China’s Foreign Trade Policy
The new constituencies

Edited by
Ka Zeng
4 Putting your mouth where your money is
How US companies’ fear of Chinese retaliation influences US trade policy

Andrew Mertha

You have multinational companies in China – I used to work for one, so I know – who are afraid of retaliation against their businesses so they often praise the Chinese government. When President Hu visited Microsoft several weeks ago, Chairman Bill Gates thanked him for the improvements in their protection of intellectual property … these companies are being politically correct in the most politically incorrect country in the world.


Introduction

Throughout China’s extended negotiations with the United States over intellectual property rights (IPR) from 1991 to 1996, Beijing’s strategy during the formal talks relied on consistently defensive posturing, surrendering as little as possible until the last possible moment, as well as demonstrating an apparent unwillingness or inability to exact concessions not directly related to the initial catalog of US demands. This interpretation holds that after sufficient hemming and hawing, the Chinese side accepted most of the US demands – which focused overwhelmingly on copyright issues – even though it did not implement many of them. If we ignore the implementation problem for a moment and concentrate solely on the negotiations, we would conclude that the Chinese “lost” at the negotiating table.

But such a conclusion is wrong. China “lost” what it could afford to lose at the negotiations because it was extremely successful at ensuring that the most troublesome issues facing US IPR holders, and the most embarrassing and intractable issue facing Chinese authorities at the time – trademark counterfeiting at the local level in China – remained off the trade agenda altogether. In other words, China was able to shape US talking points so that they concentrated almost exclusively on copyright, not trademark, protection. China was able to accomplish this by what I call here “transnational trade deterrence”, or the explicit or implicit threat of sanctions by local Chinese governments to deter foreign firms operating within their borders from making their dissatisfaction with local government performance widely known.
The term, “transnational trade deterrence” (TTD), although somewhat unwieldy, is deliberate. It exists as a counterpart to the notion of “transnational alliances” derived by John Odell in his work on two-level games. Using the notion of transnational alliances, Odell was able to explain trade outcomes that were in the interests of neither of the negotiating parties (the governments of the US and Brazil), but were very much in the interests of the domestic constituencies of both countries (IBM US and IBM Brazil). These outcomes were possible because of the linkages established between these two domestic (Level 2) constituencies (Odell, 1993).

In the case of transnational trade deterrence (I have inserted the term “trade” because deterrence in the traditional strategic studies context is almost always transnational), the relationship between the two domestic constituencies is a conflictual one. Rather than seeing eye to eye on a particular trade issue – in this case, intellectual property protection – these two constituencies have very different goals and priorities. The power and informational asymmetries between these two parties, which I explain later in this chapter, have the effect of influencing the negotiations between their two respective governments in ways that are impossible to explain by focusing solely on the negotiators themselves.

A primer on IPR trade policy: special 301

The Office of the United States Trade Representative is the key US Government agency charged with pursuing US trade policy. Section 301 of the 1974 Trade Act requires the USTR to identify and investigate countries that engage in trade practices deemed unfair to US interests and to impose sanctions where appropriate. Section 301 granted the United States unilateral power to punish countries that were considered a threat to US trading interests and to enforce US rights under existing bilateral and multilateral trade agreements (Puckett and Reynolds, 1996: 676).

The 1988 Omnibus Trade and Competitiveness Act established statutory mandates for investigations of (and the leveling of trade sanctions against) countries deemed to be violating US intellectual property. It institutionalized government–business intellectual property relations by requiring the USTR to post notices in the Federal Register, soliciting comments on the issue of IPR infringement of US products abroad, including specific evidence of IPR violations and recommendations for action.

Because of its small staff size and high turnover rate, the USTR relies on US firms and associations to provide much of the data on unfair trade practices (including IPR violations) abroad to ensure the accuracy and bolster the credibility of the charges leveled by the USTR at the target country. Thus, USTR action depends upon the provision of clear, concise and compelling information by the various business interests hurt by these practices. As one former negotiator put it, “informing, explaining become persuading.”

