The Hidden Investment War:
State Intervention and Relative Gains Seeking from Inward Foreign Direct Investment in the U.S. and China

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Tables and Figures

Abbreviations

BEA	Bureau of Economic Analysis (U.S.)
BTMC	Bell Telephone Manufacturing Company
CCP	Chinese Communist Party
CFI	Committee for Foreign Investment (PRC)
CFIUS	Committee on Foreign Investment in the United States
CIEP	Council on International Economic Policy (U.S.)
CLG	Central Leading Group, CCP
CPE	Comparative Political Economy
CNOOC	China National Offshore Oil Corporation
DoC	U.S. Department of Commerce
DoD	U.S. Department of Defense
DoT	U.S. Department of the Treasury
DPW	Dubai Ports World
FDI	Foreign Direct Investment
FIE	Foreign-invested Enterprise
FPI	Foreign Portfolio Investment
FINSA	Foreign Investment and National Security Act
FIRRMA	Foreign Investment Risk Review Modernization Act
GAO	Government Accountability Office (U.S.)
GATT	The General Agreement on Tariffs and Trade
GFC	Global Financial Crisis
ICT	Information and Communications Technology
IEEPA	The International Emergency Economic Powers Act
IFDI	Inward Foreign Direct Investment
IR	International Relations
IPE	International Political Economy
ITU	International Telecommunications Union

MNC	Multinational Corporations
MOFCOM	Ministry of Commerce (PRC)
MOFERT	Ministry of Foreign Economic Relations and Trade (PRC)
MOFTEC	Ministry of Foreign Trade and Economic Cooperation (PRC)
MPT	Ministry of Posts and Telecommunications (PRC)
NPC	National People's Congress (PRC)
NDRC	National Development and Reform Commission (PRC)
NSR	National Security Review
OECD	Organization for Economic Co-Operation and Development
OFDI	Outward Foreign Direct Investment
OFAC	Office of Foreign Assets Control (U.S.)
OFFC	Office of Foreign Funds Control (U.S.)
PLA	People's Liberation Army (PRC)
PRC	The People's Republic of China
ROP	Reform and Opening-up Policy
SASAC	State Asset Supervision and Administrative Commission (PRC)
SOE	State-owned Enterprise
SPC	State Planning Commission (PRC)
SSA	Special Security Arrangement
TE	Telecommunications equipment
TWEA	The Trading with the Enemy Act
UAE	The United Arab Emirates
U.S.	The United States of America
USD	US Dollar
WFOE	Wholly Foreign-owned Enterprise
WTO	World Trade Organization

I: Introduction

1. An empirical observation: national security concerns towards IFDI and a policy reversal

An important aspect of the China-United States (U.S.) economic conflict has been neglected in the "trade war" narratives – it is the investment conflict between both countries as a logical consequence of trade disputes. As China now owns a large number of Multinational Corporations (MNCs) and several capital-richest sovereign wealth funds (SWFs) that are capable of investing directly in the U.S. domestic market and taking over well-established American firms, the tariff tool alone would not reduce Chinese business penetration in the American market, nor cure a central concern expressed by the Trump administration – access to cutting-edge technologies in the U.S. From 2008 to 2016, annual Chinese foreign direct investments (FDIs) in the U.S. surged from $772 million to $46.49 billion, of which the information and communications technology (ICT) was the top recipient sector (Rhodium Group 2019).

At the end of 2017, U.S. Senator John Cornyn introduced a bill to expand the authority and operations of the Committee on Foreign Investment in the United States (CFIUS) – an executive body created in 1975 that stands entry on foreign capital in the U.S. With strong bipartisan support, the bill was passed as the Foreign Investment Risk Review Modernization Act in June 2018. Earlier on, some Congressmen had accused China of having "weaponized investment in an attempt to vacuum up American advanced technologies" under the "Made in China 2025" industrial policy announced in 2015 (Delaney 2018; Masters & McBride 2018). On May 15, 2019, President Trump issued an Executive Order that prohibits any transaction with a foreign adversary involving acquisition or transfer of ICT or related services subject to the U.S. jurisdiction (White House 2019). By issuing this, he invoked the International Emergency Economic Powers Act, which is only applicable to war times or national crises. Although the order did not name any specific countries or companies, it was clearly targeted at the Chinese telecommunications champions such as Huawei and ZTE after months of political pressure. By the end of 2018, Chinese FDIs in the U.S. dropped to $5 billion from $29 billion in 2017 and $46 billion in 2016. According to expert estimation, unresolved national security concerns of CFIUS led Chinese investors to abandon deals worth more than $2.5 billion in the U.S. in 2018 (Rhodium Group 2019).

A surge of Chinese investments in recent years may have two implications for the U.S. national security. The first is about the changing relative economic power of China. While international trade is the cross-border flow of goods and services, FDI is the cross-border flow of the ability to produce goods and services (UNCTAD 1995: 5).[1] Top investor countries are usually countries with high industrial competitiveness, such as from Great Britain before World War I, from the U.S. after World War II, from Western European countries and Japan in the 1970s, as well as from China since 2008. The so-called "reserve investment" from a later developed economy to an earlier developed economy usually indicates changing economic capabilities of the former, when their firms have the viability to acquire or compete with firms in more mature markets (Armijo & Katada 2015). The accompanied bigger perceptional effect of a large amount of FDI inflows on the host country than of trade inflows is that the home country becomes a next-door owner rather than just a distant contract manufacturer (see also Rosen & Hanemann 2011: 13). Foreigners' growing presence in national industries steeped in national and political symbolism can be an emotionally wrenching experience. Since economic capabilities serve to be the basis of military capabilities, relative economic gains of an adversary may have security implications.

The second implication for the U.S. national security is more at the micro-level, about the acquisition of dual-use technologies – commercial technologies with the potential for military applications – by Chinese firms. Inward foreign direct investment's (IFDI)

[1] According to the OECD 2008 benchmark definition, "foreign direct investment is a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor" (OECD 2008: 17)

essence is control of domestic assets by non-nationals. Despite the advantages such as capital inflows IFDI may bring with them, once being invested, domestic partner serves to share information, technological and managerial know-hows with the investor that answers to another jurisdiction. These know-hows and technologies then fall within the sovereignty of another country with all of the suspicions and conflicts that implies (Kudrle & Bobrow 1982; Li 2008). Especially when backed by an adversarial government, whether foreign investors will act as economically rational investors or carry political aims has been a haunting question in security reviews of CFIUS (Prabhakar 2009; Tingley et al. 2015). In recent years, not only the U.S. but also Germany, France, Australia, Canada, all haven blocked acquisitions of important national companies that the governments deem vital to national security, even by foreign investors from their security community (see Lenihan 2018). While states have largely accepted and adhered to the liberal principle that free trade and investment result in absolute gains that are beneficial to all parties, government intervention into foreign takeovers seems to contradict it.

Globalization has shifted the locus of interstate conflict away from multilateral interstate negotiations towards regulating networks of private actors (Farrell & Newman 2019). When national security is involved, government interventions in inward/inbound foreign direct investments (IFDIs) can parallel to more traditional interstate zero-sum competition, yet they are rarely discussed within the discipline of International Relations (IR). Different gains and losses in international economic cooperation are generated first in accordance with economic reasoning of firms. The problem, however, is that “CEOs do not care nearly as much about relative gains among countries as they care about benefits” (cf. Drezner 2007: 24). Multinational corporations are the major conveyer of economic exchanges and conductors of FDIs. A substantial proportion of world trade takes place as intrafirm transfers or through their intermediate suppliers (Pandya 2016; Bernard et al. 2012; Gilpin 2001: 196-224). What accompanies their intrafirm and interfirm investment transactions is not only international trade flows, but also territorial relocation of various production factors such as capital, technology, and the redistribution of wealth that are usually unequal between and within countries (Hymer 1960; Gilpin

1975; Strange 1995; Ghatak 1995; Milner 2014). As MNCs are increasingly affecting the distribution of wealth and power between states, as well as national security, they also create incentives and new rationales for state interventions.

At the time when trade was the dominant source of international exchange in the interwar period (1919-1939), governments that accepted increasing responsibility for the economic and social welfare sought to increase their national shares of international benefits which resulted from trade. Other governments that did not accept such diversion either emulated the moves of the initiators of controls or retaliated against them. The result was trade warfare and the broadening of the Depression. Yet states learned from that experience and established international rules as incorporated in the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO) to deter and channel such conflict. The odd is that although FDI has become the most important aspect of international economic exchange besides trade in the post-war era, there has not existed an centralized international investment regime like the GATT/WTO that safeguards and regulates investments around the globe. The closest analog to a WTO-regime for FDI are the Agreements on Trade-Related Investment Measures in the Uruguay Round of the WTO and the Multinational Agreement on Investment initiated by the Organization for Economic Co-Operation and Development (OECD) in the 1990s. While the former only resulted in weak protections for FDI entry, the latter never came into birth (see Åslund 2013). The tenet of protecting private property rights in the current "depoliticalized" international arbitration mechanisms enables private corporate actors to directly sue states. Moreover, bilateralism imbues the international investment regime with a peculiar character that weakens the bargaining position of states when they are in a vulnerable economic position (Simmons 2014: 13; Wu 2016). The current investment regime is thus comprised of a relatively decentralized system of rules, norms and dispute resolution procedures. It serves to check the predatory tendencies of the state and emphasizes the importance of the government's role as a protector and enforcer of private property rights (Keefer 2004), which only underlines the problem that states lack control of MNCs. The lack of a complementary international regulatory regime may be another important reason why states are setting up national institutions to regulate economic activities and behaviors of MNCs when faced with balance-of-power and security implications.

Besides the increased U.S. government interventions in Chinese investments, a historical policy reversal seems to have emerged in the recent U.S. and Chinese foreign economic policy. The U.S. was the leading guardian of free capital flows when attempts were made by other developed and developing economies to regulate international investment flows in the 1970s and 1980s. Even policy incentives made by some developing countries to attract foreign investments were "too much" for then leading officials of the U.S. Department of the Treasury because that might have "distorting effects on domestic and international commerce" (cf. Graham 2006: 122). FDI was deemed to result in the most efficient allocation of economic resources if it is allowed to flow in accordance with market forces (see also Bergsten 1979). As the U.S. was faced with a surge of IFDI inflows from Arab countries immediately after the Oil Crisis in the mid-1970s, and a wave of Japanese takeovers of American technology companies in the late 1980s, it only made limited moves to change national regulations for IFDI. Recent trade and investment restrictions show an opposite direction away from the neoliberal order that the U.S. government has actively endorsed in the post-war era. In contrast, China as a planned economy in the 1970s had extremely tight rules on foreign investors and private property rights were something that did not own a legal status in China. When it gradually opened the economy in the 1980s, foreign investments were still directed by government policies to flow only in certain areas with restrictive ownership and sector-specific requirements. However, China's IFDI policy has been continuously liberalized since the 1990s and especially since its WTO accession. In recent years, there has been a repetitive reaffirmation of the central government to further reduce entry barriers in an attempt to maintain China's position as a top destination for foreign investors. For the first time in 2019, China's new Foreign Investment Law incorporated the "national treatment principle" for foreign investors, which has been *the* informal institution governing foreign capital flows in the liberal economies.

It is even more interesting to observe the rhetorical difference between their leaders. In the 2017 annual meeting of the World Economic Forum in Davos, China's President Xi Jinping delivered a robust defense of globalization. Without mentioning the name of the U.S. President Donald Trump, he commented: "Pursuing protectionism is like locking oneself in a dark room. While wind and rain may be kept outside, that dark room will also block light and air. No one will emerge as a winner in a trade war." He expressed China's commitment to "a fundamental policy of opening-up" and "a win-win strategy" (Xi 2017). Extensive media coverage shed lights on Xi's rhetoric contrast to Trump's "America-first" doctrine advertised in his 2016 presidential campaign. Just a few months earlier, President Trump had threatened to pull the U.S. out of the Trans-Pacific Partnership initiative, renegotiate the North American Free Trade Agreement and launched a trade war against China. To a significant extent, he has delivered on his campaign promises. Comparing Trump's remarks to the Seventy-Second Session of the UN General Assembly in 2017 with Xi's speech in Davos the same year, analysts also found that Trump was the advocate of sovereignty and national interests, mentioning "sovereignty" twenty-one times and never mentioning "globalization", while Xi is the champion of globalization, saying "global" or "globalization" seventy times and not using the term "sovereignty" (see Carrai 2019: 205f). As the U.S. under Donald Trump retreats from globalization, especially from international commitments, China has dedicated itself to the opposite strategy, making long-term investments such as in the Belt and Road Initiative to improve links between China and the world. Questions abound. Are we witnessing something novel in the world politics? Is the U.S. with a liberal trade and investment policy for most of the time in the post-war era shifting to a protectionist foreign economic policy, while China transiting from an autarkic plan-economy to a defender of free trade and investment? Is there a historical role reversal between China and the U.S.? If true, what are the underlying reasons?

2. Theoretical location of the research objectives

This study deals with a central topic of the IR and its subdiscipline International Political Economy (IPE): the security implications of globalization and the role of the state (see Mastanduno 1998; Sandholtz et al. 1992; Kirshner 2006). It is an analysis of the international sources of domestic politics, or the "second image reversed" (Gourevitch 1978; Katzenstein 1978, 1985; Cortell & Peterson 2003). While globalization can cover an array of phenomena such as global trade, finance, migration, climate change, terrorism and cyberwarfare, this study concentrates on its first and foremost economic phenomenon – "the increase in the volume and intensity of cross-border market transactions" (Kirshner 2006: 10; see also Drezner 2007:23). While international trade, investment and monetary relations may have different security implications for the state, this dissertation focuses on the investment flows – of which its security implications has yet not been sufficiently discussed in comparison to other aspects of economic globalization.[2] Specifically, I analyze *how the state of the U.S. and China has responded to the looming security implications of inbound foreign direct investments, and how their IFDI policies and regulatory regimes have changed over time.*

In this study, I also pick up a once central debate in IR and IPE between the structural theories (or the so-called "grand theories") in the 1980s and 1990s on whether and when states seek relative or absolute gains, which well captured the nexus between economic cooperation and national security, but neglected the broader context of globalization and the interaction between state and nonstate actors. The gains debate has concentrated on bilateral or multilateral interstate bargaining (Grieco, 1988, 1990; Mastanduno 1991; Krasner 1991; Snidal 1991; Powell 1991; Liberman 1996; Matthews 1996; Morrow 1997). As globalization posed increased challenges to state capacities being eroded by external nonstate actors and forces, grand theories and universal laws of state behavior and

[2] There is considerable reason to believe that investment interactions have very different security implications than trade (see Rosecrance & Thompson 2003; Li 2008). Likewise, monetary interactions may also have different security implications than from either investment or trade. Although it would be very interesting and important to pursue more insights of the different security externalities of the various facets of globalization, it is yet largely beyond the scope of this dissertation to conduct such a systemic study.

international system were also being challenged (Clark 1998: 479). Entering the new millennium, the end of the "gains debate" mirrors a trend in the subject of IR that both grand theories and clashes between them were on the wane (Lake 2013: 567). Considerable emphasis again was placed on the concept of market power and the dominance of monopolies or oligopolies in international markets since the 1990s (see Strange 1990, 1995, 1996; Bates 1997; Moravcsik 1997; Friedman 2005).[3] Yet from "complex interdependence" to its extreme form of globalization, the structural effect of anarchy and the related self-help principle did not disappear with increased dispersion and interconnection of economic activities. An adaptation of neorealist theory, which expands the concept of "structure" to include the international capitalist economy, was first elaborated by IPE scholars such as Michael C. Webb (1991) and David Andrew (1994). As Helen Milner and Robert Keohane (1996: 257) summarized:

These [capital] flows have become so significant for most economies that they can only opt out of such a system by paying enormous costs. Like anarchy, exposure to the international capitalist economy has become a fact that individual states confront and can only ignore or seek to change by paying such high costs that no state can afford it. Hence, again like anarchy, states face similar pressures from the international economy, and they can respond differently to the extent they are willing and able to pay the costs to do so. As in international politics, this willingness and ability depend on their domestic environment – the leaders, political and social institutions and preferences of domestic groups. If the impact of anarchy is to create a situation where self-help and balancing theory by states dominates, then the implication of internationalization is to create a new audience – international financial markets – that political leaders must satisfy.

Under the classic anarchy assumption, states are afraid of being destroyed and enslaved by bigger powers, and thus pursue relative gains (Grieco 1990: 217). In the era of globalization, most states are less in danger of sovereignty erosion by other states, but the international market and nonstate actors. Anarchy and the related security problem have

[3] Before grand theories dominated the narratives in IR, the liberal approach of studying international politics and foreign policy through the lens of domestic politics had established its position in the subject (see Schattenscheider 1935, 1960; Truman 1951; Haas 1953). Both against the ideological background that "politics was the factor about which only the scandalous dared to speak" (Kirshner 2010: 203; see also Gilpin 1971), and against the context that the spread of international activity had reached the degree of "complex interdependence" (Keohane & Nye 1977), politics and power slipped from states to economic actors and factors (Gourevitch 1978; Czempiel 1979; see also Krasner 1978b: 26f).

only changed its face from military conflict to economic conflict, while not dividing the state from the center of international politics. Since the 1980s, even economic deregulation that has swept through many parts of the world involves creating new rules of the state rather than eliminating its influence (Ruggie 1982; Fligstein 1996; Rodrik 1998; Jordana & Levi-Faur 2004; Pearson 2005; Weiss 2005). Especially after the Global Financial Crisis (GFC) in 2008 and 2009, IR scholars have paid increased attention to the conflictive national approaches to re-regulating domestic financial markets and how states are employing global economic networks to fulfil their strategic objectives (Drezner 2010; Farrell & Newman 2010, 2019; Rosenberg et al. 2016; Bell 2017). Besides the economic aspect, the other aspects of globalization, such as the spread of terrorism, climate change, cyber-attack, all renewed important questions about national economic and political security and the purposive role of state action (see Harnisch & Zettl 2020).

How do states deal with the security implications of economic globalization and how has the nexus influenced and altered the state in turn? To answer this question, the case of the U.S. and China may offer two representative examples of how the states from two poles of the spectrum of political systems have struggled for regulation and deregulation along with their involvement in the international market. The common narrative and the prominent *Varieties of Capitalism* research paradigm describe the American state as a "liberal market economy" *par excellence* (Hall & Soskice 2001). The U.S. has been traditionally considered a "regulatory state" that the state as regulator only intervenes when market failure occurs and is otherwise separate from business. The regulator should also be politically independent, that is, it must maintain substantial autonomy from political organs such as the executive or legislative (Majone 1996). However, in the last two decades, scholars have shown that at least in some areas of the domestic economy, the American state has played an active role and some lines that once divided it from East Asian developmental states have blurred (Baltz 2017a:3). There has been increased literature (though still marginal in the scholarship) that describes the American state as "breaking new ground" (Fong 2000), nurturing a "hidden developmental state" (Block

2008; Block & Keller 2011), becoming an "increasingly enthusiastic practitioner of industrial policy" (Schrank & Whitford 2009; Weiss 2014). Scholars have also noticed that previously marginalized Keynesians have grasped the chance of the GFC to use the crisis as evidence supporting their understanding of economics and active governmental intervention in the market economy (Farrell & Quiggin 2017). If we know this changing facet of the U.S. state, it may not be surprising to see a protectionist foreign economic policy under the Trump administration. Especially in the policy issue of IFDI to be discussed below, CFIUS has fledged into an agency that offers the President a full legal toolbox to block foreign investments in any size of an American company in almost every industrial sector.

