction policies this way: "we want to look more and more like foreign firms."[10]

A manager at a small rural collective producing DVDs in Hebei complained that his firm had no foreign investment and little likelihood of attracting any. But the absence of foreign investment can sometimes be just as influential as large infusions. "We need to compete with joint ventures and wholly foreign-owned companies; competition is very fierce in this sector and so our management is very strict."[11] He continued as we toured the production line, showing how wages and bonuses were scrupulously tied to small errors in the workers' performance. He proudly explained how each worker was encouraged to report the mistakes of others in exchange for bonus points. A sign hung over the shop floor with the admonition "time is money, efficiency is life." This famous slogan had first appeared in the 1980s amid the foreign manufacturing plants of Shenzhen, across the border from Hong Kong, and was lauded by Deng Xiaoping as one of the positive slogans of the Special Economic Zones.[12] Now more than fifteen years later, it reappeared in a small rural factory in central China.

A harried manager in an urban collective in Tianjin, a city with a long legacy of state ownership and a growing unemployment problem, talked about the collective's attempt to get rid of its many small enterprises. "We contract the enterprises out to managers or when possible try to find an overseas Chinese investor to turn these companies around."[13] When asked how management and labor practices are affected by these changes, he shrugged and said, "If the manager takes over, we still make sure that they abide by certain regulations regarding wages and benefits. We let them reduce the staff but we take the laid-off workers back. Then they wait for more work. With foreigners, we give over complete management autonomy. We figure that they must know how to do things right to turn the company around. And we take the workers that they don't want."[14]

A low-level clerk in a Tianjin SOE that was recently leased to a Korean investor gave her impression of these changes. "After the Korean boss came in, all the older workers were fired, they were just sent home. They kept me because I'm young. The old SOE managers and the Communist Party Chief still hang around. They kept their office so that they could collect the rent. They're just like a bunch of landlords."[15]

My original research plan in 1996–97 was to study how the Chinese state managed different modes of labor practices. I planned to investigate firms varied by ownership to study how two modes of labor relations, capitalist and socialist, could coexist within China's political economy. Starting from where Margaret Pearson's study of joint ventures left off, I planned to study how different nationalities of investors, in different types of ownership structures, including wholly foreign-owned enterprises, managed labor in comparison to the labor practices in China's socialist firms, SOEs, and collectives. Like many well-intentioned research plans, my study was quickly redirected into examining why labor practices across different types of ownership were becoming more and more similar in the absence of political change and large-scale privatization.[16] The differences across the public-private divide that I expected to find were not as apparent as I expected, and moreover, they seemed to be diminishing rapidly over time as all firms adjusted to what they perceived to be an onslaught of competition and economic globalization. This discovery led me to examine more carefully China's opening up and how this process affected behavior on the ground. In particular, I examine how the liberalization process has affected labor relations in China, including labor-management relations at the firm level and state-labor relations more broadly.

In order to highlight the importance of early liberalization of FDI to China's continued path of economic reform without political liberalization, I analyze China's trajectory in comparative perspective, examining other cases of reform and liberalization across time and space. China's use of FDI liberalization is in stark contrast both to other reforming socialist states, which relied first on internal reform, and to other East Asian developmentalist states, which relied on export-driven growth without much direct foreign participation in their domestic economies. This comparative method allows us to see more clearly how one variable in the economic reform process can have diverse effects given its sequencing relative to other important reforms, especially privatization and state sector reform. This focus on this one variable is also warranted given the tendency in the literature on democratization to consider increased openness and greater exposure to global trade and investment as forces for political change. While I cannot show here whether or not this association is incorrect more generally, the Chinese case shows that economic openness can under some circumstances strengthen political authoritarianism.

The two primary alternative explanations for China's economic success amid political stability privilege other aspects of China's reform path. One explanation argues that the gradual nature of the reforms determined success, particularly in contrast to the shock therapy tactics in the 1990s in postsocialist countries.[17] Another explanation argues that the ability to implement "reforms without losers" created the social consensus to continue reform and reduced the threat of political instability.[18] The argument presented here takes the first explanation to be incomplete and the second to be wrong. The gradual nature of Chinese reform was a characteristic shared by the reforms of many other socialist states. Russia, Hungary, and Yugoslavia all have reform histories nearly as long or in some cases longer than China does. The experiments with shock therapy came only after the political revolutions of 1989 when gradual, piecemeal reform was rejected in favor of systemic reform, both political and economic. While Chinese reforms can correctly be described as gradual, other aspects of the reforms, the sequencing of reforms in particular, are more important in China's achievement of economic reform without significant political liberalization.[19]

China's reforms also have created losers, in terms of both relative economic status and political power. FDI liberalization made important contributions to the widening economic and social opportunities among Chinese regions, firms, and workers. Uneven liberalization of FDI led to increased competitive pressure between regions and firms for FDI inflows. Foreign-invested enterprises (FIEs) also increasingly competed with domestic state firms for skilled labor. These competitive pressures have led to increasing fragmentation and have reduced urban labor's resistance to reforms. Reduced resistance to reforms has delayed demands for political change. Openness and integration with the global economy have not brought a weakened Chinese state or a democratizing one. In fact, utilization of FDI as a change agent in the reform process has delayed political liberalization in China and enhanced the staying power of the CCP.