Moreover, Special 301 institutionalizes this informational requirement: it compels the USTR to act in response to the information – and more importantly, to the recommendations – it receives from interested actors within the business community. The establishment of Special 301 was an exceptionally successful
strategy by the IPR associations. They were able to institute a set of statutory constraints on the conduct of the US trade policy that enhanced the position and the power of the individual firms and the IPR associations vis-à-vis the USTR. Thus, access to the USTR was institutionalized, and the USTR was compelled to respond. Finally, simply having one’s intellectual property violated abroad provided the requisite “standing” to participate in the Special 301 process.

Given the ease of entry into the trade agenda setting process, why did (and do) so many companies whose losses were in the millions, even hundreds of millions, of dollars in China owing to poor IPR protection demonstrate an unwillingness to take part in the Special 301 process when they had every incentive to do so? One might argue that trademark-related losses were not that significant. Although the International Intellectual Property Alliance (IIPA) estimates piracy levels in 2000 at 90 percent for motion pictures, 85 percent for sound recordings and musical compositions, 93 percent for business application computer software, and 99 percent for entertainment computer software (IIPA, 2001: 26), these losses are based on potential sales, which assumes that purchases of pirated products substitutes or displaces the purchases of their legitimate counterparts. Given the cost differentials (USD $1 for the former vs. USD $200–300 for the latter), this is a dubious assumption. By contrast, the China Quality Brands Inspection Committee estimates that sales of counterfeit products on average account for 15 to 20 percent of total sales, that is to say, actual product, or actual sales as opposed to potential sales. This runs into the billions of dollars.

Additionally, it can be argued that trademark enforcement was significantly better than copyright enforcement. Indeed, I have argued this elsewhere (Mertha, 2006). However, this improvement in trademark enforcement actually postdates the Sino-US negotiations over IPR, which culminated in 1996. It was only after these negotiations were concluded that trademark enforcement began to improve.

Finally, one can argue that the trademark trade associations did not engage the USTR. Indeed, the International Trademark Association (INTA) deliberately engaged in a non-confrontational strategy. However, the international Anti-Counterfeiting Coalition (IACC) did not. In fact, the IACC was among the most aggressive of the IPR trade associations, hampered and ultimately marginalized because its members refused to go “on the record” to document Chinese malfeasance.

In this chapter, I argue that the answer is to be found within the transnational deterrent threat leveled by local Chinese governments against US trademark-intensive industries, which, unlike their copyright-intensive counterparts, had a substantial physical presence on the ground in China, half a world away from USTR headquarters.

The transnational trade deterrent threat

“Deterrence”, stated simply, is the attempt to influence another actor to refrain from engaging in a particular action. Rational deterrence is based upon a cost-benefit calculation: weighing the costs of conflict together with the benefits of cooperation. All things being equal, if the costs of conflict (and/or the benefits of
cooperation) are sufficiently low, deterrence will fail; if the costs of conflict (and/or the benefits of cooperation) are sufficiently high, deterrence is more likely to succeed. The focus of deterrence theory has been primarily, although not exclusively, on the role of the “defender” or the “issuing” country (the defender of the status quo; the country issuing the deterrent threat, in this case, China). The analysis below looks at both the defender and at the “initiator” (the USTR on behalf of US industry).

The actual behavior that the Chinese TTD threat is designed to prevent is foreign firms’ bringing unwanted attention to China’s shortcomings vis-à-vis implementation and enforcement of trade policy (including, but far from limited to, intellectual property). A representative from a US beverage company summarized the transnational deterrent threat in this way:

[We do] not get too directly involved with the Chinese government in complaining about the trademark issue. First of all, [we need] to maintain good relations with the Chinese government. The rules are always changing and the government can announce an “audit” if [we rub] them the wrong way. [We] also [have] expansion plans and will certainly need the Chinese government to be on [our] side in undertaking such a plan. There are also tax issues. In short, [we do] not want to put [ourselves] on any Chinese governmental “black list.”