Comparative studies have described China's political-economic system as "state capitalism" in which the state is the principal actor and judge, using the market for political gains (Bremmer 2009; Tsai & Naughton 2015). Many compare the Chinese economic reform with the East Asian developmental model (Boltho & Weber 2015). "Developmental state" was originally coined by Chalmers Johnson (1982) to describe post-war Japanese politico-economic model. This model tolerates substantial government intervention to structure markets, often in favor of particular firms whose failure would impose unacceptable social costs (firms such as national champions or those that historically have close ties to the bureaucracy) (see also Pearson 2005). The East Asian developmental states such as Japan, South Korea, and Taiwan pursued an economic strategy consisting of maximizing export and supporting domestic corporates, while keeping the domestic market relatively closed to imports and especially foreign investments (see also Johnson 1982; Haggard and Huang 2008; Boltho & Weber 2015). In comparison, however, China had a much more open policy towards IFDI in its early reform era than the previous developmental states and a very different state-private business relationship (see Zhu 2017). There is also an emerging narrative of the "China Model" since the GFC that stresses the unique development path of China (Breslin 2011). The official self-description of its political-economic system is called "socialism with Chinese characteristics", and what "Chinese characteristics" means can only be (flexibly) defined by the Chinese instead of by a scientific term. In fact, overlapping and incongruous features often characterize the Chinese state apparatus, including amalgamations of regulatory, entrepreneurial, developmental and socialist state formations (see also Howell 2006).

China's rapid integration into the global economy over the past 30 years has had undeniable implications for the Chinese state – it raises questions about how the state has simultaneously encouraged globalization and at the same time, tried to control for globalization's impact on China's economy, its culture, national security and the state itself (see also Zhu & Pearson 2013). There is a strong assumption in the scholarship of Chinese IPE that the Chinese state has played an important role in China's globalization, yet the understanding of how has globalization altered the state remains partial in the literature. *How have the two states dealt with the security implications of economic globalization and how has globalization changed the two states in turn? Is there a reversal between the foreign economic policies of the two countries? If true, why?* Driven by a strong curiosity of answers to these research questions, this study endeavors to make a comparative historical analysis of the two states in a representative policy field – inbound foreign direct investment policy – where the state is exposed to questions of industrial competitiveness and national security and where the state shows its real face.

3. Outline of the dissertation

This dissertation is divided into six parts. Part I serves as an introduction to the research objects and research questions. Part II first picks up a once central debate between the structural theories in the 1980s and 1990 – the relative-gains problem in international cooperation. I extend and reconsider the debate of when and how do states seek relative gains in the context of economic globalization. Part II then turns to the theoretical-analytical framework of historical institutionalism, introduces my research focus on the domestic institutions for IFDI regulation, and discusses the security implications of IFDI for the U.S. and China. Part III specifies the research realm, the institutions and actors of this study, and explains the methodologies and data sources used for research. Part IV and Part V provide a comparative historical analysis of the American and Chinese IFDI policy and the evolution of their regulatory regimes, respectively. The analysis first places the institutional origins and evolutions of the two regulatory regimes in the broader historical context. It gives special attention to the institutional origins of the contemporary IFDI regulatory regimes in the 1970s and 1980s in both countries, and illustrate how the institutions have evolved and effectively worked to serve states' political goals. Since China's IFDI policy cannot be separately observed from its industrial policy in specific economic sectors, Part V takes the telecommunications equipment sector as a mini case study within the Chinese case. The telecommunications equipment sector is one of the most globalized sectors and has a close connectedness with national security. The case study also shows how deregulation in the U.S. telecoms sector intermeshed with China's IFDI policy and how the Chinese state has utilized IFDIs to change its position in the global supply and value chain. This dissertation concludes in Part VI with a review of the findings on the U.S. and Chinese IFDI policy and the related domestic institutional changes. Lastly, the conclusion part also gives a reflection of the theoretical approach of historical institutionalism in explaining change and stability in world politics.

II: A theoretical reconsideration of relative gains seeking in the context of economic globalization

1. A renewed look at the "poster-boy" of realist political economy

1.1 The concept of relative gains

Jonathan Kirshner once gave the concept of "relative gains" a metaphoric and very lovely name. He said "the emphasis on relative gains is something of a poster-boy for realist political economy" (cf. 2009:39). The story of the "poster-boy" is about the distributional problem of international cooperation and the role of the state. As some scholars note, its pedigree can be traced back to classical mercantilism in the sixteen to eighteenth century's Europe (ibid; Cohn 2015: 57; Gilpin 1984: 293; Drezner 2017: 3-11).[4] In 1670, the English mercantilist writer Roger Coke wrote that "if our treasure were more than our Neighboring nations, I did not care whether we had one-fifth part of the treasure we now have" (cf. Kirshner 2009: 39). The German-Austrian economist Philipp von Hörnigk (1640 - 1714) noted that the wealth and might of a nation depend "principally on whether its neighbors possess more or less of it. For power and riches have become a relative matter" (ibid). David Hume (1711-1776)'s mercantilist contemporaries argued that a nation should seek a trade and payments surplus, basing their arguments on the assumption that it was only relative gains that really mattered (cf. Gilpin 2001: 78). Classical mercantilism emerged in the sixteenth century, when constant colonization and war were of the primary impetus for growth (see Kegley 2008: 288). Because gold and silver were used for payments of economic exchange and armed forces, states took all necessary measures to accumulate species by increasing their exports and decreasing their imports. Given these economic and political realities, the pursuit of national power and plenty naturally demanded a relative gains calculus (Drezner 2017: 5; see also Irwin 1992). The alleged connectivity between survival and economic exchange is the engine behind relative gains-seeking.

[4] Some scholars argue that it was not until the mass liberalization of the European economies marked by the Cobden-Chevalier Commercial Treaty between Britain and France of 1860 that non-mercantilist global economic norms really existed (Drezner 2015: 139; see also Stein 1984: 365).

In the era of British industrial preeminence, mercantilist ideas developed in the U.S. and evolved into the so-called "neo-mercantilism" or "economic nationalism" represented by Alexander Hamilton (1755-1804) and Friedrich List (1789-1846). Both endorsed foreign trade and investments, but contended that the state should only support them to further national industrial development and at the same time protect infant national industries. The role of the state in List's trade theory is that of the protector of the national productive powers. In his analysis of the *National System of Political Economy* (1841), the bilateral trade between those countries consisted of the export of cotton and wool from the U.S. in exchange for British manufactured goods could not allow for equal gains on both sides. It enabled the Britain to maximize their national productive powers while putting constraints on the Americans. This in turn reinforced the economic and military inferiority of the U.S. and the superiority of Britain. According to List, the role of the state in such a case was to create adequate conditions for the development of the U.S.'s productive powers through a managed trade policy (see also Levi-Faur 1997; Helleiner 2002). State intervention is thus the product of competition in the international system.

The conception of "relative power" was also evident in China's pre-Qin thoughts of the relations among the Warring States. According to Yan Xuetong, the Legalist school of thought that emerged as an alternative to Confucianism has a realist notion of the state, emphasizing the art of maximizing state wealth and power in the context of interstate rivalry. Confucian thinker Xunzi (313-238 BC) partially embraced the Legalist ideas and his view of relative power is very similar to the one of realism in contemporary IR theory: "Because the power status of a state in terms of strength is relative to that of other states, a state's relative advantage relies on its increasing the gap between its own strength and that of others […]. If the increase in strength of all states was equal, then their relative strengths would not change" (cf. Yan 2013: 83). Xunzi integrated the Confucian idea that emphasizes the morality and responsibility of the ruler. He attributes the cause of uneven development of state power to different ideas, strategies and moral authority of the rulers (ibid). In the long Chinese dynasty history after Qin, China was a feudal agrarian society that relied on domestic agricultural production as source of national wealth. Foreign trade was something complementary to the Middle Kingdom and deemed as a favor to other countries in the tributary international system with China at the center (Helleiner & Wang 2018). Unlike the mercantilist concern, foreign trade would not affect China's survival and security. However, this tributary system for Chinese rulers collapsed after the first Opium War (1839-1842). In the face of foreign encroachment in China's economy and the related sovereignty threat, an economic ideology of "self-strengthening" that mirrored the state-led, outward-oriented development strategy of Friedrich List emerged in the late Qing China. It embodies similar ideas of protecting national sovereignty and autonomy through promoting national industrial development and wealth. Thus, the story of the "poster-boy" is not confined to the Western world but also emerged elsewhere where interstate economic exchanges affect state autonomy, balance of power, and induce new conflicts.

In the IR gains debate in the 1980s and 1990s, scholars trace the notion of "relative gains" back to classical realism. Duncan Snidal points out the notion of "relative gains concerns" in Thucydides' (approx. 471-400 BC) memorable work *The History of the Peloponnesian War* that anarchy makes states worry about advantageous power of others (see Snidal 1991:701). "The growth of the power of Athens, and the alarm which this inspired in Lacedaemon, made war inevitable" (Thucydides 1910: 1.23). Thucydides was attuned to the economic-political linkage and attributed war among the Greek city-states to several economic changes, including the growth of trade and the emergence of new commercial powers such as Athens and Corinth. Yet classical realists from Machiavelli to Hans Morgenthau had little to say about matters of political economy (Cohn 2015: 57-61; Drezner 2017). Realist scholars in the early years after the WWII concentrated on the "high-politics" – military and security issues. Some discussed how states used foreign trade as an instrument of national power policy, but not how trade would be a problem for power politics (Hirschman 1945). In the relative-gains debate in IR, many give a solution to the disputes between neorealism and neoliberal institutionalism on when states seek relative gains by differentiating their research focuses. Realism should have stronger explanatory power in "high politics" such as military politics in which relative gains matter more, whereas liberalism may offer better understanding of "low politics" such as international trade and monetary policies (Lipson 1984; Stein 1990: 135; Jervis 1999: 45). This attempt to separate economic issues from security ones neglects their linkage in the original notion of "relative gains". Relative gains concerns are not confined to security issues, they naturally originate from economic exchange and cooperation.

In the IR gains debate, "absolute gain" is defined as how well states fare themselves, whereas "relative gain" stands for how well they fare compared to others (Snidal 1991: 703; also Mastanduno 1991; Reich 1990). Thus, relative and absolute gains are de facto the same substantive payoffs, only bearing different names. To define it in simple mathematical language, if party A's original wealth before cooperation is X and it becomes X_t after cooperation, then absolute gains equal Xt-X; If another party B's original wealth before cooperation is Y and it becomes Yt afterwards, then the relative gains for A in comparison to B are $\frac{Yt-Y}{Xt-X}$. A simple comparison between Yt and Xt does not cover the whole picture of relative gains, since what states worry about is the g*rowth ratio* of the cooperation partner. Seeking relative gains thus means choosing the option of higher growth rate than the cooperation partner(s)', even when other options would bring more absolute gains (see also Mastanduno 1991; Reich 1990; Grieco et al. 2018: 378)

1.2 A review of the gains debate

The IR debate on states seeking relative or absolute gains was sparked in part by the academic effort to explain increasing visible attempts of states since the early 1970s to organize cooperation in economic and security affairs (see Milner 1992: 466; Jervis 1978; Lipson 1984; Axelrod 1984; Axelrod & Keohane 1986; Oye 1986). Following Robert Keohane, "cooperation" is defined as occurring "when actors adjust their behaviors to the actual or anticipated preferences of others, through a process of policy coordination" (Keohane 1984: 51.; see also Grieco 1990: 22). Two elements are important for cooperation: First, each actor's cooperative behavior is directed towards some goals. It needs not to be the same goals for all the actors involved, but cooperation does assume rational behavior on their part; Second, cooperation provides all the actors with gains or rewards, or they are otherwise not necessarily out to help each other. “It is the anticipation of bettering one’s own situation that leads to the adjustment in one’s policies” (cf. Milner 1992: 486). However, the definition itself says nothing about how the mutual gains from cooperation will be distributed and this is where the gains debate originates.

For realists, because in an anarchic world there is no central authority regulating the use of increased capabilities, advantageous gains of a state at the present can pose threats to the other in the future and become relative losses for them (Waltz 1959: 198; Morgenthau 1978). Kenneth Waltz (1979: 105) summarized the realist perspective well:

When faced the possibility of cooperation for mutual gain, states that feel insecure must ask how the gain will be divided. They are compelled to ask not “will both of us gain?”, but “who will gain more?” If an expected gain is to be divided, say, in the ratio of two to one, one state may use its disproportionate gain to implement a policy intended to damage or destroy the other.

Clearly, Waltz pays special attention to the distributional problem in cooperation under anarchy and there is “a significant prospective motivations” for seeking relative gains that those gains would hurt oneself in a future period (cf. Keohane 1993: 281). Structural realism, also called neorealism, stresses the effects of the structure on actors. By structure, Waltz (1979: 70f) means “the arrangement of parts of the system and especially the relations between them.” Alike economics, the power structure (like the market) in international politics does not dictate how the units (companies and individuals in a market) behave, but “conditions their behaviors and their interactions” (ibid.). State is taken as the constructive unit of the structure and a rational unitary actor undivided by class and bureaucratic politics (ibid: 87-92). It does not disregard the value of absolute gains, but cares much about any pure increase in capability, especially economic and technological ones, since they are the main source of military advantage (Waltz 1993: 50). For structural realists, states can accept mere absolute gains as along as the rewards won’t change the power balance. Only gaps in gains favoring the partners’ power position may reduce the utility a state enjoys from cooperation (Grieco 1990: 41). Thus, despite the prudence states have in cooperation, anarchy alone does not generate the thesis that states all constantly seek relative gains in cooperation. Whether states can forego relative gains concerns depends on the specific structure they are surrounded by, namely, on the power position they occupy.[5]

Which kind of structure makes states worry about comparative gains of others? Neorealism presumes that great power, especially a hegemon, can tolerate other states to increase their power to an extent that does not impair its superior position. Great powers should tend to initiate economic cooperation and set the rules for cooperation, in order to transfer their norms and ideas into the international arena and build up an international order based on their advantageous share (see Gilpin 1971, 1975, 1987; Kindleberger 1973; Krasner 1976). An oft-cited example is the early process by which the international economic regime GATT developed. Especially in its first decades, the trade regime privileged the economies (such as the U.S., Japan, Canada and some Western European countries) with a comparative advantage in production that involved high technology. Those advanced economies became more powerful due to additional gains through the trade regime and drove its further development (Milner 1988b; Lake 2010; Gruber 2000). Non-hegemons and especially countries with a small market free ride the liberal trade and monetary institutions by promoting exports and capital to the rest of the world while protecting their domestic economy from international competition. These would advance their relative standing in the world economy (Kindleberger 1981). When great powers begin to wane and others rise relatively, neorealists predict a renewed emphasis on relative gains (Drezner 2015: 137). Although neorealism never excludes the possibility of cooperation, *the constant systemic constraint of anarchy determines that great powers*

[5] Power is "positional in nature." It is always understood with reference to the capabilities of other states. The definition of "power" is very disputable in political science. Hans Morgenthau once gave an excellent definition of power: "Man's control over the minds and actions of other men." (Morgenthau 1978: 26). Robert Gilpin notes that "the number and variety of definitions [of power] should be an embarrassment of political scientists" (Gilpin 1975: 24). The content of power has also changed in contemporary politics and cannot be easily understood with old concepts (Dahl 1957). For a discussion on the changing concept of power, see Finnemore, Martha, and Judith Goldstein. 2013. "Puzzles about Power." In *Back to Basics: State Power in a Contemporary World*, 3-17. Oxford: Oxford University Press.

always keep an eye on the gains distribution.

Neoliberal institutionalism agrees with neorealism on the anarchic assumption and the state's egoistic nature. Yet they differ on the extent to which the international power structure impacts upon states and their autonomy. States are of course interested in enhancing national power and ensuing security, but for institutionalism, they rather compare the gains in relation to other alternatives than to other states to ensure their highest possible payoff (Grieco 1990: 34f; Stein 1982; Axelrod 1984). Neoliberal institutionalism carries the individualist spirit of liberalism, assuming states to share a natural preference for individual gains in their interactions with others (Keohane 1984: 27).

Reasons for cooperation are evidenced for neoliberal institutionalism in the iterated game of Prisoner's Dilemma (PD). Based on the egoistic nature, states may employ a tit-for-tat strategy in interaction with others. That is, they do what their opponents do to themselves and only keep promises so long as partners do (Axelrod 1984; Lipson 1984). In a single-round situation, cheating may bring short-term benefits. However, if the game is highly iterated, states that cheat to win will get punished or retaliated by their partners' tit-for-tat strategy, namely, by being defected in the following rounds. Participants lose eventually more in cheating than in adhering to their initial promises of cooperation, which turns out to the Nash equilibrium. In the "shadow of the future", cooperation thus proves to be the best long-term strategy in the iterated PD and reciprocity plays an important role in stimulating cooperation (Axelrod 1984). However, as Milner (1992: 471f.) points out, absolute gains combined with reciprocity may not differ empirically from relative gains concerns. "To say, as reciprocity implies, that the absolute gains received for cooperation must be roughly equivalent is to say, in effect, that states must achieve no relative gains in the exchange" (see also Milner 1992: 471).

Neoliberal institutionalism, as the name itself implies, stresses the role of institutions in international politics. It argues that states join international institutions to save long-term costs, reduce transaction and surveillance or information costs — benefits that cannot be achieved through ad-hoc cooperation (Krasner 1983; Keohane 1984). Rules and regulations can eventually reduce the uncertainties in international politics and costs of overcoming them. Around sets of norms, principles, rules or decision-making procedures, actors' expectations can converge. These institutionalized rules restructure the interaction in the PD by extending the game out into the future, creating an iterated game and making conditional cooperation a stable Nash equilibrium. Moreover, international regimes can also induce "issue-linkage" – the notion that strategies utilized in different issue areas are often linked to one another – that may be conducive to the emergence of cooperative behaviour (see Alt & Eichengreen 1989: 120; see also Haas 1980; Keohane 1984).[6] Such binding and creative features of institutions can largely contribute to and stabilize international cooperation (see Jervis 1999: 53-63). In contrast to neorealists, the cooperation that is set up by great powers to serve their own interests can also endure after the decline of hegemony with the aid of institutions. Therefore, Robert Keohane concluded in his book *After Hegemony* that "when we think about cooperation after hegemony, we need to think about institutions" (1984: 246).

The publication of *After Hegemony* and the institutionalist agenda it engendered met with realist criticism. Although scholars of neorealism and neoliberal institutionalism had talked about the distributional problem in cooperation, it was John Grieco (1990) who highlighted the notion of "relative gains" in his book *Cooperation Among Nations* and brought up the gains debate amid the Third Great Debate in IR.[7] Grieco (1990) argues in his study on the Tokyo Round negotiations of the GATT between the U.S. and Western European countries that even in economic relations among allies, relative gains concerns were not absent. The relative-gains problem was furthered discussed within the "neo-neo joint framework" which was made in an attempt to reconcile neorealism and neoliberal

6 Keohane & Nye (1977) coined the term "complex interdependence" to denote the same phenomenon.
7 Grieco, Joseph M. 1990. *Cooperation Among Nations : Europe, America, and non-tariff barriers to trade, Cornell studies in political economy*. Ithaca: Cornell University Press. Scholarly discussions on the relative gains question in international cooperation are collected in the book *Neorealism and Neoliberalism*, see Baldwin, David A. (e*ds.)1993: Neorealism and Neoliberalism, The Contemporary Debate*. New York: Columbia University Press.

institutionalism based on their shared assumptions of anarchy and the rationality of state actors. As Keohane said on the panel on relative/absolute gains at the meeting of American Political Science Association in 1992: "this is not the inter-paradigm debate" (cf. Wæver 1996: 166; see also Keohane 1993: 291). The debate was no more about how incommensurable the paradigms were, but how could they be defused in a joint framework. The two most cited theoretical works must be attributed to Robert Powell and Duncan Snidal published in the *American Political Science Review* of 1991 (see also Wæver 1996: 166; Milner 1992; Grieco et al. 1993). They draw out game-theoretic models, making equations to explain the linkage between relative and absolute gains.[8] Based on the principle of rational choice in the PD, Powell links the balance of relative and absolute gains to the cost of using forces. He argues that when the cost of using force is low and at issue, concerns over relative gains will be present (1991: 1304). In Powell's model, the "technology of warfare" determines the "cost of fighting" (cf. Grieco et al. 1993: 734). When the use of force is too costly, meaning that no state's technology warfare is able to defeat the other efficiently, relative gains cannot be exploited, and cooperation will emerge even in the presence of anarchy.