FDI played three roles in this process. First, FDI liberalization placed *competitive pressure* on regions and firms to pay attention to labor practices and regulations. In order to attract ever greater amounts of FDI, regions granted enterprises increasing managerial control and autonomy over labor practices. Domestic firms, interested in attracting infusions of foreign capital, also became increasingly willing to grant foreign investors more managerial control and more flexible labor policies. SOEs as they struggled to compete with FIEs also lobbied for a level playing field and for the extension of more flexible labor policies into the state sector. These competitive pressures, combined with learning and demonstration effects, hastened the adoption of capitalist labor practices in state firms. Second, the foreign sector served as a *laboratory* for difficult and politically sensitive reforms, in particular changes in the traditional social contract between the state and urban workers. This laboratory effect was critical in allowing the competitive pressures mentioned above to manifest themselves gradually. Third, the existence of a foreign-invested sector led to an ideological reformulation that reduced the importance of *public* ownership in China, while increasing the importance of *national* ownership. China's leaders have justified the "letting go" of state ownership in order to build up national industry that is globally competitive.

While the transition described here is from the planned economy to the market as the mechanism for supplying rapid growth, the ideological transition made by China's leaders has not been from socialism to liberalism, but rather from socialism to "state-led capitalist developmentalism."[20] Developmentalism has been used in different contexts to describe a developing state's commitment to an ideology of rapid economic development. The specific policies of developmentalism vary across time and space. Latin American developmentalism of the 1950s and 1960s included a heavy emphasis on import-substitution. East Asian capitalist developmentalism of the 1960s, 1970s and 1980s looked to export-oriented production with simultaneous protection of domestic markets and firms by a strong activist state. The underlying common theme of developmentalism persists despite changing policy, that is: state-led development in the name of rapid economic growth and the nation's entry to the realms of industrialization and modernization. As Gordon White and Robert Wade have argued, successful late development is most often a "process in which states have played a strategic role in taming domestic and international market forces and harnessing them to a national economic interest."[21] Capitalist developmentalism in the Chinese context is an ideology of rapid economic growth through state-led development and state control over society. The heavy state role is justified by the growth itself, with political pluralism or democracy rejected in favor of "social stability," which the regime takes as the foundation of rapid growth. This view of state-led development borrows heavily from the experiences of other East Asian capitalist states, in particular South Korea, Taiwan, and Singapore.[22] Unlike most of its East Asian neighbors, however, Chinese developmentalism is built upon active and large foreign participation in the domestic economy.

The study thus raises a related question, but it is a question that can be answered only as the future unfolds. That is, is heavy dependence on FDI compatible with developmentalism itself (as opposed to its mitigating effects during the transition from socialism)? Does the nationalist element inherent in developmentalism create a contradiction between state-led development and a liberal FDI policy? The study gives some reason to question the long-term compatibility of developmentalism and FDI. As Chinese society struggles to met the challenges of WTO membership, the contradictions between openness and developmentalism will become more pronounced. State enterprise reform, banking and financial reforms, and rising unemployment are all now intimately connected to increasing FDI and foreign competition. Reliance on FDI as a change agent also invites the temptation to use FDI and globalization more generally as a scapegoat for the difficulties of China's transition to capitalism.

Overview

The study proceeds as follows: In chapter 2, I present the main argument about the effects of contagious capitalism on China's domestic development. The Chinese case is discussed in comparative perspective against other reforming socialist states and East Asian developmental states. This argument is based analytically on three separate functions of FDI: as competitive pressure, as a laboratory of capitalism, and finally as ideological justification. These functions are examined in detail in four empirical chapters. Chapter 3, on competitive pressure, is an account of the evolution of foreign ownership in China from 1978 to 1999. In this chapter I show how foreign ownership has expanded over time and become increasingly integrated into China's domestic economy. I also show how ownership itself has blurred with the rise of hybrid firms that can no longer be neatly classified as "state-owned" or "foreign-owned."

Chapters 4 and 5 examine institutional changes related to the existence of these laboratories of capitalism within the Chinese domestic economy. Chapter 4 focuses on the firm level. I argue that the public-private divide is no longer important in determining labor practices. Firm-level responses to the trends detailed in chapter 3 are increasingly similar. In particular I examine two institutions that were intended to protect labor from the vagaries of the market: the labor contract system and the official trade union organization. As I show, these institutions in implementation have instead enhanced managerial autonomy and control over labor. Chapter 5 focuses on the broader institutional environment, especially the development of legal institutions to structure and mediate labor relations and labor conflict. I show how this drive for legal institutions was directly related to the problems and challenges of managing FDI. I also show that despite the increasing use of state-sanctioned labor dispute resolution processes, labor conflict is rising quickly in China with the highest rate of labor disputes in firms with foreign investment. This chapter also conveys the growing resistance of workers to their increasing marginalization at the workplace.

Chapter 6, the final empirical chapter, goes beyond the previous chapters' examination of change in economic structure, practices, and institutions to examine the underlying changes in ideology. This change in ideology is important because it demonstrates that despite a liberal FDI policy, China's ideological change has not been directed toward liberalism, but rather toward a developmentalist ideology that is inherently nationalistic. In the conclusion I relate this contradiction between ideology and practice to the potential contradictions inherent in China's FDI policy.