And this is by no means a new phenomenon, as Jim Mann (1989: 191–2) wrote almost twenty years ago about the early reform period:

Why were the foreign companies so unwilling to complain? Each company feared Chinese retaliation. China had successfully created a climate in which favoritism was expected. If Coca-Cola complained that it was being unfairly restricted, Chinese authorities might counter by making life tougher for Coke (or better for Pepsi) … Foreign correspondents doing stories on business conditions in China regularly found that unhappy local representatives were willing to voice bitter complaints, but only in private. They might talk to the press, but only on background or off the record … Few news articles were written about difficult business conditions in China, and the ones that appeared had a remote, abstract feel to them. They contained few names or concrete examples.

Moreover, even in the post-China WTO era, this sentiment continues to inform US business strategy:

In reaction to the explosion of counterfeiting and other theft of intellectual property rights, [multinational enterprises] doing business in China have adopted a non-confrontational strategy of long term cooperation and informal lobbying. … MNEs that approach the United States government have been careful in the past not to ask the U.S. government to initiate any formal action
under U.S. federal trade law. Many MNEs have adopted a strategy of publicly praising the PRC government for improving its IP enforcement regime, while privately these same MNEs lament that the piracy problem is worse than ever. MNEs pursue a non-confrontational strategy because MNEs are afraid of doing anything that might offend the Chinese government and that might lead to retaliation against their businesses in China. For this reason, MNEs avoid any actions that might be interpreted as hostile or threatening, but instead take every opportunity to praise the Chinese government for any improvements in IP enforcement.

Where does this fear of retaliation come from? Whether arising from a firm’s own actual experience, from that of a competitor or an associate, or whether it simply exists “out there” as a thinly-disguised threat, the specter of such retaliation has become an unremitting fact of life that contributes to a chronic sense of insecurity for foreign commercial actors operating in China. This threat of retaliation has become internalized by these foreign actors and shapes their behavior to a great extent. The size of the Chinese market, the substitutability of most foreign firms and their products, and the power asymmetries at the local level between Chinese government officials and foreign company representatives, all underscore the high stakes and the ease of execution that underlie this threat. However, although this threat is taken as a fact of life in doing business in China, its impact beyond China’s borders is less well understood.

Much of deterrence theory revolves around “strategic deterrence”, which states that “if you do x I shall do y to you”. If the opponent expects the costs of y to be greater then the benefits of x, he will refrain from doing x; he is deterred.” However, once the application of strategic deterrence theory extends to increasingly complex situations – such as the trade negotiations examined here – it begins to run out of explanatory power (George and Smoke, 1974: 49). It is thus necessary to revisit some of the basic assumptions of traditional deterrence theory, specifically, the degree of anticipated retaliatory damage following a deterrence breakdown, and the specificity of the deterrent threat. By examining these concepts, we are able to explain analytically and theoretically the empirical phenomenon that very few are willing to acknowledge even exists, at least in public.

The degree of retaliatory damage

George and Smoke place the crystallization of traditional deterrence into strategic deterrence theory as resulting from the ability of states to inflict greater degrees of pain on the target state’s general population without first destroying the state itself. In other words, is it the ability to inflict a substantial degree of “pain” that makes deterrence possible. But as we move from a military context to that of international trade, these concepts need to be revisited and perhaps “weighted” somewhat differently.

The “degree of retaliatory damage” is important for the defender’s (China’s) deterrent strategy. In order to make his deterrent threat credible, the defender must
demonstrate both the capability and the will to carry out the threat. However, this raises questions about how to think about credibility when the deterrent threat may not, in the end, be sufficiently “painful.” On the one hand, the fact that the stakes are lower increases the likelihood that the issuing country will carry out the threat. On the other hand, if the stakes are lower than in the case of military action, they are arguably easier to absorb. Insofar as credibility involves both the capability and the will to carry out the threat, if a critical dimension of credibility (“capability”) is deemed absorbable, the “will”, and, by extension, the defender’s overall threat may be seen by the target country as far more credible, but somewhat less threatening than in a military context. As a result, the defender must develop a strategy that compensates for this. In the present context, the most important of these is the manipulation of information to make it ambiguous, or to deliberately render it “incomplete”.