Duncan Snidal takes not only the importance of relative gains but also the number of participants in the repeated PD as independent variables. When relative gain is as important as to a certain high point (when r=1 in his model), the PD is transformed into a zero-sum play. He argues that in the zero-sum game where there are only two players, states care much about relative gains while disregarding absolute gains because changes in capabilities are very clear for the opponent in the simple relationship (Snidal 1991: 706). When transferring from the two-actor world to international politics with multiple players, redistribution of gains gets more complicated and concerns over relative losses attenuate. In such case, neoliberal institutionalism gains explanatory power (see also Liberman 1996; Stein 1990; Werner 1997; Zhang & Yue 2013).

[8] As Wæver (1996: 166) noted, the neo-neo models did boom a business: "Finally International Relations could make it into American Political Science Review with articles full of equations." For a more mathematical and computational modelling of relative and absolute gains, see Halas, Matus. 2009. "Post Scriptum on Relative and Absolute Gains", *Perspectives* 17(1): 27-55.

Powell and Snidal's "neo-neo synthesis" models show that when anarchy is a constant, relative gains concerns vary with other systemic constraints. This is one way of reconciling the arguments between neorealism and neoliberal institutionalism.[9] Several IPE scholars made further contributions to the empirical study of when states seek relative gains. Michael Mastanduno (1991) argues in his seminal article that the U.S. proved less sensitive to relative gains concerns vis-à-vis Japan prior to the 1980s, and in fact even encouraged patterns of interaction that worked to the relative economic advantage of Japan.[10] However, by the latter half of the 1980s, clear signs of relative gains-seeking behavior appeared in the U.S. foreign economic policy towards Japan. The immediate concern was not military security, but *economic competition and welfare concerns,* specific to certain industrial sectors and the capacity to convert temporary market-share advantages into long-term competitive advantages (see also Liberman 1996: 149). Similarly, in Grieco's case (1990: 182-209), he suggests that relative gains concerns of the European Community limited cooperation in setting the Tokyo Round codes on government procurement and technical standards for the fear that these two issue areas would have a major impact on its capacity to retain an advanced and independent technology base. He connected relative gains to future bargaining power and independence, but *not military security*. John Matthews makes this point more clear: Security cooperation may not always be impeded by relative gains concerns, such as U.S.-Soviet cooperation on nuclear arms control in the 1970s and 1980s, when the gains do

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[9] I agree with Grieco's criticism that both authors' models repeat or underline some neorealist and neoliberal assumptions, while converging a few. The conclusion drawn from Powell's model (1991: 1315) that "a unit's current relative gain may be translated into a future absolute gain for that unit and a future absolute loss for the other units" can be summarized in the classic sentence from Kenneth Waltz: "today's friends may be tomorrow's enemy". Moreover, Powell's "costs of fighting" argument is contestable, because if high costs of fighting would impede relative gains seeking, there should be little to fear about increases of any security capabilities between nuclear countries, when both sides already have enough to defeat each other (see Brodie 1946). Snidal's assumption that "states can alter the terms of the cooperative arrangement or offer side payments until the distribution of gains is sufficiently proportionate" sounds very like the "issue-linkage" argument of neoliberal institutionalists (1991: 703). Powell and Snidal themselves did cast doubt on the models' deductive strength: How actors assess the payoffs (the cost and possibility of using force in Powell's model, and the complication of assessment in Snidal's large-n model) can largely influence their policy preferences, which consequently should be an "empirical study project" (Powell 1991: 1316; Snidal 1993: 739; see also Jervis 1999: 47; Deng 2000: 978).

[10] Grieco (1990: 168f, 216-220) also noted this phenomenon in his case that the U.S. tried to maximize its security by giving advantages to the European Commission.

not have cumulative effects in the long-run (see Matthews 1996: 135-140, 143-146). In overview of the gains debate, the two reasons for seeking relative gains are cumulative long-term absolute gains in the future and/or national security. While some scholars well captured the security implication of economic cooperation (Grieco 1990; Powell 1991; Morrow 1997), many other empirical studies have delinked it in the gains debate (Mastanduno 1991; Snidal 1991; Matthews 1996). In practice, analytically distinguishing between behaviors motived by long-term economic gains rather than by security proves difficult (see Kirshner 2009: 40; see also Liberman 1996). The decoupling between relative economic gains and security concerns (and externalities) might be related to the geopolitical structure in the 1980s and 1990s. On the one hand, the accelerated decline of the industrial base in the U.S. brought economic competition with Japan and Western Europe into sharper focus, yet the latter were not security challengers of the U.S. On the other hand, the principal security challenger – the Soviet Union – was not an economic competitor for the U.S. As Mastanduno notes (1998: 839): “International economic and security relations seemed to be different games involving major players”. This international structure separated security concerns to some extent from relative economic gains.

1.3 Reconsider the debate in the context of economic globalization

The gains debate petered out in the early 1990s and the net result of which remains open to competing interpretations.[11] As globalization was imposing much deeper and overwhelming effects on nation states than “complex interdependence,” in the scholarship of IR and IPE, it also posed new challenges to state-centrism. Considerable emphasis was again placed on the concept of market power and the dominance of monopolies or oligopolies in international markets since the 1990s (Kirshner 2009: 41). A resonance of liberal approach emerged in IR (Moravcsik 1997), while in IPE it is called

[11] A mini-literature in social constructivism and behavioral science further contributed to the gains debate in the late 1990s, see Berejekian, Jeffrey. 1997. "The Gains Debate: Framing State Choice." *American Political Science Review* 91 (4):789-805; Rousseau, David. 1999. Relative or Absolute Gains: Beliefs and Behavior in International Politics (manuscript); Rousseau, David. 2002. "Motivations for Choice: The Salience of Relative Gains in International Politics." *The Journal of Conflict Resolution* 46 (3):394-426.

the Open Economy Politics (see Bates 1997; see also Li & Liu 2016). Research focuses shifted from state actors to domestic and transnational actors, from national relative gains to domestic relative gains, from international reciprocity to domestic reciprocity. As "cooperation under anarchy is no longer a central problem" in a very institutionalized world (Drezner 2013: 284), the "poster-boy" – lost its attractiveness.

The open ending of the poster-boy's story in IR is not very satisfying. As James Fearon (1998) summarizes, international cooperation has a common sequential structure that begins with negotiation and follows with the enforcement of the agreement. The IR debate on relative and absolute gains has concentrated on the negotiation phase in which decision-makers argue over what they expect to achieve in draft agreements (Grieco 1990; Mastanduno 1991; Krasner 1991; Liberman 1996; Matthews 1996). Nation-states are the primary actors in international bargaining, albeit occasionally constrained by domestic politics (Putnam 1988). However, I take this periodization of international cooperation as an incomplete understanding of the relative gains-problem. *Reconsidering the distributional problem within the context of globalization, we must first think about where do the gains come from, who produces and divides them?* In security cooperation such as weapon sales and development of nuclear energy, the central government is usually the main conveyer who is out to help each other for common defense goals. In the domain of international economic exchange, be it a commodity, capital, or technology, cooperation between countries is in the first place between societal economic actors. A firm in one country seeks a partner in another country to do exchange, thus the gains in a foreign economic relationship are first generated and divided by societal economic actors. MNCs that carry out and promote the cross-national production networks are the key agents of economic globalization and major conveyers of foreign investments (Prakash & Hart 2000; Gilpin 2001). While multilateral or bilateral interstate negotiation and ratification only stand for the content and possibility of an economic cooperation agreement, it is the step of implementation by social economic actors that effectively touches the reality of cooperation and its inherent distributional problem (Lantis 1997; Zhang & Sun 2016). Moreover, some economic agreements between countries only serve to provide governmental safeguards to pre-set corporate decisions, but they do not *generate* any substantive gains. Thus, a mere discussion on states seeking relative gains in the negotiation and ratification period without paying attention to cooperation activities conducted by nonstate economic actors (especially MNCs) is an incomplete understanding of the distributional problem and short of empirical touch. Understanding how states use economics to pursue their strategic objectives requires that we focus on the role of commercial actors – the entities that usually conduct "economics" (see also Norris 2010: 14).

Moreover, states can effectively seek relative gains through internal means. In the classic realist world, traditional military form of statecraft was closely intertwined with possibilities for economic gain. Economic actors were presumed to have an interest in the political and military capacities of "their" states, just as state managers have an interest in the capacities of "their entrepreneurs" (see Evans 1997: 66). However, economic decisions of MNCs are usually based on internal corporate strategies that aim at improving and maximizing corporate benefits.[12] A large body of literature in both economics has explored the determinants of FDI flows. Foreign investors choose to do business abroad because it has certain advantages and benefits that overcome the related costs and risks and thus justify doing business abroad rather than only at home (Dunning 1988; see also Eden & Li 2010). For states, tariff and taxable income are only part of the gains that states profit their economic activities. What matters the state more is the competitiveness of their corporations, the opportunity for technology transfer, domestic employment and social welfare, as well as the national economic capabilities. When economic cooperation between non-state actors generates a distributional structure that run contrary to national interest, the most efficient way for a state to seek relative gains in international economic cooperation is to regulate its "most economically empowered

[12] It would be a bias to assume that contemporary Chinese state-owned enterprises all follow political aims of the state. They are also firms with defined commercial interests. Many SOEs have been listed in stock markets and act very differently from those organization governed by the industrial ministries before the economic reform in 1978, who followed state instructions with no strain attached. As to be discussed in Part V, small and medium-size SOEs in China have been encouraged to find their own financial resources other than depending on the state budget allocation since the SOE reform in the late 1990s.

citizens" such as MNCs (see also ibid: 65; Milner & Keohane 1996: 11; Gilpin 1975).

Realist scholars did pay attention to the internal means of power balancing. According to Waltz, a state may balance the relative power of another either externally, through "moves to strengthen and enlarge one's own alliances or to weaken and shrink an opposing one", or internally, through "moves to increase economic capability, military strength, or to develop clever strategies" (Waltz 1979: 118-125).[13]. States can emulate the military, technological and governing practices of the most successful states that yield more from the international market (see also Mastanduno et al. 1989; Taliaferro 2006). Besides learning from the dominant states, there are also other strategies of state intervention to balance powers. For instance, a rising state can support the development of indigenous producers. Such support may take a variety of forms, including research and development (R&D) subsidies, tax reduction, preferential loans and credit allocations targeted at specific firms or industries. However, indigenous innovation demands long-term and large capital investments, especially in R&D-intensive sectors. In order to accelerate the general process of technology diffusion, where knowledge naturally spreads from high-tech to low-tech countries over time, a rising state can also take a "transacting" strategy such as concluding commercial transactions with foreign entities that result in technology transfer. The rising state can put pressure on those firms to share technology with domestic actors in exchange for market access; It can also conduct a "taking" strategy to sponsor outward investments and takeovers of high-technologies owned by companies in another country (see Kennedy & Lim 2018). Applying the "transacting" or "taking" strategy to reach faster growth rate within shorter time is by nature a strategy of seeking relative gains. As Scott Kennedy points out (2011:20): "As a late-late developer, China does not have the luxury of unfettered access to technology and markets that the United States felt more comfortable providing Japan during the Cold War; hence, it has had to be much more open to foreign direct investment. At the same time, the changing cost structure of production has generated opportunities for China to attract investment and its

[13] Waltz, however, devotes most of his attention to external balancing and leaves the notion of internal balancing (emulation) underdeveloped, see also Taliaferro 2006.

accompanying technology not available to others." For an early developed dominant economies such as the U.S., its task is to protect the advanced technologies from being transacted or taken over by the latecomers – to defend relative gains from international economic cooperation. Government intervention into foreign economic activities can thus be used as a tool of internal balancing to preserve or enhance domestic economic capabilities.

When balancing powers through internal means, states do not intervene in every foreign investment, they fight battles especially in strategic sectors. Beyond the gains debate, IR scholars have noticed that relative gains concerns have been salient in particular economic sectors with a link to national security. They are usually generalized as "strategic sectors" or "strategic assets" (Kurth 1979; Baldwin 1985; Borrus & Zysman 1992; Shafer 1994; Busch 2001; Gereffi et al. 2005; Hseuh 2011; Ding & Dafoe 2020). Horizontally, a national economy is composed of different sectors (or also called "industries"), such as aviation, energy, electricity, textiles and telecommunications. Vertically, a sector further consists of several subsectors. Since David Baldwin's (1985) authoritative discussion about "strategic good" and economic statecraft, a general consensus is that *a strategic sector is the sector that is of vital importance to a country's technological and infrastructural base.*[14] Therefore, a strategic sector usually has positive externalities across different economic sectors and generates great consumer demands from other sectors. Because of their technological progressiveness, strategic sectors vary across time. In the early 20th century, railway, chemical and telegraph were the strategic sectors for industrial development. In the late 20th century, the semiconductor, computer, biotechnology and aircraft engines were commonly regarded as strategic (see Milner & Yoffie 1989). These sectors continue to be important, but are also being complemented by artificial intelligence, advanced manufacturing and 5G in the contemporary era (Petricevic & Teece 2019: 1497; Ding & Dafoe 2020).

[14] For a through discussion of the different dimensions of strategic sectors, see Ding, Jeffery, and Allan Dafoe. 2020. "The Logic of Strategic Assets: From Oil to AI". Center for the Governance of Artificial Intelligence, University of Oxford: https://arxiv.org/pdf/2001.03246.pdf.

Contemporary globalization in its economic aspect means a cross-national production network (Borrus & Zysman 1997: 2). Within the network, a sector's supply chain is disintegrated into constituent subsectors that can be contracted out to independent producers wherever those companies are located in the global economy. For instance, a mobile phone is made up of many different components such as a circuit board containing the "brains" of the phone, an antenna, a liquid crystal display, a microphone, a speaker, a battery and a camera, etc. Each of its components are further divided into different micro-components. Within the global supply chain of a product, certain components have much larger value than others. Strategic (sub)sectors are usually characterized with intensive R&D process, in which returns only accrue after long time and large capital investment but generate first-mover advantages. Semiconductors, for instance, are an essential element of the "electronic food chain" extending from upstream materials and production equipment manufacturers to downstream systems producers such as computer and office equipment manufacturers (Brown & Linden 2009). Accordingly, the competitiveness of these end-product sectors – their rate of innovation, export performance, and their productivity growth – depends on their ability to incorporate the most advanced chips. Since the spillover effect of strategic sectors is huge, so the investment costs, firms in strategic sectors either form financial alliances (such as through cooperation with foreign investors) or seek support from the state. Therefore, in strategic sectors, there is often a natural cooperation between the state and the private sector (including capital-rich MNCs) in strategic sectors because the former depends to a large extent on the latter to supply their technology needs.

If one firm from a country precedes firms from another country entering a strategic sector, it can affect the very logic of competition between firms in the two countries – substantially disadvantaging the latecomer in the long term (Borrus et al. 1993). The dominance of a country in a strategic sector will increase the dependency of other countries in the global supply chain. In such case, the current position of one nation in the international economy is not its final reward. "At stake are future gains and losses in terms of each nation's dynamic potential for long-term growth, increased standards of living, and technological preeminence" (cf. Borrus & Zysman 1992: 40). As Stephan Krasner's (1991) analysis has found, cooperative agreements in the global communication such as on the electromagnetic spectrum, on regulating radio and television broadcasting, and remote sensing, have changed in line with changes in the distribution of power (a variable determined by technology and market size). In global communications, where the initial allocation of property rights have distributional consequences, changing the rules would benefit some actors at the expense of others. Thus the cooperation framework in these sectors is based on power relations and has power implications. In "life on the Pareto frontier", all gains are relative gains (ibid: 365). States that want to earn relative gains in the economic globalization must possess strategic sectors and those who have them must police them if they want to preserve a larger share of the global profit pie (see also Busch 2001). This logic is reflected in the "strategic trade theory" (Krugman 1986; see also Busch 2001), but also applies to and has been practiced in the issue area of investment policy (see Hart & Prakash 1997; Gilpin 2001; Kennedy & Lim 2018; Petricevic & Teece 2019). As many scholars have noticed, government intervention in IFDI can be used as a "light-form industrial policy" contrasted with a "heavy-form industrial policy" that targets specific domestic industries for government support and protection while either excluding foreign firms from the targeted industries or subjecting them to performance requirements (see Rodrik 2009; Gallagher & Chudnovsky 2009; Moran 2014).

Besides the economic gains of strategic sectors, the value of strategic sectors has been frequently linked to national security (Kurth 1979; Shafer 1994; Segal & Thun 2001; Gereffi et al. 2005; Hseuh 2011). The vague linkage between "strategic sectors" and national security lies in the dual-use of some technologies in both civilian economy and military applications, such as semiconductors and aircraft engines. Technological advancement and economic globalization have only made the security concerns more complex. In the digitalized world, state or nonstate actors can remotely attack an opponent's computer systems with malicious codes to impair its infrastructure. Artificial intelligence, robotics and autonomous systems, which themselves are very broad concepts, are becoming defense technologies. The risks of being attacked by civilian-used technology have been largely increased with technology advancement, while the costs of launching attacks decreased. In other words, the boundary between defense and non-defense technologies is becoming very amorphous. Moreover, the global production networks let the military and industrial capabilities of a country rest in part on foreign technologies that lie outside of the national border. As Ding and Dafoe recently note (2020: 38), "the globalization of supply chains and the increased number of components in military platforms has exposed states to the poisoned chalice-strategic logic". It is almost impossible to identify the full range of subcontractors for a weapons platform due to the complexity of supply chains and sheer number of foreign suppliers. One Boeing official estimated that "the defense contractor's supply chain for a weapon system would include up to 2,000 foreign subcontractors" (cf. Brooks 2007: 671f). It is also due to the complexity of a global supply chain that states can theoretically declare any industrial sector or subsectors as "strategic" and important for national security. In Rosa Brooks' (2016) evocative description, globalization has created a world in which "everything became war".

Scholars have long noticed the relationship between security threat, technology dependence and neo-mercantilist politics (Feigenbaum 1999, 2003; Stubbs 1999; 2005; Katznelson 2002; Block & Keller 2011; Weiss 2014). Based on Charles Tilly's defining study of the relationship between war-making and state-building in early modern Europe, Richard Stubbs contends that key to understanding Northeast and Southeast Asia's economic success and the neo-mercantilist, export-oriented policies of the developmental state are war and geopolitics of the region (see Tilly 1975; Stubbs 1999, 2005). The fighting of and preparation for war and the transfer of substantial U.S. aid and investment to its allies in Asia have had "profound, and on the balance very positive, effect on these economies" (Stubbs 2005: 16). Evan Feigenbaum (2003) reviews how military considerations have dominated the development of science and technology in China's early industrialization and economic reform. Roselyn Hseuh (2011) argues that the difference in strategic values of different sectors and subsectors have affected China's FDI liberalization and state intervention. Linda Weiss (2014) investigates the American state's evolving role in promoting innovation and enterprise, and its correspondent institutional arrangements in the 1970s. She emphasizes that national security was the main motivator of transformative innovation in the U.S. economy and the "national security state," which primarily included the Department of Defense, Energy and Homeland Security, the Central Intelligence Agency, the National Science Foundation and the National Institutes of Health, is the vital actor in that enterprise. Even Silicon Valley – a region widely regarded as the archetype of private entrepreneurialism – owned much of its emergence as a technological powerhouse to government money from military electronics contractors (see Block & Keller 2011). This study also falls within the scholarship inherited from Charles Tilly (1975)'s famous thesis that "war makes the state": it is a story about the "second image-reversed", about how security implications of globalization have changed the state of the U.S. and China.

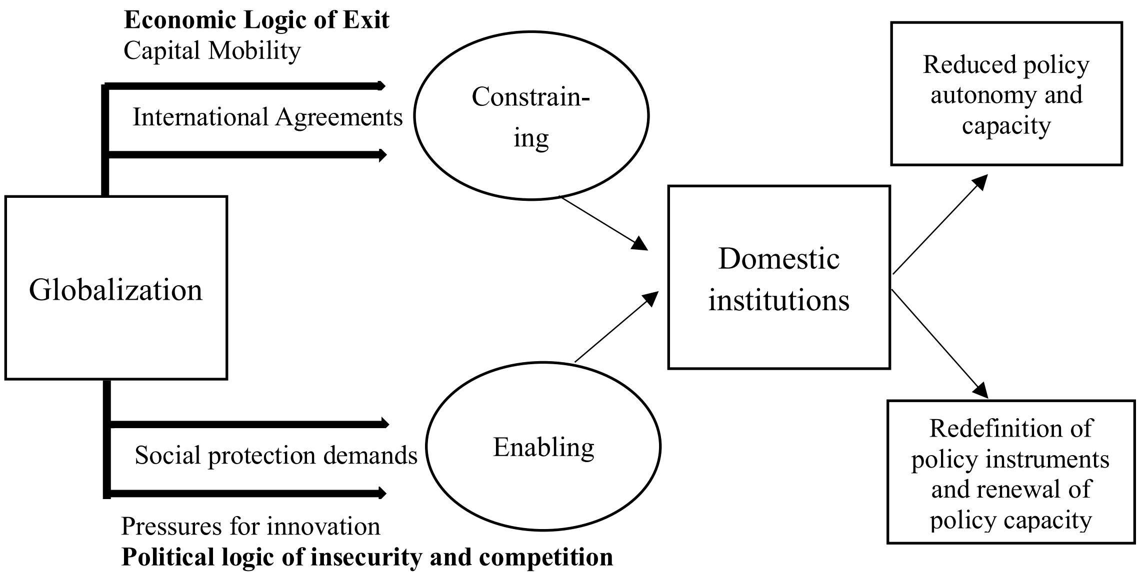
As Daniel Drezner notes (cf. 2017: 15), "an approach that concedes the significance of globalization but asks how states try to maximize their relative advantage in such a world is more fruitful than the current realist gambit of assuming the phenomenon away." In the context of economic globalization, power and security threat have increasingly come from transnational actors rather than from other states in the form of a direct confrontation. IFDI policy is not only a public regulatory policy but also an important aspect of foreign economic policy. The success of the latter is yet depending on the state capacity and incapacity to regulate foreign investors. States reserve the right under international customary law to block foreign investments on national security grounds. This right is frequently recognized in countless bilateral and multilateral investment treaties, and in investment chapters of free trade agreements (see Jackson 2013: 7). Thus, despite the overall global trend toward economic liberalization and the reduction of barriers to FDI, the particular right to restrict foreign investment for national security reasons remains untouched and its use has surged in recent years (see UNCTAD 2016; see also Lenihan 2018). Within the context of economic globalization, I understand states seeking relative gains not only in the lens of ad-hoc government intervention and policy, but also in the lens of altering domestic regulatory institutions. States may seize on opportunities and use their international legal sovereignty rights to alter domestic institutions in the pursuit of national security and relative power (see also Krasner 2011).

1.4 Foreign capital and security implications for the U.S. and China

"Global integration raises many questions about the state of the state. Its policy capacities, its institutional integrity and, not least, its political powers have been dramatically altered, so many pundits claim, by the spread of social relations across the global" (cf. Weiss 2005:345). As Weiss elegantly summarized, globalization has both *constraining* and *enabling* effects. "Tightly constrained by exposure to global capital markets, the exit power of multinationals, participation in the multilateral trade regime and, in specific cases, European integration, the transformed state appears to be 'straitjacketed' rather than 'in retreat'" (ibid; see also Friedman 1999, 2005). As Thomas Friedman describes it, globalization acts as a "golden straitjacket" which narrows the "political and economic policy choices of those in power to relatively tight parameters" (1999:87). When barriers to trade, investment, and finance fall, governments increasingly compete to attract and retain mobile capital. They pursue policies that complement the preferences of MNCs and financial markets lest these highly mobile investors exercise the exit option and take flight to lower-tax and welfare-conservative environments. Consequently, financial openness and corporate mobility are expected to exert downward pressure on fiscal and social policy, forcing welfare retrenchment, corporate tax cuts, and shifts in the tax burden from capital to labor. Moreover, intergovernmental agreements and international organizations like the WTO have constrained the state to pursue protectionist trade, industry, and financial polices to strengthen domestic economy. This is the influential "constraints" view of state transformation within the context of globalization. However, "using two eyes rather than one", some constraints "become less important when set against the existence of ample room for action in key policy areas" (cf. Weiss 2005: 345). The important challenges for domestic adjustment do arise from the pressures of economic integration, but they can also be neutralized. Globalization thus also enables the state to transform domestic institutions and seek new policy instruments.

The “enabling” effects of globalization can be clearly seen in the construction of social welfare. After WWII, a particular set of relations between state, society, and global market was institutionalized, creating a system of relatively stable national economies organized through an international order of “embedded liberalism” (Ruggie 1982, 1994). These economies were tied together through a negotiated regime of multilateral trade, free flow of capital, global network of production, but buffered from the full effects of these international markets by institutions limiting the global market effects on domestic market and social welfare. The tensions, either caused by incremental or abrupt changes along with globalization, have been reconciled historically in a variety of institutionalized national and international models of capitalism, underpinned by different state-society alliance (Hall 1986; Scharpf 1999; Hall & Soskice 2003; Streeck & Thelen 2005). Due to the enlarged needs of social welfare, “economic integration is strongly linked with the centralization of public expenditure and taxation, as fiscal resources have generally shifted into the hands of national governments (even while subnational officials may find their political autonomy enhanced)” (cf. Weiss 2005: 352). Besides, globalization also reveals a political logic of competition and insecurity caused by nonstate actors such as MNCs, which generates incentives for governments to take initiatives. Relative gains seeking through state interventions and state-making reflects this political logic and the enabling effect of globalization.

Figure 1. The logic of globalization, domestic institutions and state responses



Source: cf. Weiss 2003: 6.

In practice, foreign direct investment posed new challenges for both countries in the 1970s. In the U.S., it was a surge of foreign investments from the Organization of Petroleum Exporting Countries (OPEC) after the Oil Crisis that first raised the political awareness of setting up a regulatory agency on IFDI. In China, the need to regulate IFDI was triggered by the elite-led reform decisions to re-integrate China into the global market. The "the room was ample" for action. However, the political logic of insecurity and competition through IFDI was essentially different for the U.S. and China in the 1970s and to the present day. In the post-war era, thanks to the U.S.' superior economic position, the power and security implications of IFDI rather came from the access of foreign investors to cutting-edge technologies in the U.S., especially those in strategic sectors. Economic globalization in the post-war era was first a American-MNC-led globalization. It is characterized with a cross-national production network (Borrus & Zysman 1997). Within the network, an industrial sector's value chain is disintegrated into constituent functions that can be contracted out to independent producers in various countries. The producers in various countries not only supply different products or components in a global supply chain but also generate different labor values, ranging from research and development (R&D), procurement, manufacturing, coordination of production, assembly to marketing and support. These labor functions are carried out across national boundaries by different firms under the coordination either of a lead MNC for its own production or intermediate service companies who manage the production value chain for clients (ibid; Gereffi 2018). To produce more efficiently and reach new markets, companies enter into partnerships of varying degrees with firms from other countries at every stage of the product cycle. Borrus and Zysman (ibid) coined the "Wintelism" to describe the architecture of the global value chain in the computer industry. It describes the phenomenon that Microsoft Windows and Intel exercise huge influence and advantage of over access to the personal computer market without ever producing computers themselves. By asserting intellectual property over software standards, they controlled the pace of innovation and decisively shaping the trajectory of their respective industries. Moreover, Microsoft and Intel profit greatly from "royalty fees" others have to pay when using their technology standards, and at the same time from low-cost manufacturing in developing countries.

The architectural controllers of these strategic sector are without exception headquartered in the U.S. and a few other technology-advanced countries. Hart and Kim (2002) further developed the concept of Wintelism and linked the new industrial regime under Wintelism with national competitive power. They argue that the reliance on open but U.S. owned technical standards and extensive outsourcing of component production facilitated by the standards underline the resurgence of U.S. competitiveness in the global market. At the same time, this "industrial regime" represented by Wintelism has also created new ways to produce winners and losers in the global market under a structure generally biased against the technology followers (see also Zhou 2006). If latecomers are to move along the same path, they would inevitably encounter barriers and have to pay considerable fees to use the technology (ibid). In Gilpin's words, the U.S. in the 1970s was at the "core" of the global political and economic system (Gilpin 1975). MNCs from the U.S. tapped into the labor advantages of developing countries, while profiting from the proliferation of American firms' technologies and standards (Porter 1990). The power and security threat of IFDI thus came from competitors who wanted to take over advanced American firms, especially the dual-use technologies for both military and civilian applications.

IFDI has fundamentally different power and security implications for China. A general belief of FDI is that it contributes to the economic transformation of developing countries and their industrial upscaling in global value chains (Pandya 2016; Sun & Grimes 2017). The product life cycle model of Raymond Vernon well captures the spillover effects of FDI from developed to developing countries and its implications for global supply and value chains. In his famous paper (1966) *International Investment and International Trade in the Product Cycle",* Vernon assumes that a product has four development stages. The first stage is an introductory stage when a new product is invented by companies and sold in the domestic market. In this initial stage, the finished product is usually made in facilities based in developed countries; Entering the second stage, as competition emerges from other firms and as the large-scale entry into a developing market becomes attractive and lucrative, MNCs start to engage in FDI activities in developing countries. The lower labor costs in developing countries enable MNCs to compete with other firms by reducing their product costs. Physical presence of their production facilities in developing countries also helps the MNCs to break down trade barriers and protectionist regulations in local markets; Over time, in the third stage, if there is a government policy and cooperation form with MNCs that promote technology spillovers, the foreign country increases its production and imitates the technology; In the last stage, FDI-generated facilities and technological spillovers localize the once imported intermediate goods. The later developed host country has possessed the facilities and technologies for domestic production and even exports the finished products to the global market, including the original investors' home markets (see also Cumings 1984). The major nodal of the global supply chain then shifts to developing countries and local firms get integrated in the global value chain (see also Gereffi 2018). Through IFDIs, firms in developing countries can become qualified participants in the global market, specializing in specific stages of production process and developing more capabilities to move upwards along the value chain. Therefore, globalization and IFDI may help narrow the gap between Chinese and

American economic capabilities through technology and knowledge transfer and increased productivity, which serves to augment military capabilities. Concerning the constant conflicts between China and the U.S. over Taiwan, North Korea, in the East and South China Sea, military modernization has always been a central concern of the Chinese government (see Feigenbaum 1997; Segal 2006; Norris 2016). Preparation for war, especially for several, demands a growth rate much faster – relative gains – than the enemies.

However, this restructuring effect of FDIs from developed countries to developing countries on the global value chain is sometimes a mere wishful thinking in theory. Foreign investors do not have much interest in promoting industrialization in host nations because their priority is to further their commercial interests, usually obtaining profits through setting up processing firms and utilizing cheap local labor costs in the developing countries (Wade 1990). In such case, FDI does not generate technology spillovers nor stimulate the host country to enter the stage of production localization. It rather poses a threat of suppressing domestic competitors in developing countries, especially when they enjoy preferential policies from the government (Huang 2003). FDI can enhance, but sometimes also breaks the general rule of comparative advantages in international trade and impede the maximal utilization of domestic resources. The growing intrafirm trade took place at transfer prices set by the firm itself within its global corporate strategy did not necessarily conform to the conventional trade theory based on traditional concepts of comparative advantage (Gilpin 2001: 289). Consistent FDI inflow from developed to developing countries may also increase the latter's dependency on foreign capital, which can accumulate to debt crisis (Moran 1978; Stallings 1990). As early as in 1990, Barbara Stallings scrutinized the differing approaches to and experiences with foreign capital in two of the Asian miracles, South Korea and Taiwan, in comparison to the two largest Latin American countries, Brazil and Mexico. She and many following scholars have found that Latin American countries had a much higher reliance on foreign capital in the 1960s and 1970s, which accumulated to debt crisis in some countries, while the East Asian countries have had a relatively lower reliance on FDI for capital and technology and the states determined the conditions under which FDI has taken place (see also Kohli 2016). Stallings arrived at the conclusion that "development of the host countries is a fortuitous side effect at best, which will only come about if the host government maintains enough autonomy and control to guarantee that the benefits of FDI are shared between providers and recipients of foreign capital" (1990: 82). Therefore, the general technological diffusion through FDIs from high-tech countries to low-tech countries are slow and unpredictable. In many industrial sectors, such as the semiconductor, the industrial regime characterized with Wintelism retained over time, in which the architectures and first-movers – a few earlier industrialized countries – have cumulative gains, while latecomers remain at the lower end of the value chain and even have to pay "royalty fees" to this architecture (see also David 1985; Arthur 1994).

Therefore, the security externalities of IFDI for China rather arose from demand dependence on foreign firms and suppression of domestic competitors – the so-called "national economic security". In extreme case, uncontrolled capital and trade flows of foreign firms into the domestic market can be an encroachment to sovereignty and cause social and political unrest that could lead to the toppling of the regime. In the end, a transitional economy shifting from an autarkic or a centrally planned economy to a market economy often faces a dilemma that they must welcome forces that they fear will weaken the state control over the economy and the society, but at the same time are essential for the augment of industrial base and the related military capabilities, economic growth and regime legitimacy. Therefore, using Peter Evan's words of describing the different types of state intervention in the industrialization process (1995), institutional change in China is more about deregulation and its main IFDI policy goal is to *promote* IFDI; In the U.S., free market entry has been the default unless a regulation is at issue. Its main policy goals is to *police* IFDI.

2. Theoretical-analytical framework: Historical Institutionalism in International Relations

2.1 The nature of IFDI policy

According to the OECD 2008 benchmark definition, "foreign direct investment is a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor" (OECD 2008: 17). OECD and most other countries in the world share the standard that FDI must include an ownership of least 10% of the voting power of the investment recipient, evidencing a "lasting interest" in the latter.[15] Because capital flow has directions, FDI can be divided into inward FDI and outward FDI, namely, IFDI and OFDI. IFDI can entail either the purchase of existing business (mergers and acquisitions), or the building of new facilities (greenfield investment).[16] The other kind of foreign investment in the form of portfolio investment is that investors only purchase financial assets such as bonds and securities (long or short-term) and do not expect to influence the management of the enterprise.[17] Whereas the purpose of portfolio investment is to obtain a financial return, FDI is usually part of an international corporate strategy to establish a permanent position in another economy (Gilpin 2001: 278). Firms engaging in FDI often take as long as two or more years to execute on investment decisions and reflect more long-term considerations than short-term solutions

[15] The 10% threshold is an arbitrary distinction determined for statistical purpose, differentiating FDI from foreign portfolio investment (FPI). The U.S. Securities and Exchange Commission has long adopted the 10% threshold under the Securities Exchange Act of 1934 to register foreign ownership. However, FDI was in practice scarcely distinguished from FPI until the 1960s (see Gilpin 2001: 286; Hymer 1960). China had a higher threshold that foreign equity capital inflows are classified as FDI only if they lead to a foreign equity stake at or above 25%. Since 2004, Chinese official statistics also adopted the 10% threshold (MOFCOM 2015).

[16] There are in general four types of FDI: 1) purchase/sale of existing equity in the form of mergers and acquisitions – the former refers to the amalgamation of two or more firms into an existing form or to form a new firm, while the later means the purchase of at least 10% of the ownership of another enterprise without amalgamation or consolidation of the firms; 2) greenfield investments: the build of enterprise in another country from scratch; 3) extension of capital, such as reinvest the profits from established business in itself, and 4) financial restructuring (investment for debt repayment or loss reduction). In neither of these cases should there be any necessary actual flow of capital from one country to another. Foreign investors could just borrow money on the local market without taking any money abroad with them (Buckley & Roberts 1982: 2). The similarity of them is that the owner of capital is a resident belongs to another nationality.

[17] There are long-term or short-term portfolio investment, depending on the different contract. In the case of public portfolio investment, treasury bills can be issued with a maturity of less than one year, or long-term saving bonds over decades.

to credit crunches (Danzman 2019: 16).[18] Portfolio investment is often carried out by individuals and banking institutions through the capital market, whereas a FDI is usually carried out by companies. The principal conveyor of a foreign investment is usually (or become) a Multinational Corporation (MNC) that engage in production of goods and services, as well as financial exchange in more than one country. A small but growing fraction of FDI has been accounted for by sovereign wealth funds (SWFs) (Milner 2014: 2; see also Drezner 2008).[19]

The policy area of foreign direct investment is characterized with what Culpepper (2011) termed as "quiet politics". Issues of high political salience such as tax cuts, provision of social welfare and trade tariffs tend to matter a large range of social groups and are comparatively accessible subjects in public debates. The dynamic of IFDI policy is different: citizens remain generally ill-informed or uninterested, and the most relevant policy is highly complex and shielded outright from public view (see also Danzman 2019). Usually, inward foreign direct investment, be it merger and acquisition (M&A), greenfield investment or financial extension, does not win public attention. Some investments in well-known brands may attract media coverage, but most investment cases are conducted privately between companies. Due to reputational and economic concerns such as stock price fluctuation, most companies do not announce investment deals beforehand or make them public afterwards. Unlike a product with a stamp of "made in China" telling you where it comes from, corporate ownership is often complicated and enjoys information privacy right. It is also common that some "foreign investments" are in fact owned by a country's own nationalities who use foreign corporations as convenient covers for their investments in the domestic market.

The low salience of IFDI is coupled with high regulatory complexity, because this issue

[18] A FDI contract usually confines a certain time period within which the investors cannot resell the invested assets.

[19] Most literature on governmental regulation of IFDI discusses cross-border M&A, while other forms of FDI can also induce security concerns such as dependence on and technology transfer through joint ventures with foreign firms. Security review of Chinese FDIs in the U.S. is also extending to greenfield investment. Thus, in this dissertation, I do not use "M&A regulation" to replace the broader IFDI policy.

concerns not only entry, operation or promotion policy but also financial policy such as banking, taxation, exchange rate and other regulations over company ownership, land use, procurement policies and export balancing. Unlike trade, regulation of foreign capital is rather an esoteric issue that had to be designed by squabbling bands of arcane economists. Labor groups that protest against MNCs cannot expect immediate effects by one policy change such as tariff increase in trade policy. Foreign multinationals' greater resources and long-term perspective also make them less vulnerable to strikes or boycotts. "When issues are marked by low salience and high technical complexity, related political battles do not often occur through public debate and citizen group pressure on elected or responsive government officials. Instead, the consequential details of the policy are determined through bureaucratic and legislative committees" (cf. Danzman 2019: 79; Culpepper 2011:188). It is often only within the context of a surge of IFDI and media exposure of well-known brand investment that labor and mass groups earn attention to investment issues. Thus, the state in this policy area is presumed to have more autonomy vis-à-vis the society than in trade policy.

The most influential social actor in IFDI policy is domestic firms or their business groups, because the coming of foreign competitors directly influences the domestic market composition and the financing opportunities within a country. Domestic firms can be further divided into international-oriented firms that have business abroad and domestic-oriented firms that are not engaged in international business. Winners or supporters of an open IFID policy are usually those international competitive corporates who are afraid of retaliation in their host countries if the domestic market closes (Jenkins 1993: 103; Crystal 1998: 516f). International firms besieged by foreign competitors can also ask for government assistance in opening markets abroad, subsidizing them at home, or protecting them from foreign takeovers. State's pursuit of relative national gains driven by the political logic of globalization supports the domestic firms and business groups that also pursue or already own relative gains from the international market within their industries. These domestic firms need not to be large, but they are or aim to be the controllers of the global industrial regimes. However, globalization also generates losers within the domestic economy. Domestic-oriented firms that have trouble competing against imports and whose interests are not overseas can be hurt by the output of foreign subsidiaries and more worried about foreign competition in the domestic market. The influence of the domestic firms depends on the institutional structure within states, namely, whether they have formal or informal channels to translate their interests into policy (see Crystal 2003). Large MNCs, particularly those own close connections to government officials and the business insights of the costs and effects of FDI regulations may have a great deal of influence over policy outcomes. In the U.S., business groups are well organized and routinely consulted on economic and technical matters either through informal processes and lobbying efforts or through formalized tripartite negotiation principles. In China, large MNCs are usually state-owned enterprises that are subject to government entities and own organizational ties with the party-state. As Culpepper (2011: 188) rightly observes, "expertise and lobbying capacity" become the key power resources in a political process typified by "ongoing exchanges among interest group representatives and representatives of the state." Such "quiet politics" is thus well-suited to an institutionalist approach that focuses on the elite and class politics within state institutions (see Moore 1966; Skocpol 1975; Yashar 1997; Collier 1999; Mahoney 2000).