What type of reputation is China after?

Traditional deterrence theory stipulates that the deterrent threat must be clearly stated for deterrence to hold (Harvey, 1999: 842). However, transnational trade deterrence is more likely to be successful in situations of incomplete information, in which the defending country’s intentions, and to a lesser extent, its capabilities, are sufficiently opaque (Betts, 1985: 154). In other words, the TTD threat is effective even when it is not clearly stated. How do these Chinese actors cultivate the reputation they are after?

First, when the ability to inflict substantive pain is curtailed, it becomes increasingly important for the defender to strategically manipulate information and maximize ambiguity and thus minimize accurate information about its retaliatory capabilities, including the limits of the damage that could be brought about by such retaliation. Limits on the knowledge about an actor’s weakness can contribute to, and even drive, other actors’ inflated assumptions about its strength. Under conditions of “perfect information”, it is easier to gauge an opponent’s likely moves, as well as to analyze and break down the threat (and make arrangements to absorb it), thus mitigating its impact. Under conditions of “imperfect information”, it is far more difficult, if not impossible, to establish ex ante defenses against the transnational deterrent threat.

Second, it should be noted that TTD has never been articulated as national policy in China precisely because it originates within the domain of local political officials, and leaders in Beijing may not support such threats – for domestic political reasons – even as they help Beijing’s negotiating posture. TTD represents the degree to which Beijing is unable to rein in local government defection from national policy. In fact, locally articulated threats may actually be more potent the more they depart from national policy: the fact that these threats can be made in the first place implies Beijing’s inability to guarantee the “safety” of a foreign firm operating outside Beijing’s immediate jurisdiction even if national policy pledges to do so. The diffuseness of these threats also contributes to the effectiveness of their strategic ambiguity. The threats cannot be isolated or systematically
identified and aggregated; this feeds foreign firms’ perception that they are omnipresent, and, therefore, it is easy for these firms to exaggerate their range and power.

Third, the decision to bluff, or to refrain from doing so, can have a significant impact on a country’s reputation. Such a mixed-strategy equilibrium is captured by Barry Nalebuff (1991: 319):

If it was thought that a weak country would never attempt to bluff or act tough, then seeing a country act tough would indicate true strength. This would improve its reputation immensely, possibly enough even to motivate a weak country to act tough (which would not be in equilibrium). As bluffing becomes increasingly likely, the enhancement of a reputation following tough behavior is diminished. At some point, the probability of bluffing is sufficiently high (and the improvement of reputation is sufficiently small) that the cost of the weak country acting tough is exactly offset by the gain in reputation.

Nalebuff raises the notion that acting tough (that is, through an explicit demonstration of an actor’s ability and/or will to carry out a deterrent threat) reaches a point of diminishing returns. One can similarly argue that the decision not to act tough may actually be an equilibrium strategy. In other words, an optimal strategy for a country to demonstrate its capability and will to exercise retaliation, under certain conditions, may be to simply do nothing.

Fourth, the TTD threat need not pose a direct threat to the US, or to a particular commercial sector, to be capable of inflicting a tremendous amount of damage on a single firm, or even a small group of firms. Therefore, to the individual foreign firm operating in China, the diffusion and the ambiguity of the TTD threat combined with local Chinese governments’ ability to inflict pain, creates an environment that provides a substantial disincentive to rock the boat regarding IPR and other trade-related issues.

Credibility of transnational trade deterrence

Successful deterrence must be credible. For a deterrent threat to be credible, the defender must demonstrate the capacity and the will to carry out its threat. The “targets” of such deterrence in the context of this chapter are the actors within the US IPR trade lobby that set the US trade through Special 301. Is an objective TTD threat credible to this set of targets?