2.2 Path dependency and institutional change

This study focuses on the regulatory regimes for IFDIs and their related institutions in China and the U.S. (see Part III). Institutions are understood here as "distributional instruments laden with power implications" that induce particular kinds of behavior by constraining and by laying out a logic to the market and policy-making process (cf. Mahoney & Thelen 2010: 7f; Hall 1986; Skocpol 1995; Zysman 1994: 243). While formal institutions define "the rules of the game in a society" (North 1990: 3; see also Ikenberry 1994: 14), informal rules such as economic cultures, norms and traditions are communicated and enforced outside of "officially sanctioned channels" (Helmke & Levitsky 2004: 728; see also Tsai 2006). Regardless of which level and kind of institution – domestic or international, formal or informal – *its relationship structure should be what HI studies capture* (Yang 2005: 46). As such, institutions can also be conceived as arenas of conflict, as “regimes” in which both “rule-makers”, defined as the actors that “set and modify the formal rules that constitute an institutions”, and the “rule-takers” that are “expected to comply with such rules, struggle to adapt the institution to their needs and agendas” (cf. Streeck & Thelen 2005: 13). The historical institutionalist idea here is that state are not only *targets* of struggle, but also *sites* of struggle that “influence the formation of groups and the political capacities, ideas and demands of various sectors of society” (cf. Skopol 1985: 21). For IR studies, institutional analyses do not deny the broad structural influence on state behavior, but domestic institutions mediate structural influence, structure the domestic political battles and in doing so, influence their outcomes (Thelen & Steinmo 1992: 3).

Historical institutionalism have two conceptional tools that have made significant contributions to comparative politics, which also helped to comprehend (domestic) institutional change: path dependence and critical juncture. Path dependence is a central causal mechanism in HI to explain continuity and change of institutions and politics (see Thelen 1999; Pierson 2000; Farrell & Newman 2010). It means that preceding steps in a particular direction induce further movement in the same direction. Specifically, it is well captured by the idea of “increasing returns”, also described as “self-reinforcing” or “positive feedback processes” (Pierson 2000: 251). While Pierson points to “increasing returns” through four mechanisms – large set-up or fixed costs, learning effects, coordination effects and adaptive expectations – some scholars stress power implications of institutions and the “veto players” (Tsebelis 2002; Mahoney & Thelen 2010).

Institutionalist studies usually stress the “stickiness” of institutions. Especially in historical institutionalism, institutions are characterized by long periods of stasis and change only happens in response to a significant crisis or critical junctures (Ikenberry 1988: 223f). After establishment, they have “a life of their own” – they “outlive the constellations of interests that created them and hence provide barriers to market-driven policy change” (cf. Garrett & Lange 1996: 49; see also Goldstein 1993). Rational-choice model says that when game rules change, players will also adopt their choices and strategies because these rules structure the choices that will maximize the players' self-interest. This is a key premise in HI analysis as well. However, "historical institutionalists tend to see political actors not so much as all-knowing, rational maximizers, but more as rule-following 'satisficers' (ibid: 8). In other words, "people don't stop at every choice they make in their lives and think to themselves, 'now what will maximize my self-interest?'". They just rely on certain tracks (Ikenberry 1988; Thelen & Steinmo 1992; see also Fioretos 2011: 380). If choice is uncertain, actors tend to stick to the pattern that has generated increasing return.

While large-scale continuity can be found in the basic organizational features of state and society, long-term shifts in a country's international political and economic position, and the more narrow evolution in state institutions, can induce changes in the struggle over foreign economic policy (Ikenberry 1988: 222). The historical institutionalist approach gives special attention to critical junctures and the *politics* around institutional and policy change. In a Weberian terminology, a country's political institutions can also be called "tracks". Politics and society run on "tracks" that are laid down at critical moments in a country's history (Weber 1946: 280). Critical juncture, or "critical moment" in Weber's words, has been generally defined as "a period of significant change, which is hypothesized to produce distinctive legacies" (Collier & Collier 1991: 29). These critical moments can be conditioned by antecedent political and social-economic features, growing out of a fundamental societal or political cleavage, or triggered by a contingent event such as war and economic crisis (Collier & Munck 2017: 4f).[20] Politicians and administrators are continuously engaged in coping with socioeconomic challenges on track. At critical moments however, these challenges call into question existing rules of the game and the repertories of state action. Ideational contestations are especially apparent in this period.

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[20] In general, historical institutionalists agree on the view that a critical juncture is "(1) a major episode of institutional innovation, (2) occurring in distinct ways, (3) and generating an enduring legacy" (Collier & Munck 2017: 2). See Büthe & Jacobs 2017.

Institutions do change. As argued above, states can change domestic institutions to seek relative gains in the international market. In the rational choice paradigm, institutional changes are explained from the actors' perspective. Actors, or "agencies" in the literature, such as political coalitions, interest groups or key decision-makers, react to external changes and alter institutions. The institutional origin is an equilibrium made by actors with bounded rationality (see Yao 2008: 4). Because of the bounded rationality, there is a natural "gap" that exists from the start or emerge over time between the intended "design" of an institution and its on-the-ground implementation and effects. The institutional initiators cannot foresee future challenges in the long term where the original design may lose its efficiency, but certain adaptive rationality for agents enables it. Actors bear the adaptability to adjust the institutional structure to future challenges and reinterpret the original design (Pierson 2004). However, as scholars (Powell & Colyvas 2008: 277) note, "institutional theory gains little by making unleashed actors the drivers of institutional change". The goal of HI is to understand how rules provide actors with creative leeway. In this way, rules of a game are both constraining and empowering (see Sheingate 2010: 168).

One of the best examples is in the game of chess, where a fixed and clearly delineated set of rules gives rise to the different strategies of the players. "It is the multiplication of rules governing the movement of different pieces that gives chess its dynamic character when compared with a simple game like checkers (ibid: 169). Institutionalized rules, "by their very nature, often leave 'gaps' that actors can exploit in pursuit of their own interests and in their political struggles for advantage within existing constraints" (cf. Thelen 2010: 57, see also Pierson 2004). Only rules in which expected and actual behaviors correspond to each other will lead to the reproduction of individual beliefs (Greif & Laitin 2004: 638). In such case, it is often the *ambiguity* that provides a critical operation by actors for the creative interpretations and alternative ideas of rules – and the potential for fresh insights into how actors aminate the process of institutional development (Thelen 2010; Streeck & Thelen 2005). Faced with ambiguous rules, actors may find leeway to reinterpret them to promote institutional change. Endogenous institutional change can also occur through shifts in the social coalitions underlying an institutional arrangement (Mahoney & Thelen 2010). In particular, institutional power may influence the dynamics of social coalitions in favor or against institutional reform. Endogeneity is what makes HI different from rationalist and sociological institutionalism and what makes the idea that "history matters" different from a simple time-series notion of causality (see Rixen & Viola 2015: 307).

In the policy area of foreign direct investment which is featured with low political salience, or "quiet politics" in Culpepper's word, and highly technical rules, political entrepreneurs seeking institutional change will typically face higher collective action costs to gather sufficient support to renegotiate the existing institutional configuration (see Capoccia 2016: 1112). In such case, even though political entrepreneurs can force the rule-makers to put institutional reform on the agenda at critical junctures that happen upon a crisis or an external shock, the rule-makers can usually control the timing and the agenda of institutional reform. Incumbents of the regulatory institutions can respond to crisis in the short term by "gesturing" toward reform through various rhetorical expedients (see Hacker & Pierson 2014: 651), but delay action until the salience of reform among rule-takers is again low, at which point they can either adopt cosmetic changes that do not challenge the existing power configuration, or shelve reform together (Capoccia 2016: 1112). For instance, in his recent comparative analysis, Culpepper (2011) asked why public debates on corporate governance reform in advanced economies invariably led to the institutional outcome preferred by interest organizations of managers of large firms, "often against substantial political opposition" (ibid: 3). He found that politicians have incentives to delegate most formal rule-making to ad-hoc expert committees and working groups, which keep corporate governance reform off the political agenda, thus avoiding the attention of workers with pension income invested in companies. During exceptional moments, when reform captures the attention of rule-takers (due to a crisis, a scandal or to initiatives of political entrepreneurs), managers usually have the ability to control the timing of corporate governance reform and thus substantially limit the subsequent reform outcome. "Given the cyclical dynamics of issue salience among rule-takers, institutional configurations that give power-holders control over the timing of institutional reform place them in a very strong position to influence the shape, the sustainability, and even the possibility of reform coalitions, and to resist undesired institutional change" (cf. Capoccia 2016: 1114). As argued above, the highly technical nature of IFDI regulation can generate large information asymmetries between rule-maker and rule-takers, which leads to the assumption that bottom-up social changes in this area, such as altered power relations between domestic and international firms in a certain industrial sector, may be countered by the incumbent elites because they own the expertise and the power over the agenda of institutional reform. In such case, there may be gaps between social changes and institutional changes, showing institutional stickiness and path dependency.

III: Research design

1. A study of long-term institutional and policy change

The relative autonomy of the state vis-à-vis the society in the policy area of foreign investment varies from state to state. The phenomena that the lack of variation in the independent variable (globalization) has led to variation in the dependent variable (various policy outcomes across states) has long been the research focus in IPE. Already amid the increased "complex interdependence" between states in the 1970s – not yet its upgraded version of globalization – IR scholars recast their attentions to state power and state strength.[21] In Peter Katzenstein's seminal work *Between Power and Plenty: Foreign Economic Policies in Advanced Industrial States*, he and the co-authors traced the ways in which different institutional configurations shaped distinctive foreign economic interests, strategies and behaviors of six advanced capitalist states when faced with similar outer shocks such as the Oil Crisis in 1973 (Katzenstein 1978; see also Ikenberry 1986; Gourevitch 1986; Hall 1986). Under the pressure of international structural constrains, *states* do vary in their capability to act on their interests. The rapid economic development of East Asian countries also increased the attention to the benefits of a stronger state vis-à-vis the market and society, such as in Japan, South Korea and China (see Johnson 1982; Wade 1990; Shirk 1993, 1996; Evans 1995). A literature of "brining the state back in" in the mid-1980s recast scholarly attentions to the role of the state and its institutional arrangement in structuring domestic politics (see Evans et al. 1985). The state as an entity opposite to the society and market, and its institutional design, its legal precepts and its normative views serve the literature of Comparative Politics to explain particular policy options and outcomes (see Goldstein 1988: 185).

In the gains debate, Mastanduno also shows that variation existed among different industrial sectors in the U.S.-Japan economic relations in the late 1980s. The U.S.-Japan

[21] For a discussion of the difference between "interdependence" and "globalization, see the Keohane, Robert and Joseph Nye. 2000. Globalization: What Is New? What is Not? (And So What?)", *Foreign Policy* 118: 104-119.

cooperation had existed three industrial sectors, aircraft, satellites, and high-definition television, prior to the 1980s. At the time, the U.S. was not sensitive to relative gains concerns and in fact accepted or even encouraged patterns of interaction that worked to the relative economic advantage of Japan. Yet, by the latter half of the 1980s, policies associated with relative gains-seeking behavior were adopted differently in the three areas against a same international structural exchange – the diminishing threat of the Soviet Union (1991: 109). "Something was lost in the translation from international system to policy outcome. It is necessary to move from the international to the domestic level of analysis in order to account for that variation" (ibid: 109). In Mastanduno's study, institutions that confined who came to the negotiation table and what their missions were largely influenced the variation in the different industrial cases. Domestic arrangements themselves can change over time, thereby rendering more or less possibility to pursue relative gains.

In Comparative Politics, the states of the U.S. and China have been situated at the two poles of the spectrum of political-economic systems. The defining characteristic of a political system is the power of the state in relation to its own society. The power is based on the state capacity in terms of three aspects: 1) the capacity to formulate policy goals independent of particular groups within its own society; 2) to change the behavior of the specific groups, and 3) the capacity to change the structure of the society in which it operates (Krasner 1988: 644). The U.S. state was located at the pole of "weakness", for it is very difficult for American central decision-makers to change the behavior of non-state domestic actors (see also Wade 1990: 337). In contrast, the Chinese state before the economic opening in 1978 was located at the other extreme where the state is able to remake the society and culture, such as altering economic institutions, values and patterns of interaction among private groups. Even after 1978, the state has continuously played an essential role in regulating the market and is itself a major actor within the market through state-owned enterprises and other policy tools (see Howell 2006; Tsai & Naughton 2015). An entire dissertation devoted to the comparison of both states may seem a surprising enterprise. Comparing the state of the U.S. and China would be like comparing "apples with pears" in the German saying, or "apples with oranges" in the English idiom, indicating a false analogy between two items. The independent variable – globalization – naturally generates distinctive IFDI policies in the U.S. and China.

However, I argue that in understanding the role of the Chinese and the American state in economic globalization, the "weak" and "strong" assumptions of both states are inadequate for a long-term comparative analysis. A longitudinal research may justify a comparison between the Chinese and American states that have been sorted into completely different categories. The state and its institutional arrangement in this study not only have a "mediating role", but are themselves in change (Gourevitch 1978). The focus on institutional change and the historical logic that accounts for particular structural outcomes is the second and broader research agenda of the institutionalist approach that lies in the realm of historical institutionalism (HI) (Ikenberry 1988: 229-335). "Understanding the structures of state and society and the dynamics of change requires attention to phases of political and economic development. In these large scale processes of historical development, the basic characteristics of organizational structure emerge" (ibid: 229). The balance of power between different state agencies and social coalitions, the centralization and coherence of bureaucratic organizations and the resources and policy instruments available to executive officials are all aspects of prevailing organizational structures of state and society. A state-centered analysis thus must be grounded in the larger set of historical dynamics that undergird institutional structures and policymaking.

Moreover, the above-mentioned political logic of globalization – insecurity and competition – challenges the weak state" tradition in American political science. This study seeks to contribute to a new understanding of American state power that has emerged from recent studies of American political development (see Block 2008; Weiss 2014; Baltz 2017a). A central theme of this relatively youthful subfield of political science is the idea made famous by Charles Tilly that has been applied by other historical and sociologists that "war makes the state" (1975:42). "Applied to the modern era, this means that national responses to international problems like war and trade have transformed political institutions" (cf. Weiss 2014: 16).[22] This study employs a same logic and pays special attention to strategic sectors, in which the state in any countries, including the most liberal economies, tends to play an active role.

At the same time, the above-mentioned market logic and constraining effect of globalization also challenges the "strong state" tradition in Chinese political science and Comparative Politics. In the U.S. case, the country had already changed from a debtor to a creditor country after WWI, which indicates an tremendous increase of financial autonomy. Thanks to the European investments and (forced) technology transfer, the country also moved to the world' technology frontier in the early 20th century. In comparison, the time the People's Republic of China entered the international economy in the late 1900s was a very different one as the United States in the late 1800s. When the U.S. integrated into the international market in the late 19th century, there did not exist a strong bureaucracy. The founding fathers were primarily concerned with a strong federal government for the defense of the interests of the American people. The large internal market allowed the emergence of integrated business enterprises in the late 19th century to grow in the absence of large and capable state apparatus. Prior to the First World War, there was already a strong internationalist coalition composed by some politicians, bankers and large American enterprises, together with the military, who were prone for overseas expansion. At the time, there also did not exist an international regime such as the WTO that bundled states to follow certain cooperation norms. When China reopened its door and embraced the international market in 1978, the party-state had been well consolidated with a set of plan agencies, industrial ministries, a strong presence of state-owned enterprises and a strong socialist ideology that suppressed the development of private economy. Due to the then geopolitical structure, Western economic blockade and self-isolation, the Chinese state had to exact resources from the society to support industrial development. The almost one hundred years' time distance with the U.S.'

[22] Katznelson, Ira, and Martin Shefter. 2002. *Shaped by War and Trade. International Influences on American Political Development*. Princeton and Oxford: Princeton University Press.

engagement with globalization in the late 1900s fundamentally transformed the world's image. In 1978, an international economic order was well embedded in numerous international institutions and rules led by the GATT, IMF and World Bank. Unlike other "hegemonic cycles", China does not just face a hegemon, it faces a wider and deeper system, an order which is "unusually durable in the face of power shifts" (cf. Ikenberry 2019: 17). Latecomers that want to join the international market have to first adopt pre-existing standards and rules of the current international market (Drezner 2010: 794). Actors learned to use the rules, coordinate with others, and adapt their expectations according to the rules (Arthur 1994; David 1985; Pierson 2000). Given China's economic backwardness in the late 1970s, it had to follow the rules of the game and take what was available at the table, if it wanted to yield any gains from the international market. If strong states, such as France, had to give way due to international capital flight in the early 1980s (Garrett 1992), such constraints must hold a fortiori for less developed countries. As Hendrik Spruyt precisely points out (2013:582), "how much latitude states still have to pursue neo-mercantilist strategies and thus link economic development and state making, as late developing European states could (Gerschenkron 1962), is an ongoing matter of debate." Therefore, Gerschenkron's assumption of a strong state and active state interventions of late industrializers may have its limitations when applied to the Chinese case who arrived the international market at a very late time. Like the U.S., China's geography bestows upon the Chinese state certain advantages and disadvantages to and links with the global economy. Its huge domestic market is attractive to foreign investors to sell to and invest in, but it also enables domestic firms to exploit significant production economics of scale just by selling at home. With its economic opening, China is in a good position to implement developmental state-type industry policies and selectively adopt features and neo-liberal economic policy to engage with the global economy on terms of its own choosing. However, its market liberalization, physical size and large population have also enabled its sub-national governments to enjoy a large degree of autonomy from the center throughout its long history and this has posed enormous challenges to the central government and the implementation of strategic industry policy (Liew 2005: 334; see also Wang 1991; Zhu 2017). The Chinese state had to transform itself and be resilient at the same time in the face of a set of international rules and norms. Therefore, the significantly different sequences of industrialization and integration into the international market between China and the U.S. may generate pressures for convergence over time.

2. Locating the institutions and actors of this study

IFDI policy in this dissertation refers to the regulatory policy regarding the specific amount and content of investment projects. Citing from Steven Vogel (1996: 3), "while a liberal policy allows competition and a decisive role of market, regulation is defined as the formulation and creation of rules to achieve state goals." IFDI regulatory statutes are multifaceted and encompass a diverse set of rules regarding equity restrictions, screening requirements, licensing laws, legal provisions regarding profit repatriation, export balancing requirements and so on. Depending on the specific sector, location, size and investment content, the legal framework for any particular investment can touch on a wide range of laws, regulations and other policy determinants. Regulations can be broadly classified into three categories: 1) entry and establishment; 2) treatment and operation; 3) promotion and facilitation (Danzman 2019: 6) . In terms of protecting national security and national industrial competitiveness, states regulate FDI in the first place by limiting their entry and establishment. In the Chinese case, since the policy goal was more about promoting IFDI, regulatory policy also covers the second and third category. In this dissertation, I do not study the technical and operational terms of IFDI policy, but concentrate on the political goals and tenets of the IFDI policy.

Entry and establishment rules further consist of three layers[23]: First, flat prohibition on alien ownership in select industrial sectors such as aviation, communication, nuclear energy, shipping, or sanction measures against adversarial countries. Such regulations are to prevent these defense-related sectors from external interference. Foreign investors usually voluntarily avoid investing in sensitive industrial sectors which they might

[23] This categorization is made by the author herself based on the broad literature of FDI entry regulations. For similar but not identical categorization, see Danzman 2019:30-61; Wehrlé & Pohl 2016: 13f.

encounter restrictions; Second, a screening mechanism that permits FDI only when such investment is not contrary to national (security and economic) interests, such as the Committee on Foreign Investment in the United States (CFIUS) which owns discretion in judging the implications of certain foreign ownership on national interests; Third, regulative policy such as anti-monopoly laws, patent right, worker safety and environmental regulations, which usually concerns the issuance of licenses for business operations and has its standalone economic and public policy justification for playing a role in investment regulation. The first and third layers are usually long-term regulations decoupled from short-term decision makings and also apply to national firms. Active governmental intervention in FDI deals rather takes place on the second layer. The "screening mechanism" that reviews and approves IFDI is the regulatory institution studied in this dissertation. In the review and approval process, the state has its discretion to decide the economic and security implications of IFDI and can use the security argument to prevent foreign investment in even the most benign of sectors. Even when industrial sectors and procedures for investment review are determined by law, there are contingencies that are inevitably unforeseen by the law and the law cannot spell out the rules and procedures to be followed in every conceivable circumstance in precise detail. This is especially true for assessing the economic effects of the investments in question. The responsibility on the form of conduct thus falls on the shoulders of law enforcers, usually administrative agencies in economic and security field, which enjoy wide discretion in assessing effects of specific deals.

In most countries, a regulatory regime and regulations first stem from the national legal code, which is promulgated through a government's legislative body. Investment or Company Laws provide the legal basis on which a government's regulatory authority rests, while regulations of IFDI for national security reasons also stem from additional defense laws. While these laws provide the basic contours of FDI regulation, executive branch agencies often retain a great deal of autonomy in interpreting, reviewing and adjusting final details (ibid: 42). In the Chinese case, specific regulatory measures are rather in the form of administrative "rules", "circulars" or "provisions" than national statutes. In the U.S. case, executive orders also served to complement national statutes for specific operational terms.

The basic conundrums of American foreign economic policy is that the legislative (i.e. committees and subcommittees with interests related to foreign economic policies) and Executive each with a constitutional claim of jurisdiction over international economic affairs. Congress has the constitutional power to "regulate Commerce with foreign Nations and among the several States."[24] In terms of foreign investment issues, the Senate Committee on Banking, Housing and Urban Affairs, and Committee on Commerce, Science and Transportation, as well as the House Committee on Energy and Commerce, and on Financial Services are usually where legislations about foreign investment are introduced and debated. In the specific realm of regulating foreign assets, the Trade with the Enemy Act (TWEA) of 1917 created the statutory bases permitting the President to declare a state of emergency and make use of delegated powers from Congress to exercise control over private international economic transactions with adversaries. It set the tradition to put the President and the Treasury Department in charge of assessing and securing the national security implications of international economic exchange in national emergency, which exempts from judicial review (Berg 2018). In 1977, the TWEA was amended as the International Economic Emergency Power. Besides the presidential power of making economic sanctions, the Committee on Foreign Investment in the United States (CFIUS) is at the heart of the U.S. regulatory apparatus governing IFDI in the U.S. Members of CFIUS are thus also the most important agencies that set the U.S. IFDI policy. By Executive order 11858 in accordance with Section 721 of the Defense Production Act of 1950, President Ford created the Committee on May 8, 1975. In its original design, the Committee consisted of six members: the Secretaries of the Treasury, the State, Defense, Commerce and the Assistant to the President for Economic Affairs and the Executive Director of the Council on International Economic Policy. Since 1975, the membership, mandate and procedures of CFIUS have changed

[24] U.S. Constitution, Art.I, §8, cl.3.

through four major legislations, the Exon-Florio Amendment of 1988, the Byrd Amendment of 1992, Foreign Investment and National Security Act of 2007 and the Foreign Investment Risk Review Modernization Act of 2018. Along with several executive orders, these legislations expanded CFIUS' membership and provisions.

I observe two pairs or levels of relationship within the institutional arrangement of CFIUS in Part IV: The first micro-level relationship considers the interagency relationship between different CFIUS administrative agencies.[25] At the micro-level, specific operational rules are made to regulate IFDI. The second level of institution is at the meso-level concerning the power relationship between the Executive and Congress (i.e. committees and subcommittees with interests related to foreign economic policies). The Congress-Executive relationship decides whether foreign economic policy is influenced by "politicized sites" such as Congress, or outcome of centralized decision-making process of the bureaucratic sites. The micro-level rules are embedded in and reflect the broader *state-market relationship* and the economic culture at the macro-level which is deemed to be more stable in historical institutionalism. The economic culture legitimizes the role of the state in the market, including its role towards foreign investors.[26] As Thelen (1999: 384) argues, "institutional arrangements cannot be understood in isolation from the political and social setting in which they are embedded." Agencies operate both within the micro-level rules and the wider context of state-market relations.

In contrast to the U.S. case, there is not a separate regulatory regime as CFIUS in China, of which the institutional origin and changes can be observed along a clear timeline. An inter-agency committee reviewing the national security implications of IFDI was preliminarily established in 2011, has yet not become a governmental agency with its own jurisdiction. The regime locates the State Council at the head of decision-making and put

[25] In many ways, the political origin of CFIUS resembles that of the guarding institutions in the trade policy arena – the Office of the U.S. Trade Representatives (USTR): "both are institutional products of the attempt Congress to recapture the power to regulate foreign commerce that it ceded to the White House during the Great Depressions and World War II" (cf. Kang 2003: 170).
[26] This trichotomy is inspired by Li Wei's model of analyzing the institutions in American foreign economic policy, see Li 2010: 87f.

the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) as the lead agencies for national security review.[27] In fact, this interagency committee is only something new in its name and bears a more clear mission of reviewing national security implications of IFDI. The major review, approval and administrative duties still lie on the shoulder of the NDRC and MOFCOM (and their predecessors before 2003), as well as their local offices. Before the 2019 Foreign Investment Law, there were three primary foreign investment-related laws (waizi sanfa) implemented by the National People's Congress, which the local and central governments relied on to regulate foreign ownership: the Chinese-Foreign Equity Joint Venture Law in 1979, the Chinese-Foreign Cooperative Joint Venture Law in 1986 and the Wholly Foreign-Owned Enterprise Law in 1988. In the three laws, the National People's Congress delegated the power of regulating foreign investments to "the ministries in charge of foreign economic affairs or agencies authorized by the state council".[28] As I will introduce more in detail in Part V, the regulatory agencies mainly refer to the NDRC, MOFCOM and their local offices. In 2003, China's first "Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" also designed MOFCOM as the principle approval authority. Depending on the specific industrial sector and the deal size concerning the transaction, NDRC and MOFCOM will consult with multiple agencies on approvals of major investment projects. The Ministry of Industry and Information Technology (MIIT), for instance, is not granted by law as regulatory bodies, but de facto exercise authorities in the regulatory regime concerning the automobile and telecommunications industry from its establishment in 2008. Since the administrative reform in 2003, the State Asset Supervision and Administrative Commission (SASAC) and its local offices also step into the regulatory regime for supervising mergers and acquisitions of state-owned enterprises (SOEs) and their business unites. These "super agencies" (NDRC, MIIT, SASAC) justify their involvement in regulatory activities as

[27] As discussed below in Part V, the Foreign Investment Law passed in March 2019 did not codify a statutory national security review regime for FDI.
[28] MOFCOM's predecessor is the Ministry of Foreign Trade and Economic Cooperation, which incorporated the former State Economic and Trade Commission and the State Development Planning Commission(within the State Council) into MOFCOM in 2003.

they retain ultimate responsibility for overall economic performance of the economy and of its most strategic sectors. They are the source of policy goals that must be implemented by other regulators – a function that in Western economies is often served by national legislatures (see Pearson 2015: 38).

I also observe the evolution of China's regulatory regime in two pairs of relationships: The first micro-level relationship concerns the inter-agency relationship within the executive branch such as between MOFCOM, NDRC, and other specific ministries concerning the IFDI-related industry. The administrative reforms of 1993, 1998, 2003, and 2008 have restructured these ministries; The second relationship at the meso-level concerns the relationship between the central and local governmental agencies. It is important to note that the local government is both a nominal agent of the central government and an independent and competitive actor in its own right (Wang 1991: 11). For the large society and local population in China, the local government is a part of the state representing public authorities. But for the central government, the local government could be infected with dangerous "localism" threatening the whole state structure. As Wang Shaoguang points out (1991: 10f), "it is obviously wrong either to reduce the local government simply to an outpost of the central government, or to treat it as the mouthpiece of local societal interests." The duality of local and central government has been regarded as the most salient aspect of governmentality and path dependencies connecting past and present in China (Herrmann-Pillath 2017: 533; Yao 2008). It decides the capacity of the central government to realize its policy objectives. The Chinese IFDI regulatory regime has been continuously decentralized through administrative "rules", "circulars" or "provisions" since 1978, granting the local agencies with more autonomy (see also Oi 1992; Yao 2008; Xu 2011). Parallel to the U.S case, the interagency and central-local relationships are also embedded in and reflect the macro-level state-market relationship and the economic culture in China.

3. Tracing institutional change

3.1 Comparative historical analysis

This dissertation is a comparative historical analysis of the regulatory regimes of the U.S. and China towards inward foreign direct investment. I first put the institutional origin in the 1970s in both countries in the broader historical context, which set the historical sociology and determined the ideational context of setting up the new institutions. In this sense, the institutional origin in the 1970s is a dependent variable of the former historical process. After establishment, it itself becomes the independent variable that determines the institutional paths afterwards. A process is path dependent if initial moves in one direction elicit further moves in that direction (Pierson 2000, 2004, Rixen & Viola 2015). In the face of international or domestic crises – at critical junctures as discussed below – the state structure serves as the intervening variable that filters and mediates the structural effects.

Since the 1970s, specific historical events (mini cases) that opened windows of opportunity for institutional change and led to critical junctures will be closely analyzed. At critical junctures, there are alternative paths to choose in addition to the original one (see Bennett & Elman 2006: 252). Critical junctures are the moments when major decisions that have distinct consequences are made and can be made, no matter if institutional change follows or not (Büthe & Jacobs 2017). The independent variable (the state structure) then becomes a dependent variable of the critical juncture(s). In order to understand institutional changes and the accompanied path dependency after the critical junctures, I identify the main decision makers and the dynamic of their interaction, and endeavor to reconstruct which institutional alternatives were politically viable at the time. The mini cases in Part IV and V serve to empirically illustrate the political practices within dominant patterns. A first critical juncture marks the begin of a path and the reinforcement of certain distributional mechanisms. Ideational contestations are especially apparent in this period. Once the institutions are established and ideational contestations are pacified, as Pierson argues, "the dead weight of previous institutional choices seriously limits room for maneuver." As the comparative cases will show, critical junctures in the early design of the regulatory regimes in the 1970s left a long shadow over the later institutional development in the U.S. and China. This is not saying that institutions and the embedded power relationships do not change. Historical legacies only constrain institutional change, when the power structure within the institutions is repeatedly reproduced, but cannot impede it.

This research project proceeded through a combination of induction and deduction. The deductive part was very thin. I only assumed in line with an institutionalist approach in the scholarship of comparative foreign economic policy that the institutional structure within a state determines policy preferences and outcomes (Katzenstein 1978). Accordingly, policy change may be traceable to institutional change. As Ikenberry (1988: 220) note, "an understanding of how [the] social and international forces are transmitted and mediated within the black box of government is particularly important when analysis are investigating small numbers of policy choices in a single country." Tracing the evolution of the regulatory institutions and the IFDI policy in China was a inductive work for me. As Bennett & Checkel (2016: 17f) noted, there is often a phase of "soaking and poking" when the investigator has little prior knowledge of the case or when the case is de facto much more complex than as theory presumes. "Here, one immerses oneself in the details of the case and tried out proto-hypotheses that may either quickly prove to be dead ends or become plausible and worthy of more rigorous texting" (ibid). "Soaking" in a complex historical process can be a very frustrating process, yet the approach is not an inappropriate one for historical institutionalist studies.

HI is neither a hard theory with testable hypotheses, nor a methodology with procedural guidelines, "it is best understood as an approach to studying politics" (Steinmo 2008: 150). "This approach is distinguished from other social science approaches by its attention to real world empirical questions, its historical orientation and its attention to the ways in which institutions structure and shape political behavior and outcomes" (ibid.).

In Theda Skocpol's seminal work of HI, *States and Social Revolutions (1979)*,[29] rather than assume that class structure or elite power would explain different patterns, she did the hard work of examining the actual revolution paths in France, China and Russia, placing them in their comparative and historical contexts. Eventually, she realized that the structure of state institutions in the pre-revolutionary period had enormous consequences for revolutionary outcomes. "In hindsight, this may seem obvious, but at the time it was a revelation to many (especially American) social scientists that the state mattered" (Steinmo 2008: 150).[30] Comparative politics was largely made up of detailed studies of particular countries. Therefore, instead of pre-setting any variables and causal chains, this study mainly proceeded in an inductive way.

3.2 Factors for institutional change

For a liberal market economy like the U.S., in which the market is generally open towards foreign investors, institutional change is rather caused by external factors. A surge of IFDI often concerts with dramatic currency devaluation and economic distress in certain sectors. Financial incentives were thus powerful and uncertainty surrounded possible political options for dealing with foreign competition. Foreigners' growing presence in national industries steeped in national and political symbolism can be an emotionally wrenching experience. Mergers and acquisitions of national champions deemed vital in their respective industries can arouse high publicity and trigger state intervention. Moreover, elite politicians, economic experts and representatives of MNCs that have information and the expertise in capital management, industrial knowledge, corporate laws etc. can also initiate and influence policy change.

In the Chinese case, institutional change is not only caused by international events but also by elite-led domestic reforms, which preceded China's engagement with globalization. This generates difficulties to figure out the determining critical junctures.

[29] This book was her dissertation, to which she devoted nine years!

[30] The rapid economic development of some East Asian countries also increased the attention to the role of the state vis-à-vis the market and society, such as in Japan, South Korea, and China (see Johnson 1982; Wade 1990; Shirk 1993, 1996; Evans 1995).

In terms of IFDI policy, as I will describe in the empirical part, changes in the interagency relationship have been mainly punctuated by domestic administrative reforms in 1993, 1998, 2003, and 2008. The threshold of central-local approval authority for investment projects has also been adjusted every 4-5 years without major external pressures, which makes the identification of clear critical junctures very difficult.

In contrast to the U.S. case, major policy decisions are made not only by state agencies and the legislative, but also within the party. As quoted from Zhao Shiping (1997: 13), "the Party is in the state institutions, but it is also above and around the state institutions." In such a system, change comes primarily from the top party leaders. The top political leadership is embodied in the Chinese Communist Party's (CCP's) Political Bureau (Politburo), consisting of twenty to thirty members, who serve as top personnel for the party, government and military apparatus and determine general programs and major policies. Ultimate decision-making power rests with the Politburo's Standing Committee (PSC), a smaller group of less than ten leaders headed by the party's secretary general. The running of the party-state is divided into major functional sectors, each supervised by a Central Leading Group (CLG) headed by paramount Party-Secretary and led by two other SPC members. The CLG consists of the leading members of the ministerial-ranking government, party and military agencies. In particular, foreign investment affairs fall within the decision realm of the CLG on Financial and Economic Affairs (zhongyang caijing lingdao xiaozu), which also include leaders of the "superagencies". The CLGs are the key institutions that bridge political elites to the country's vast bureaucratic networks, acting as a forum for the political leadership to meet with top bureaucrats. According to interviewees, NDRC and MOFCOM are the lead agencies who provide policy suggestions and initiate foreign investment-related regulations and laws. Therefore, I will pay close attention to the elite and bureaucratic conflicts at critical junctures.

3.3 Indicators to capture institutional change

The theoretical-analytical framework of this study is the "historical institutional" idea that states are not only *targets* of struggle, but also *sites* of struggle that "influence the formation of groups and the political capacities, ideas, and demands of various sectors of society" (Skocpol 1985: 21). "Institutional structures refer both to the organization characteristics of groups and to the rules and norms that guide the relationships between actors" (cf. Ikenberry 1988: 223). To trace institutional change means first to trace the continuity and change of the above-mentioned two pairs of relationship: The micro-level interagency relationship and the meso-level Congress-White House relationship in the U.S. case; the micro-level interagency relationship and meso-level relationship between the central and local government in the Chinese case. Moreover, in this study, I also analyze and assess the *state capacity* to regulate IFDI, to change the behavior or oppose the demands of domestic and international firms in order to prevent or promote the transfer of critical technologies. Again, I stress here that there is no reason to stick to the label of "strong" or "weak" state when making a long-term historical comparison between the Chinese and U.S. state in a same policy field. "Tracing institutional, ideological and organizational patterns over long stretches of time allow us to avoid being mesmerized by event-driven zigs and zags" (cf. Pierson & Skocpol 2007: 6). This dissertation sets out the goal to understand the structural tendencies and emerging processes of the U.S. and Chinese state and foreign economic policies.

In understanding the regulatory regime for FDI, I trace not only the relational change within the institutions, but also the state capacity. State capacity is "the ability of states to assert control over political outcomes" (Ikenberry 1986: 133), or in Michael Mann's words, the "infrastructural power". I observe five aspects of the IFDI regulatory regimes, which were both inspired by the literature (ibid; Mann 1984) and summarized upon empirical observations. They offer the "instruments" upon which the central decision-makers can coerce and extract foreign capital for the purpose of defending or promoting national industrial competitiveness.

First, "monitoring capacity" – whether there are agencies staffed by competent career officials that own reliable information and have expertise in inward foreign investments; Second, a lead agency with strategic orientation and discretion. Agencies that carry the considerations of national power and national security in making decisions about investment deals contrast with less captured *regulatory* agencies that are oriented more toward upholding a process and less toward generating specific outcomes; Third, well-defined authority and operation areas. State intervention cannot happen in every foreign investments. To reach strategic goals such as obtaining economic advantage or protecting national security, the state must have prioritized operation areas and well-defined operation procedures that increase intervention efficiency; Fourth, coherence of the bureaucracy. The strategic agency in lead needs supports of other agencies to implement strategic policies; Fifth, institutional linkage with domestic firms and business organizations – whether there are formal or informal channels for the social interest groups to articulate their interests. When such linkages are formalized and frequent, as well as a negotiation process to establishment and executive goals, a highly effective form of infrastructural power is achieved. These factors are used in this study to investigate and assess the power of the states in both countries over domestic or transnational nonstate actors, especially economically dominant ones such as the MNCs (see also Skocpol 1985: 19).

4. Data and literature review

For traceable FDI data after the 1970s, this study relies on statistics published by governmental authorities.[31] The U.S. Bureau of Economic Analysis (BEA) conducts an annual survey of U.S.-based MNCs or their facilities, looking at a wide range of financial and production activities. Firms are legally required to participate in the survey. In China, the National Bureau of Statistics (NBS) and Ministry of Commerce (MOFCOM) are

[31] Data on foreign investment is difficult to seize precisely in practice. Nobody knows the full extent of foreign investment from a country, because much of it comes across borders with anonymity. An enterprise's shareholder abroad can be owned by another shareholder in another country and there is often an ownership chain locating in several countries behind an enterprise. For instance, due to lower taxes and loose policy environment, many enterprises are registered in Cayman or Cyprus, whereas the true owners are sitting far away in Israel. Lax reporting requirements, hidden ownerships, and other circumventions of the laws have made it virtually impossible to keep track of the flood of foreign money. Another difficulty in analyzing the investment data is that there is much confidential microdata on the firm level which are only owned by the firms themselves or governmental institutions. A regional investment grant can be negotiated privately with a firm, and portrayed as "purely domestic policy" for local economic development (see also Bergsten 1974: 150). Thus, as long as the host country does not own an overall policy transparency regarding their treatment of MNCs, precise figures of IFDI and OFDI are very difficult to get.

responsible for the calculation of IFDI-related statistics and publication of reports.[32] The historical data such as the IFDI inflows prior to WWI was gleaned from research papers and publications by scholars, as well as policy and business analysts. The figures of the Sino-U.S. investment are collected from a professional research institute – the Rhodium Group – that monitors the annual bilateral investment flows since 2011. The China Investment Monitor was commissioned and supported by the National Committee on US-China Relations in the U.S. and serves to be the major database for tracking the bilateral investments. The United National Conference on Trade and Development publishes annual world investment report that serves to be a reliable additional source for FDI statistics.