The issue of capability is relatively straightforward. “Capability”, in this context, means the ability to severely undermine continued or future penetration of the domestic Chinese market, or utilization of its inexpensive labor force. Local Chinese officials have the ability to carry out a deterrent threat. The absence of an effective, autonomous legal system throughout most of China and the lack of transparency within the political process provides few checks and balances on arbitrary local power (Lampton, 1987; Lieberthal, 2003). Moreover, the national government lacks the requisite power to substantially rein in local officials, and
therefore is unable to reduce local manifestations of this deterrent threat even if it sought to do so.

Retaliatory action would also inflict a considerable degree of pain on the individual foreign firm (as opposed to US interests writ large). The lure of the vast Chinese consumer market as well as China’s equally large (and low-cost) manufacturing capacity is sufficiently compelling to inhibit foreign firms from risking their ability to capture such a lucrative consumer market and manufacturing base.

I think basically companies have decided that it’s better to be in China and get your technology stolen than to not be in China. That’s basically what people have decided. Companies go into China with their eyes wide open. They’re willing to put up with things in China they would never put up with in any other country of [sic] the world. Why? Because the dream, ever since the British started this whole thing several hundred years ago with thinking … if we could only sell a shirt to every person in China … everybody is afraid not to be a part of that dream.¹⁰

In some cases, this might mean the closure of a foreign firm’s operations on some pretext. It my also take a more basic form of “flexing local governmental muscle” to force a foreign firm to go along with the wishes of its Chinese host. Or it may involve both. In either case, the power asymmetries between local governments and foreign firms are pronounced, and although it is impossible to be systematic in presenting such examples, the following instance of this second type is as representative as it is illustrative.

In the latter half of the 1990s, a foreign firm had signed a contract with local authorities in a town in Northwest China to build a high-tech factory (the “interior factory”), capable of producing two “families” of sophisticated industrial generators. This arrangement was undertaken as a joint venture between the foreign company and a local manufacturer, the Zhonghua Motor Factory. While this interior factory was being built, another factory was under construction in a commercial area (the “coastal factory”) along China’s eastern seaboard. This second factory was literally a “carbon copy” of the interior factory, all the way down to the minute details in the material specifications. Moreover, the coastal factory had actually begun operations while the interior factory was still under construction.

Representatives from the coastal factory approached the foreign firm and said that they had established a “similar” facility and that they would like to establish a partnership with the foreign firm. If the latter refused, the coastal factory threatened to “dump” its generators on the domestic market at a third of the projected interior factory price and crowd the interior factory (and its foreign joint-venture partner) out of the market. As a result, the foreign firm had little choice but to abandon its nine million dollar investment in the interior factory, and entered into a forced partnership with the coastal factory.¹¹

In addition to illustrating the power asymmetries between foreign firm and local government (both the “coastal” and “interior” factories enjoyed varying degrees of local governmental involvement), this example underscores the financial resources
and the coordination abilities across broad geographic areas that some local governments have at their disposal.

It is somewhat more difficult to generalize about the notion of “will”. It should be noted that while such “strong arm” tactics, as in the example above, characterized national-level contracting to foreign firms during the 1980s and early 1990s, they are far less the case today. However, at the local level (the provincial level and below), such tactics remain the norm. It is therefore necessary to look at the incentives facing local leaders in China.

At the grassroots level, cadres are generalists, and must often choose from competing (and often conflicting) policy objectives to implement with the limited resources at their disposal. This decision is greatly simplified by the prioritization of these tasks by their administrative superiors. These priorities vary somewhat from region to region, but the most important of these almost invariably include economic development, tax extraction, the “alleviation of poverty”, and the implementation of the “one-child policy” birth control program. They are institutionalized within performance indicators under the “cadre responsibility system” (ganbu gangwei mubiao guanli zerenzhi) and reinforced by the “one-level down management” supervision system (xiaguan yiji) (O’Brien and Li, 1999). At higher levels, performance appraisals are far more complex, although it is ultimately the generalist officials in the government and Party organs that make the final decisions on local priorities and these overall priorities are largely the same as at the grassroots level. Moreover, in the absence of a concerted national campaign (with the corresponding extrabudgetary outlays) to shift these priorities in an alternate direction, they are unlikely to change.