The comparative historical study in Part IV and Part V of the dissertation was based on both primary and secondary sources. Primary sources about the political debates in the U.S. part include transcripts of congressional hearings and floor debates, government reports and studies.[33] Fortunately, many of these sources are accessible in digital or published form. For those sources that are not accessible outside the U.S., secondary literature on the historical development of CFIUS provided invaluable insights (see the specific citations in Part IV). The legislative history and legal implications of CFIUS's establishment and reform have also been closely documented by members of the legal profession, many of whom have hitched their career specialties to this organization, such as Niehuss (1975), Alvarez (1989), Zaring (2009). For studying the Chinese institutional history, the materials about elite conflicts, bureaucratic bargaining, corporate interests and lobbying efforts were not as available as in the U.S. case. Therefore, the empirical part about critical junctures and political struggles in China is relatively thin compared to the U.S. case and relies on factional research. Nonetheless, signs of stress in the leadership and institutional change can be captured if one pays close attention to the variants in official formulae of public news, which usually spearheads an open rift within the

[32] The State Administration of Foreign Exchange (SAFE) is responsible for the data collection of financial investments and reports the statistics to MOFCOM.

[33] Some important archival data in the U.S. National Archives at College Park of Maryland that I planned to visit could unfortunately not be obtained due to visa barriers.

leadership and the change of personnel at the apex of Chinese power (see also Dickson 2010: 33). Compared with the investigation and review data published by CFIUS, overall statistics of annul investigated or refused FDI transactions are not made available by Chinese authorities. Only some high-profile transactions have been broadcasted by the media. In December 2019, NDRC made for the first time an official notification that the acquisition deal of Yonghui Retail is under national security investigation. Chinese analyses tend to reiterate multiple rationales including efficiency, new and improved functions, cost-cutting, enhanced morale, and political benefits (Lin 2007: 321). Western explanations for the causes of bureaucratic change in China typically uphold the primacy of elite factionalism. This study keeps an open mind toward these possible motivations and the Chinese case will focus on the *empirical* institutional changes that have been made to address the essential functional tasks of formulating and implementing IFDI policies and address social contentions over power and resource redistribution. Besides, I profited a lot from conversations with Chinese scholars and officials who have been involved in the institutional reform process. I interviewed two local officials working at the bureau of commerce at the provincial level and one official form the National Reform and Development Commission who have been engaged in China's foreign investment reviews and approvals. They largely helped me to understand the different roles of the involved agencies in China's IFDI policy. All with more than five years' working experience in this area, they provided me precious insights of the review and approval criteria, and answered my questions on the central-local relationship in this policy area.

This work lies at the interstices of Comparative Political Economy (CPE) and International Relations (IR). In the realm of theory, this work contributes to the literature on the nexus between economies and security. Despite a long standing recognition among scholars of the importance of the relationship between economics and national security, relatively little work has focused on the micro-foundations of how states might utilize and regulate the interstate economic interaction carried out by transnational economic actors to further their strategic goals. Some IPE scholars have pointed out that the subfields of security studies in IR and IPE studies have been separated into two distinctive research fields. As Mastanduno (1998) notes, the minimal likelihood of security threats among advanced western economies during the Cold War may partly explain the relatively isolated history of development of the distinct subfields of security studies and IPE. The debate of relative gains-seeking in the 1980s and early 1990s offers a theoretical understanding of the exercise of economic power in pursing strategic goals. Just as military tools may be used to achieve strategic national objectives, economic tools may also be used. However, as discussed above, the debate petered out in the 1990s without a deeper reflection on how states seek relative gains in the context of economic globalization.[34] This study pays special attention to the domestic institutional change for regulating direct foreign investors that works as one of the most effective ways of pursuing strategic foreign economic policies and protecting national security in the context of economic globalization. Moreover, from an empirical perspective, studies of China's and the U.S.'s manipulation of economic policies for strategic goals have concentrated on trade, sanction and monetary policies.[35] Notable examples concerning the American government's manipulation of MNCs for foreign policy goals include Robert Gilpin's (1975) *U.S. Power and the Multinational Corporation* and Stephen Krasner's (1978b) *Defending the National Interest: Raw Materials Investment and U.S. Foreign Policy.* Regarding the China case, William Norris's (2016) work *Chinese Economic Statecraft: Commercial Actors, Grand Strategy, and State Control* provides an excellent study of how the government has utilized Chinese MNCs and outward investments to realize strategic goals in its relations with Taiwan. With the roll-out of China's Belt and Road Initiative, a new literature on China's foreign economic policy has emerged, paying special attention to China's outward investment strategy towards

[34] State manipulation of international economic activities for strategic purposes has been described by some scholars as "economic statecraft" (see Baldwin 1985). Economic statecraft featured prominently in the literature on American post-WWII containment strategy (e.g. Marshall Plan, Bretton Woods, economic sanctions and the proliferation of American MNCs).

[35] See examples such as David A. Baldwin. 1985. *Economic Statecraft.* Princeton: Princeton University Press; Mastanduno, Michael. 1988. "Trade as a Strategic Weapon: American and Alliance Export Control Policy in the Early Postwar Period." *International Organization* 42 (1):121-150; Kirshner, Jonathan. 2006. *Currency and Coercion: The Political Economy of International Monetary Power*. Princeton: Princeton University Press; Li, Wei. 2017. *Struggle for Institutions: Sino-U.S. Relations in the Era of Strategic Competition (制度之战：战略竞争时代的中美关系).* Beijing: Social Sciences Academic Press.

developing countries.[36] While these works all stress the "going out-strategy" of the states, the inward perspective of regulating foreign capital and MNCs has been rarely studied.

In terms of the IFDI policy of the U.S., many social scientists and legal professionals have offered thorough analyses of the institutionalization process of CFIUS and the political struggles thereof. This study profited a lot from the literature of Matthew Baltz (2017a, 2017b, 2019) who conducted a very thorough research of CFIUS' establishment and institutionalization in the 1970s and 1980s based on newly unclassified documents. However, Baltz' study does not cover CFIUS' institutional changes in 2007 and 2018 as this study does. Very scarce scholarly attention has been given to the broader historical context of the U.S.'s IFDI policy prior to WWI and to the longer-term capacity change of the American state in regulating foreign investors. Graham & Marchick's (2006) analysis of national security and state interventions in IFDIs in the U.S. covers the period of WWI but concentrates on the macro-economic implications of foreign investment, lacking an institutional focus. In comparison to the present literature, this study shows its strength in providing a casual explanation of the U.S. IFDI policy with an institutional approach and in drawing a holistic historical picture of the U.S. regulatory regime for IFDI.

The literature on Chinese IFDI policy has been concentrated on the state's pragmatic approach in this issue area and the discussion of the macroeconomic implications of IFDI on China's economy (e.g. Wang 2000; Huang 2003; Yin 2006; Hsueh 2011; Chen 2018). While a large number of literature has emerged on China's trade and monetary policy and their institutional foundations, I found very few studies on the institutional contours of China's IFDI policy from the 1970s to present. In this aspect, this study may be one of the first to provide a long-term institutional analysis of China's IFDI policy. Many legal professions have compared the American and Chinese national security review (NSR) regimes on IFDI (e.g. Li X. 2016; Li & Bian 2016). Yet the NSR regime in China is only

[36] Goh, Evelyn 2016. *Rising China's Influence in Developing Asia*. Oxford: Oxford University Press; Wong, Audrye. 2019. "China's Economic Statecraft under Xi Jinping". The Brookings Institution: https://www.brookings.edu/articles/chinas-economic-statecraft-under-xi-jinping/.

a tip of the iceberg of state interventions in IFDI and regulations. A regulatory regime for IFDI has existed in China since 1979 to serve political goals. Last but not at least, this study also contributes to the Sino-U.S. competition literature by providing analyses of the two countries' recent investment conflicts that have been neglected in the "trade-war" narratives.

IV: CFIUS and relative-gains seeking from IFDI in the United States

The start with dyestuffs and the Trading with the Enemy Act

1. Developmentalism behind a liberal façade in the 19th century

America's need of foreign capital came from two expensive things in the late 18th century – war and nation-building. During the Independence War, the Thirteen Colonies relied on the money borrowed from French and Dutch bankers and wealthy merchants to finance the war and the economic construction in the aftermath (Wilkins 1991: 18). For the founding fathers, developing the West was a more important task than integrating into the international economy. Until the late 18th century, the frontier was sparsely populated and the plantation economy in the South played the most important role in the nation's economy. Loans from European bankers were crucial in the westward expansion of the railroads and land purchases (see also Tolchin & Tolchin 1989: 267). Large public utilities and retail corporations looked to foreign private firms or individuals in Europe to borrow needed capital (Wilkin 1991: 11).

Alexander Hamilton's famous Report on the Subject of Manufactures issued in December 1791 was one of the first governmental statements on the U.S.' economic policy that cast a long shadow over the U.S.' foreign trade and investment policy (Irwin 2004; Seitzinger 2013). His proposals, of which many were implemented in the country's early economic policy, showed a very open attitude towards foreign capital than foreign goods. Among others, Hamilton proposed to impose high tariff on the infant industry,[37] supported federal subsidies to manufacturers, government assistance for the immigration of skilled workers, as well as welcome of foreign capital. As the first Secretary of the Treasury, Hamilton aimed at promoting manufacturing through public finances and foreign loans. He wrote in the Report (1791):

Foreign capital ought to be considered as a most valuable auxiliary; conducing to put in

[37] Import tariff in late 18th century reached 50%, when British and other European countries in the first Industrial Revolution were far advanced in terms of productivity and organization.

motion a greater quantity of productive labor, and a greater portion of useful enterprise than could exist without it. It is at least evident, that in a country situated like the United States, with an infinite fund of resources yet to be unfolded, every farthing of foreign capital, which is laid out in internal ameliorations, and in industrious establishments of a permanent nature, is a precious acquisition.[38]

Most of Hamilton's economic policy proposals were implemented in the later Jefferson and Madison administrations, including building a federal treasury to pay off the debt that the states had incurred to finance the Independence War (Irwin 2004). Fruit of the federal intervention was a good credit of the federal government, which allowed the Jefferson administration to borrow from Europe to finance the Louisiana Purchase in 1803. The founding fathers recognized the benefits of foreign capital and created an environment that assured its future welcome (Tolchin & Tolchin 1989: 265). Government debts were granted to European creditors to finance the construction of large public utilities such as railroads and canals. By 1828, the Britain held 25% of the entire U.S. debt and in the 1830s the majority of the nation's cotton plantations were mortgaged to British investors (ibid). Innovations in the textiles industry was mainly European in origin (Buckley & Roberts 1982: 30). It is estimated that by the mid-19th century, foreigners owned half of federal and state debts and one-quarter of municipal debts (Wilkins 1989: 144). While tariff policy in the 19th century's America was very vulnerable to sectoral and party conflicts between the Northern industrial areas and the Southern plantation economy,[39]

[38] Hamilton, Alexander. 1791. *The Report on the Subject of Manufactures*, December 5, 1791: https://founders.archives.gov/documents/Hamilton/01-10-02-0001-0007.

[39] The constitution granted primary responsibility of tariff setting to the House of Representatives in the Commerce Clause of the Constitution of 1787. Article 1, section 8, assigns Congress exclusive jurisdiction over all foreign commerce, including tariff levies on such commerce. (see Goldstein & Gulotty 2016). Tariff setting was tightly held in the hand of Congress and not regarded as a proper sphere of government intervention until the late 1800s (Lake 1983; Goldstein & Gulotty 2016). The political debate on tariff and the power contestation on tariff setting went more than a century long since America's independence. Tariff policy in 19th century's America resulted from sectoral and party conflict between the country's Northern and the Southern part. Despite the "Great Tariff Debate" in the presidential election of 1888, tariff reform failed to pass in the face of protectionist opposition in the Senate. The Northern manufacturers, associated with the Republican Party, sought access to markets in less-developed area of the world while also protecting American manufactures against competition from other developed nations. The other coalition in the South, associated with agricultural interests and the Democratic Party, preferred to maintain cooperative relations with the other major powers, who were the primary markets for American agricultural products (Flynn & Fordham 2017: 749). Although tariff reduction owned consensus periodically, tariff remained at 40-50% before WWI. It was not until 1934 that Congress eventually delegated its statutory authority over foreign commerce and tariff setting to the President through the Reciprocal Trade Agreements Act (see also Bailey et al. 1997).

there was lack of prudence towards overseas investors. As Drezner noted, "beginning with Alexander Hamilton's decision to honor Revolutionary War debt at par value, the United Stated embraced foreign investment more than foreign trade." (cf. 2015: 151; see also Frieden 1987)

The U.S. economy after the Civil War was becoming very attractive to European investors due to the country's rapidly expanding domestic market and transportation infrastructure (see Buckley & Roberts 1982: 32; Peters 2017: 116f). Massive foreign direct investments came in the United States during its widespread industrialization in the second half of the 19th century. A so-called "manufacturing belt" in America took shape in the Northeast around the 1850s and proved, as scholars noted, "remarkably persistent" (Krugman 1991a: 80; see also 1991b; Perloff et al. 1960). Millions of immigrants flooded into the industrial centers,[40] among which there was also high-skilled labor from Europe who promoted a widespread and rapid development of mechanical skills in the U.S (Buckley & Roberts 1982: 25f). High tariff policy in select manufacturing sectors stimulated more European investment in the U.S. to avoid extra export costs (ibid: 22f). A real influx of foreign direct investments began to match the traditional portfolio investments and boomed in a broad range of sectors such as agriculture, mining, manufacturing, including service areas such as in shipping, trading services, insurance, and international banking (Perloff et al. 1960: 43-84). The majority of those FDI inflows took place in the form of greenfield investment in today's terminology, meaning that investors established enterprises from scratch, set up factories, equipment, and employed local labor for operation. Many European shareholders also settled down and became U.S. citizens, changing foreign investments to domestic industrial corporations (Wilkins 2004: 7). Although the investments were geographically dispersed throughout the nation, most capital naturally went to the Northeastern industrial areas and fueled the regional economic growth.

Besides the manufacturing industry, foreign investments in the 19th century also largely

[40] Immigration was also stimulated by the "gold rush" after the discovery of gold in California in 1848.

benefited America's banking sector. After the Civil War, legal restrictions that prevented bank capital from moving were lowered and American banks and stock markets developed rapidly to serve the transfer of outbound and inbound capital (Engerman & Sokoloff 2000).[41] By the turn of the 19th century, the U.S. had become one of the world's industrial leaders and a major host of foreign investment (see Lake 1983; Stein 1984; Frieden 1988). With America's economic growth, bankers and businessmen could repurchase from European creditors a large part of the stocks and bonds of American industry which were held abroad. The share of foreign ownership in American banking sector also began to throw back. New York was one of the world's financial centers and major stock markets as London, Amsterdam, Paris or Frankfurt before WWI. The U.S. Dollar was used as common currency in European and American stock markets in the late 19th century.[42] American Banks such as Morgan; Kidder, Peabody; Brown Brothers; Kuhn, Loeb functioned primarily as channels to draw loans into the U.S. from the worlds' financial centers, while also operating overseas to channel trade and lending in European and Caribbean countries, as well as in China (Frieden 1988: 17-20; Meng 2008: 31f). U.S. outward direct investments also grew gradually from the 1880s and was concentrated in raw materials extraction and agriculture in the Caribbean basin. Refiners of cooper and petroleum, producers of machinery and equipment, motor vehicles, and processed food were all major exporters as well as major foreign investors. There was little overseas investment by labor-intensive industries such as foodstuffs and textiles, most of agriculture sector and standardized industrial goods such as steel (Frieden 1988: 65f).

While the country was still a bit player in global trade in the early 20th century, it was already a chief capital player. By July 1, 1914, an amount of roughly $7,1 billion in long-term stakes in the U.S. took up 20% of its gross national product, making the U.S. the largest debtor country before WWI (Wilkins 2004: 4-9).[43] Inward FDI in the U.S.

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[41] Many British firms were only headquartered in the home country, where their capital also came from, but had no operations there. Such "free-standing companies" extended abroad to control their overseas business (see Wilkins 1991).

[42] In 1879 the U.S. adopted the gold standard de facto and with the 1900 Gold Standard Act de jure, and retained it until the end of the Bretton Woods System. See Wilkins 2004: 5.

[43] Data of foreign inward and outward investments of the U.S. was very scant at the time. Historical data

reached a substantial volume of $1,7 billion, while long-term portfolio investment was much larger, reaching a total value of $5,4 billion in the same investigation.[44] Foreign investors owned not only certain amount of liquid financial assets such as government securities in U.S., but also plants and equipment, real estate, patents, trademarks and other tangible or nontangible properties besides the financial part (ibid). Outward U.S. investment in total reached a significant amount of $ 3.5 billion in 1914, making the U.S. the fourth largest source of capitals worldwide after Great Britain ($18.0 billion), France ($9.0 billion) and Germany ($7.3 billion) (see Table 1).

Opposition to extensive foreign ownership already emerged in the 1880s and 1890s, but only within some states concerning land ownership (Jenkins 1993: 76f). Although half of the federal states passed laws in the 1890s to restrict foreign ownership in farmland due to large European purchases, the laws were virtually unenforceable (Tolchin & Tolchin 1989:6). British and other European investors continued to buy land, aided by the federal states themselves, who often reimbursed foreign investors with state lands when they couldn't pay off their bonds (ibid; see also Vagts 1961: 1495). Regulations on foreign firms at the state-level were heterogenous and weak, barely had a regulatory effect on the direction and total volume of IFDI. In fact, until the early twentieth century, corporate law in the U.S. simply did not make a distinction between "foreign" and "domestic" corporations beyond their place of incorporation. Only those companies that registered in a different country were understood to be foreign corporations, despite that many domestic registered companies had de facto foreign ties (Zajacz 2019: 118f). In the late 1880s, numerous western and southern states passed antimonopoly laws under agrarian pressure to curb the power of the Eastern railroad companies which inflated the price of corn by fixing the price of transport by railway (see Stigler 1985). The Sherman Act of 1890, which also applied to foreign mergers, was passed against a wave of

before 1945 used in this dissertation is largely derived from academic literature and scholars estimations based on their archival studies such as from Wilkins 1989, 2004, Frieden 1988 and from Graham 2006; Pastor (1980: 220) noted a similar amount of $7.2 billion. He also noted that this was nearly 20% of the $38.6 billion GNP.

[44] Wilkins based her estimates on compilations of data by the United Nations and other studies around WWI, see 2004: Chapter 1, fn. 15&16.

conglomeration of big corporations, particularly in the tobacco, petroleum, rubber and electrical machinery industry. The antitrust laws were aimed at promoting market competitiveness, when transportation costs largely decreased in the U.S in the late 19th century and a national market emerged. Some federal laws that discriminated against foreign investors on a sectoral basis, such as in mining, shipping and banking sector, were separately noted in different laws instead of in a monolithic catalogue (Wilkins 1989: 580-584; Zhang 2011: 55).