“Intellectual property rights enforcement” is generally far too specific to make it onto local performance indicators. However, several of the most important of these indicators can be in direct conflict with intellectual property protection. The first three indicators listed above, generally deemed the most important, and which encompass the “general principles” of the top leadership, are often inconsistent in practice with effective intellectual property protection. Insofar as IPR-infringing activities on the part of local factories, middlemen or retailers contribute to economic development, the alleviation of poverty, and the supply of tax revenue, a disincentive for intellectual property enforcement is institutionalized into the priorities on which local officials’ performance is appraised. As one Party Vice-Secretary of Chongqing put it, “I believe that intellectual property and economic development are both important, but I consider economic development to be the more important of the two.”

When local priorities dovetail with those of foreign firms operating in those areas, these firms are unlikely to articulate dissatisfaction with local governments. When the goals of a foreign firm do come into conflict with the priorities of local officials, the former (in the absence of a TTD threat) are far more likely to raise the issue with higher-level governmental units in China, or directly through the Special 301 process. Because local governments have a strong preference to stay out of Beijing’s crosshairs, and because of the possibility that Beijing could make an example of the local government in question, there is an extremely strong
incentive for the latter to prevent such behavior on the part of the foreign firm. Implicit or explicit deterrent threats are almost always far less costly than the alternative. Therefore, it is reasonable to claim that local Chinese leaders do, indeed, have the will—whether overt or latent—to deter foreign firms operating within their jurisdictions.

The transnational trade deterrent effect and impact on US trade policy

If the empirical puzzle of this chapter is to explain why the US copyright lobby was so aggressive (during the early 1990s—far less so now) while the trademark associations were so feeble in bringing their case to the USTR, how can TTD explain such variation? Much of the answer has to do with the fact that during the Sino-US negotiations over intellectual property, which spanned the period from 1991 to 1996, trademark-intensive firms had a physical presence on the ground while copyright-intensive ones did not. As a result, throughout the Special 301 process, trademark demands were muted and vague while copyright-related demands were aggressive and specific. The USTR had no alternative than to move forward on those issues for which it had credible information and to shelve (or at least focus less on) those for which it could not make a credible case. After all, insofar as the USTR relies on US firms to provide information on the basis of which it makes its international case against China (or any other country), its credibility is inextricably linked with the credibility of those firms providing the data to make its case. If the firm fails to provide adequate information because it is deterred from doing so, the USTR has no political choice but to table those demands until such information is available. The result was that the negotiations focused almost completely on the less problematic issue (at the time) of copyright protection rather than the rampant counterfeiting that was draining US companies of hundreds of millions of dollars. This is supported by the fact that the copyright-intensive firms have become far less confrontational vis-à-vis their Chinese hosts, as evidenced by the quote that began this chapter. This has led to a far less confrontational strategy by the US today than that which framed US trade policy throughout the 1990s. Indeed, one can point to the fact that the US has been quite skittish in bringing an IPR case against China under the WTO. Although many in the government (and in business circles) are chomping at the bit to undertake such action, the US has been reluctant to do so for one important reason: it cannot bring a case for the WTO mediation if no company wants to go on record as being that case. Remarkable former congressman Dave McCurdy, now the head of the Electronics Industry Alliance (EIA):

It’s not the failure of the WTO as an instrument … The question is, do you have evidence to bring a case that’s credible so that you don’t lose all of your international credibility in using this mechanism? It cannot be a political tool based on anecdotal information or a kind of broad-based sociological and general economic information. There has to be a clear case of failure to comply with these rules. I will tell you that when we went through the process
of building this document, we had a hard time. We had a lot of examples, but there was not one single company prepared to put their [sic] name on that document. Now, we gave this to the Chinese government, we’re distributing this. Because there is the real potential for retaliation or retribution. It may not be direct; it may not be today. It may not be six months from now, but there is this long term fear.\textsuperscript{19}

And the impact on the US negotiating position is no less dramatic:

When I worked for a multinational company, we also went to the US government and we said we would like you to bring this issue up with China, but please don’t use our name. And that’s what is going on here. Because the companies are screaming at the US government, but there’s only so much in my opinion that can be done if the companies are not willing to take this, are not willing to do anything to offend the Chinese government. If the US government tries to negotiate with China and says to China you cannot retaliate against these companies, nothing is going to happen. China is not going to agree to that.\textsuperscript{20}

In other words, the US is not going to have a tenable bargaining position vis-à-vis Beijing without such credibility. Rather than show its empty hand under the spotlight of international scrutiny, the rational choice for the USTR is simply to jettison non-credible demands from its negotiation agenda (as it did throughout the 1991–1996 period) or to refrain from (or at least to demonstrate extreme reluctance in) bringing about a case against China in the first place, as is currently the case regarding the WTO action against China.

**Conclusion**

I have argued that China has been able to manipulate the substance of the agenda setting process through transnational trade deterrence. Variation within the agenda setting and ratification processes can be explained by the degree to which a given company or member of a trade association was in the direct line of fire of the TTD threat. Companies and trade associations that had credible information – names, places, dates, times, and so on of IPR violations they faced – were able to mobilize the USTR on their behalf as a result of the information they provided under Special 301. Those firms that were unable to provide such credible data were not taken seriously by the USTR and certainly not by Beijing. As a result, they were unable to mobilize the USTR on their behalf.

The irony is that those firms and associations that were losing the most, and who could make the most credible cases, were precisely those who were sidelined by the process. I have endeavored to account for this anomaly by arguing that these companies were deterred from taking effective action against China as a result of a threat that emanated not from Beijing as a coherent, concrete policy, but rather which arose from the political context of the physical location in which these firms
were operating in China. The result was that this transnational trade deterrence was able to shape the US trade policy agenda by preventing those issues that were most troublesome for China to appear in the first place.

The problem always is, how do you explain a non-event? How do you explain something that did not occur? How do you account for the lack of items on a trade negotiating agenda? The off-the-record and rare public expressions of frustration are not enough to explain such an outcome, only to articulate the perception that something is going on behind the scenes. It is the purpose of this chapter to account for this non-event by making the case that this behind-the-scenes activity is very real, very potent, and can be explained by an analytical framework – transnational trade deterrence – that may be all but invisible, but which keeps many US CEOs and government officials awake at night, and which has shaped and continues to shape US trade policy in ways that are as substantial as they are imperceptible.

Finally, it should be noted that the foregoing is not terribly stable. This is because reputation can also work against these same local governments. If local governments establish a reputation as being hostile to foreign firms under the rubric of TTD, they will lose out on the benefits of foreign investment. In addition, there is variation across local governments in terms of their calculations for attracting foreign investment and/or a foreign manufacturing presence. Arguably, areas in the interior are far more likely to be more accommodating – and less threatening – to foreign firms in their midst because of the relative value of a single or a small group of foreign firms or investors within their jurisdictions. In order to attract these firms and to keep them happy, these local governments seem to be less inclined to engage in TTD-type behavior. Indeed, these governments are likely to bend the laws and regulations in order to attract and accommodate these firms (the willingness of the Sichuan provincial government to do so in order to attract Intel is a case in point). The flip side, however, is that if we make this claim, then it can be argued that it is in the more developed areas of China where TTD is likely to occur. This is because – to simplify greatly – local governments can pick and choose among those firms that can offer them the most benefit. If this is the case, then TTD, from the dimension of local government calculations, is likely to continue, possibly even expand.

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Notes

1 Interviews with Chinese trade official, Beijing, March and August, 1999.
2 Interview with former USTR official, December 1998.
3 Ibid.
4 CAFEI Quality Brands Protection Committee (QBPC) Pamphlet.
Interview with US beverage executive, Shanghai, 5 April 1999. This source mentioned that as far as investigative work is concerned, he outsources to private investigation firms in order to guarantee the safety of his staff, noting that in several instances investigators hired by his company were threatened and even physically assaulted.

Chow, written comments, 8 June 2006.

In this paper, I am implying that TTD does not stem from national policy. I am also assuming that the national government does not assist local governments in intimidating foreign firms. This does not mean that the national government does not really know what is going on. Rather, because it is easier to claim that the Chinese state acts with one voice, I am arguing that we can explain these trade outcomes by simply looking at the actions of local governments. This is not meant to let Beijing off the hook, but rather to underscore the complexity of the structures and processes that result in China’s trade policy behavior. My focus on local governments, and my claim that Beijing is not directly involved, is meant to simplify my argument for the sake of clarity. However, what I am arguing is not at all inconsistent with the notion that Beijing may be fully aware of what is occurring locally.

Local officials are often fond of saying “above has its policies, below has its countermeasures” (shang you zhengce, xia you duice), much to the chagrin of national-level officials in Beijing. This dimension of state capacity was a frequent lament among national-level government interviewees.

Of course, one can argue that by issuing a deterrent threat, local leaders will simply force foreign firms to move their operations to a location in which local officials are less inclined to make such threats. However, this involves significant transaction costs on the part of the foreign firm. Moreover, when combined with the uncertainty regarding the new government hosts’ propensity to level such a threat once the relocation is consolidated, the benefits of such a move – when viewed against the associated transaction costs – may not be able to overcome the prohibitive costs. To a considerable degree, the foreign firm is at the mercy of the local host government, and not the other way around.

Chow, oral remarks, 8 June 2006.

It later came to light that the foreign firm’s joint venture partner in building the interior factory, the government-owned Zhonghua Motor Company, was responsible for giving the original (and highly confidential) factory plans to the coastal factory because it was unable to pay for its technology transfer payments at the time, and the coastal factory offered Zhonghua generous partnership terms in return. The foreign firm had very little choice but to go along with the Chinese. Although the foreign firm had been advised that it could take the case to court, by the time any settlement could be reached, they would have already been pushed out of the local markets in both the coast and the interior (interview with IPR lawyer, Shanghai, 27 May 1998; and Interview with US company executive, 17 August 1998). Both sources insisted that, for their own protection, place and company names must be changed; I have honored their requests.


Interview with Chinese scholar, Shanghai, 15 June 1998; and interview with private investigator, Shanghai, 15 June 1998.

Interview with private investigator, Shanghai, 15 June 1998.

The Xichang VCD wholesale market in Kunming is an important source of revenue for the Wuhua District Administration for Industry and Commerce (AIC) through the management fees (guanli fei). The Wuhua District AIC was, until recently, firmly under the control of the Wuhua District Government, and provided a considerable source of revenue (interview with provincial official, Kunming, 22 June 1999). As a result, it was able to engage in the widespread and open sales of pirated VCDs, with only cursory and largely ritualized raids twice a week (interview with vendors, Kunming, 23 June 1999).

As a result, some local authorities choreograph raids to demonstrate that they are doing something, often ensuring that the actual punishments are relatively benign. Another tactic is to delay the investigation until all (or most) of the product is moved out of the factory (interview with Chinese scholar, Shanghai, 15 June 1998).

Meeting with Chongqing Municipal Party Vice-Secretary, Chongqing, March 12 1998.
Even when foreign and local official interests converge, it may be useful to maintain some sort of deterrent signaling to forestall any potential future change in the status quo.

McCury, oral remarks, 8 June 2006.

Chow, oral remarks, 8 June 2006.

All the more so because included in the package was the offer that the Sichuan government would build the factory and all the physical aspects of the operations, making it easy for Intel to “exit” if they found local conditions to be sufficiently “inhospitable” after the fact (conversations with bankers in Chengdu, March 2003).

References


CAFEI Quality Brands Protection Committee [QBPC] Pamphlet.