Table 1. Creditors and debtors, by July 1914

Principal sources of capital		Principal recipients of capital	
Host country	Amount	Host country	Amount
United Kingdom	18.0	**United States**	7.1
France	9.0	Russia	3.8
Germany	7.3	Canada	3.7
United States	3.5	Argentina	3.0
Netherlands	2.0	Austria-Hungary	2.5
Belgium	1.5	Spain	2.5
Switzerland	1.5	Brazil	2.2
		Mexico	2.0
		India and Ceylon	2.0
		South Africa	1.7
		Australia	1.7
		China	1.6
Other	2.2	Other	11.2
Total	45.0	Total	45.0

Source: cf. Wilkins 2004: 5. (in billions of USD)

Prior to WWI, the United States followed a liberal policy towards foreign capital, be it portfolio or direct investment.[45] This policy, however, rather came from the needs of war finance and the developmental goals of Alexander Hamilton than from a liberal ideology. Hamilton's different position towards import and inward investment in developing American manufacturing mirrored a mercantilist ideology than a liberal one. He observed

[45] Major foreign direct investment went to the private sector and private corporations, whereas public finance in the form of purchasing federal, state and local government securities was of a portfolio nature (Wilkins 2004: 6).

a positive correlation between the “abundance of specie” and a “flourishing state of manufacture”, so that an open investment policy towards foreign capital happened to serve a mercantilist goal in trade (see also Drezner 2017:4). “Not only the wealth but the independence and security of a country appear to be materially connected with the prosperity of manufactures.”[46] The historical legacy of foreign capital was a strong belief in the nation-wide benefits of free capital flow. America’s developmental goals melded neatly with a liberal approach to foreign investments.

As shown in its “Open Door Policy” towards China and the “Monroe Doctrine” towards the Caribbean countries, an “internationalist coalition” had emerged in the U.S. by the turn of the 19th century, consisting of some politicians, bankers and traders, together with the military, who were prone for overseas expansion. Although America’s foreign economic policy was designed to serve the domestic industry and market until the early 1900s, liberal ideas also gained increased acceptance among many industrial sectors (Goldstein 1988: 197). Foreign capital in the form of portfolio investment during and after the Independence War, and more in the form of direct investment after the Civil War, fueled America’s industrial development and made it less dependent on foreign goods (Frieden 1988: 25). Immigration, jobs, technological innovations and organizational skills came along with foreign capitals into the United States.[47] To some extent, IFDI not only brought in needed capital, labor and new skills in the country, but also boosted its industrial autonomy. By the late 19th-century, the U.S. had already become one of the major leading industrial countries besides Germany and Great Britain, who were also the top investors in the U.S. (Bairoch 1982: 292; Kennedy 1988: 202).

[46] Ibid. fn.28

[47] During the 19th century, the U.S. engaged in various forms of violations of intellectual property right (see Peng et al. 2017). The U.S. was an importer of European technology and free-rider in patent right. It did not join the Berne Convention for the Protection of Literary and Artistic Work signed in 1886 by Belgium, France, Germany, Haiti, Italy, Liberia, Spain, Switzerland, Tunisia and the United Kingdom.

Table 2. Estimated foreign investment of the U.S. by July 1914 and December 1918

	U.S. investments abroad					Foreign investments in U.S.				
			Private accounts					Private obligations		
Date	Total	Government lending	Total	Portfolio Investments	Direct Investments	Total	Government borrowings	Total	Portfolio Investments	Direct Investments
June 30, 1914	3.5	0	3.5	0.8	2.7	7.1	0.1	7.0	5.3	1.7
Dec. 31, 1918	13.7	7.6	6.1	2.5	3.6	3.0	0.1	2.9	1.9	1.0

Source: cf. Wilkins 2004: 64. (in billions of USD)

2. Critical juncture: World War I and dealing with the enemy's assets

The economic position of the U.S. in the world economy was further upgraded through the First World War. From 1914 to 1918, many European producers, including British, German, Dutch and Swiss producers, transferred their facilities to the safer American continent. Their desperate wartime purchases of food, materials, and munitions resulted in America's "phenomenal increase in export", while much of the goods were produced by European subsidiaries (cf. Wilkins 2004: 24). Although the U.S. had already run trade surplus before WWI, a large excess of exports over imports was established during the war and this favorable balance continued afterwards. European buyers paid for commodities from the U.S. by selling back their assets in the U.S. to the federal government (Frieden 1988: 70; Seitzinger 2013:2). In 1915, when the U.S. government began to investigate the amount of foreign investment in the country, "its size and extent startled policymakers" (Graham & Marchick 2006: 3). Researchers noted that it was from this investigation that American policymakers began to realize that how much of the US economy was under foreign control (ibid; see also Wilkins 2004: 24f).

The very early national security concerns regarding IFDI were triggered by Germany's hostile war stance during the First World War. In 1914, Germany ranked the second largest direct investor in the U.S. with a narrow distance after Great Britain and an investment stock of $525 million, followed with large gap by the Netherlands and France with $125 and $80 million, respectively (Wilkins 2004: 9). In comparison to many resource-seeking investments from the U.K., German investments concentrated on science-based chemical industry and radiotelegraphy – the then “high-tech sectors” and strategic sectors in war time. The chemical industry was vital for the production of explosives and pharmaceuticals, while radio station served the intelligence work. How to deal with German assets in the United States was closely related to America’s war stance. Before President Woodrow Wilson declared the country’s neutral war stance on August 4, 1914, the U.S. government had already seized several German-built radio stations.[48] One of the two high-power radio stations in the United States and a subsidiary of the German firm Telefunken, Sayville, had already been under the U.S. Navy’s scrutinization in 1912 for its ability to collect intelligence for the German government (see Zajacz 2019: 117f). As scholars noted, “the long-term significance of the Sayville installation for foreign ownership regulations laid less in the station’s ability to reply confidential information than in the attention it drew to the definition of corporation nationality” (cf. ibid: 118; see also Sidak 1997: 36). On the next day after Wilson declared the U.S. neutrality, a British-owned high-powered radio station at Tuckerton, New Jersey, built by German company Hochfrequenz Maschinen AG für Drahtlöse Telegraphie, was confiscated by the American government before it should have had been transferred to a contracted French wireless firm. With Germany and France at war, an asset transition from a German to a French owner could convey an unneutral message for the U.S. government (Wilkins 2004: 14).

Although German companies had owned significant assets in the U.S., it was not until hostilities broke out in late 1914 that doubts were raised about the level of German involvement in the U.S. economy (Graham & Marchick 2006: 3f). National security concerns about strategic imports and exports occupied U.S. policy-makers’ attention. Prior to WWI, almost all the synthetic organic chemicals consumed in the U.S. were supplied by Germany. Chemical materials that made high explosives with unmatched lethality had wreaked havoc on Allied forces in the early months of the war, and for a

[48] The radiotelegraphy sector was also the first industrial sector where the American government introduced federal restrictive policy towards foreign ownership. Under the Radio Act of 1912, all foreign radiotelegraph companies were confiscated during WWI.

time, the Allies could not reciprocate (ibid: 5f). Essential U.S. imports curtailed by wartime conditions included dyestuffs, potash and tin. By 1915, the shipping blockade of German products to the U.S. thus prompted enhanced production of dyestuffs and other chemical products in German-controlled plants in the U.S. This benefited the U.S. when it later entered the war.

The sinking of the British passenger ships Lusitania (with 129 Americans) in May 1915 and later the Arabic (with two Americans) in August 1915 by German U-boats galvanized anti-German public opinion in the U.S. A diplomatic accident on August 14, 1915 further catalyzed such sentiment (see Wilkins 2004: 31). Materials found in the briefcase left by the German diplomat Heinrich Albert in a New York subway revealed Germany's efforts between 1915 and 1916 to circumvent the British economic blockade: Diplomats from Germany had engaged in setting up military enterprises with businessmen under the mask of American ownership. The documents also proved that the German government had supported the sabotage of some American military equipment production sold to the Allied, while funding war materials production to enhance Germany's war capabilities.[49]

3. The Trading with the Enemy Act of 1917 and massive confiscations of German assets

After the U.S. violated its neutral war stance in April 1917, immediate concerns about the security risks posed by German-controlled firms led to the passage of the Trading With The Enemy Act (TWEA) in October 1917 (Graham & Marchick 2006: 4f). The TWEA was designed to sanction trade and other economic exchanges with Germany and the Central Powers. Section 5(b) granted the President for the first time in the American history the authorities to "investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition holding, […], or transactions involving, any property in which

[49] For instance, the Bridgeport Projectile Co., a company that produced artillery shells contracted with American and German government was found to be used as a device through which the delivery of munitions to Allied armies would be delayed or thwarted. The company was initially established in 1915 by a German agent, Carl Heynen, who formed the business along with local business men to give the company an American face. See the history of the Bridgeport Projectile Company in Connecticut: https://connecticutmills.org/find/details/bridgeport-projectile-co.

any foreign countries or a national thereof has any interests".[50] "Enemy" was broadly defined in Section 2 and included "any individual, partnership, or other body of individuals, or the government of any nation with which the United States is at war." Section 6 of TWEA authorized the President to appoint an official known as the "alien property custodian" (APC), "who shall be empowered to receive all money and property in the United States due or belong to an enemy, or ally of enemy, which may be paid, conveyed, transferred, assigned, or delivered to said custodian under the provision of this Act".[51]

The wartime anti-German fever resulted in the confiscation policy of large-scale German assets and patents in the chemical industry (Steen 2001). President Wilson appointed A. Mitchell Palmer, a Democratic Congressman and an attorney in profession, APC in October 1917.[52] Under Palmer's administration, many German enterprises that produced materials relevant to the war effort, such as glycerin for explosives and chemical materials for medicines were confiscated by the Office of Alien Property Custodian (OAPC). Tangible and intellectual properties of large German chemical company such as Merck and Bayer were forced to be sold to American buyers.[53] From 1917-1918, many assets that were jointly held by German and other foreign investors including Danish and British ones were confiscated (Graham & Marchick 2006: 5f). Congress approved in March 1918 the Urgent Deficiency Bill that granted the APC with the power to sell any property in his custody. In late 1918, Palmer reported that he was managing 30,000 trusts with assets worth half a billion dollars.[54]

Although provisions of the TWEA allowed for the return of the confiscated foreign assets

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[50] TWEA, App. § 5(b)(1)(B)
[51] TWEA, App. § 6.
[52] Mitchell served the Ways and Means Committee in the House from 1911 to 1915. There he was the principal author of the 1913 Underwood Tariff Act, which lowered the tariff and implemented a federal income tax. For more history of APC, see https://www.archives.gov/research/guide-fed-records/groups/131.html#131.1.
[53] The asset transfer of Bayer to the American firm Sterling Products also included the right to use the Bayer name in the U.S., which is why Sterling still sells aspirin under the Bayer trademark to this day.
[54] As I mentioned above, IFDI stock in the U.S. 1914 reached, according to scholarly estimation, $ 1,7 billion, that means quite a large share of foreign assets were confiscated by the APC.

to their original owners following cessation of war, massive transfer of German assets to US ownership did not expire with the victory of the Allied in 1918. There was public fear that German companies, which had dominated the chemical, military equipment and communication sector worldwide, would quickly regain their former strength relied on their comparative technological advantages. Not only tangible assets, but also intangible ones such as intellectual patent rights were confiscated and transferred to U.S. firms without a legal basis.[55] In the chemical industry where patent right plays an essential role in business, its massive transfer to another country would be devastating to the domestic industry. In 1919, the OAPC sold some 4,500 patent held by German chemical firms to the Chemical Foundation, a corporation established specifically to administer those patents and licensed them to local firms (Steen 2001: 175).[56] Although their value was estimated at up to $8 million, they were transferred for only $250,000 (Huddle 1945). In his report of February 1919, Palmer presented the expropriation of enemy property as a measure of so-called "economic warfare":

Instead of permitting myself to a mere conservator of enemy property, I have tried to make the Trading with the Enemy Act a fighting force in the war. (...) The sale to the United States Government of the Hamburger-American and North German Lloyd dock on the Hudson River at New York and at St. Thomas in the Virgin Islands; the sale and liquidation of the enemy interests in the great American metal, textile, chemical, electrical and other industries before the armistice was signed, helped to bring the German government to a realization that regardless of possible military victories, she had already lost the war.[57]

The massive confiscation of German radio stations, military and chemicals factories was targeted at undermining Germany's war efforts; However, it also went beyond national security concerns to benefit U.S. firms and the domestication of foreign technologies and patents. The quest for a domestic chemical industry gained adherents far beyond the group

[55] It was not until December 1941 that Congress amended section 5(b) of the TWEA to grant the president the ability to "vest" seized foreign property – meaning that such property can be licensed, liquidated, or sold (cf. Coates 2018: 163).

[56] Francis P. Garvan, who was a lawyer in profession and served the president of the Chemical Foundation, succeeded A. Mitchell Palmer as APC in February 1919 as the latter was named Attorney General.

[57] A. Mitchell Palmer, APC Report, February 15, 1919, https://babel.hathitrust.org/cgi/pt?id=mdp.39015049033908&view=1up&seq=7, p.15.

of American firms who sought immediate profit from the asset transfer. For academicas, government officials and the wider public, promoting the national chemical industry became a "patriotic duty" after the war (cf. Steen 2001: 98). In the spring of 1919, it was reported in the *Journal of Industrial and Engineering Chemistry* that the transfer of chemical product patents would prevent importation and give time and opportunity for the development of American manufacture.[58] In a federal lawsuit of 1925 that challenged the legality of the Chemical Foundation, the firm certificated that:

[the Firm] was created and empowered to purchase enemy-owned patents seized by the Custodian and to hold the property and rights so acquired in a fiduciary capacity for the Americanization of such industries as may be affected thereby, for the exclusion or elimination of alien interest hostile or detrimental to the said industries, and for the advancement of chemical and allied science and industry in the United States.[59]

The court dismissed the complaint against the patent transfer of the Chemical Foundation and judged it to be "lawful", which safeguarded OAPC's confiscation policy. While the Senate terminated many war acts in 1921, the TWEA was specifically exempted because the U.S. government had yet to dispose of a large amount of alien property in its custody (Casey et al. 2019: 4).[60] Clearly, seizing such funds and assets during peace times violated the basic private property rights the American Constitution should safeguard (Peng et al. 2017).

The transfer of German assets was one of the important reasons for the drop of FDI inflows in the U.S (Wilkins 2004: 63). In 1919, the stock of FDI in the U.S. fell by half to $0,9 billion from what it was in 1914 (Hymer 1960: 30). However, between 1914 and 1917, U.S. domestic dyestuffs output jumped more than twenty folds measured in dollars and sevenfold measured by weight. Imports recorded in dollars remained about stable

[58] Author unknown, online resource: https://pubs.acs.org/doi/pdf/10.1021/ie50112a004.

[59] District Court for Delaware 1926: United States v. Chemical Foundation Inc., online resource accessible from the Cornell Law School: https://www.law.cornell.edu/supremecourt/text/272/1#writing-type-1-BUTLER.

[60] Governmental retainment of German assets echoed Article 297 of the Versailles Treaty, which permitted Entente nations to use enemy property to repay the claims of their citizens against the defeated powers, see the Treaty text from the Lillian Goldman Library, Yale Law School: https://avalon.law.yale.edu/imt/partx.asp.

despite the soaring prices of dyestuffs and reduced weights in imports (see also Buckley & Roberts 1982: 44). Prior to WWI, American chemical industry did not own a dyestuff sector. The basic product for refining artificial dyes was aniline, which is derived from black coal. The world's first aniline plants were the Frankfurter Anilinfabrik, Farbwerke Hochst am Main, and BASF in Ludwigshafen established in the mid-19th century. German research in chemistry underwent enormous progress during this period, and by the end of the 19th century, nearly all new dyestuffs were being invented in Germany. The dyestuffs themselves were only an end product and mainly used for the textiles industry. However, the aniline dye industry and the related refining technologies are very adaptable. They also produced other materials such as sulfuric acid, which could be used in the production of explosives, and the chlorine gas that was used as a chemical weapon during WWI. Besides dyestuffs, products of aniline dye factories were also used for civilian economy such as cosmetics, fertilizers, pesticides and medicines, as well as for the film and photo industries (Roth 2009).

Table 3. U.S. dyestuffs production and trade in 1914 and 1917

			U.S. Trade		
	U.S. production		Exports	Imports	
Year	Value ($)	Weight (lbs.)	Value ($)	Value ($)	Weights (lbs)
1914	2.5	6.6	0.4	7.5	42.4
1917	57.8	46.0	11.7	8.0	6.1

Source: cf. Wilkins 2004: 29, org.cf. the U.S. Tariff Commission in U.S. Senate, Committee on the Judiciary. 1922. *Alleged Dye Monopoly*, p.68. (in millions of USD)

In a congressional hearing on November 20, 1919, Assistant Secretary of War Benedict Crowell stated:

The dyestuff industry is one peace time enterprise which will furnish plants and equipment which can be hurriedly converted to essential uses in time of war [...]. Every dye factory worker is, without additional training, explosive maker [...] every chemical factory must be regarded as a potential arsenal.[61]

[61] U.S. Congress. Senate. Committee on Finance. Dyestuffs: Hearing on Act to Regulate the Importation of Coal-tar Products, to Promote the Establishment of the Manufacture Thereof in the United States, And, as Incident Thereto, to Amend the Act of September 8, 1916, Entitled "An Act to Increase the Revenue,

That the confiscation of German assets went beyond a compensation to America's war effort was clear in its later industrial policy. In the Warren Harding administration (1921-1923), Congress increased tariff upon 30% for organic chemicals, while tariff in other industries largely decreased. At the same time, the government did not pass any legal restrictions on foreign investment in the chemical sector throughout the interwar era. Consequently, German companies were allowed to re-enter the U.S. market after WWI, often in partnership with the same American firms that had acquired former German assets (Graham & Marchick 2006: 7f.). Although firms would be reluctant to sell the very technologies that had enabled them to dominate the market, in the circumstances following the war, firms from a vanquished country were in no position to refuse outright but take the benefits earned from technology sales (ibid). Thus, licensing technology to U.S. firms became a major business activity for German companies as the 1920s progressed. Relative gains concerns were apparent in the U.S. confiscation policy towards German assets, as the relationship became a zero-sum competition during the war time that any gain of the enemy was the U.S.' loss. The liberal façade of America's early policy towards foreign capital fell down as economic nationalism revived in the wartimes. The state aggressively took over strategic wartime goods and technologies owned by German firms in the U.S. Such foreign investment, even when it comes from antagonistic countries, eventually served the interests of the U.S. Thus, the confiscation policy was not only driven by security concerns but also by long-term economic benefits that were critical to the U.S. industrial development.

After WWI, European major powers went back to high tariff levels and were in urgent need of capital to restore the economy. At the same time, the 1920s saw a continuation of the wartime increase in overseas American lending and investment. The U.S. changed from a debtor to a creditor country through WWI and experienced an undeniable increase in its autonomy. With the technology European – especially British and German FDIs –

and for Other Purpose, 66th Cong., 1st Session, December 8-13, 1919 and January 12, 1920, https://books.google.de/books?id=uhI9AAAAYAAJ&dq=dyestuff+weapon&source=gbs_navlinks_s.

had brought in, the U.S. moved to the technological frontier, gaining in the capability to conduct more investments overseas, especially in manufacturing, utilities and petroleum (Frieden 1988: 63). Increased tariff barriers of European countries in the interwar era also stimulated American exporters to relocate production facilities into Europe. By 1929, U.S. overseas private assets, including direct and portfolio investment, along with other assorted long-and short-term assets – were $15.5 billion, far more than its income capital stock (Hymer 1960: 30). Overseas investment in 1929 were equivalent to about one-fifth of the country's gross national product, a level that was reached again in 1981.

4. Historical legacy

The large internal market of the U.S. allowed the emergence of integrated business enterprises in the late 19th century to grow in the absence of large and capable state apparatus. Prior to the First World War, an internationalist coalition composed of bankers, large enterprises in the energy and some manufacturing sectors, together with the military, had already emerged in the U.S. At the time, there was neither a domestic regulatory regime that governed foreign investment, nor an international regime such as the WTO that bundled states to follow certain cooperation norms. As scholars note, the framers of the American Constitution were primarily concerned about a strong federal government for the defense of the interests of the American people (Edling 2003; Wright & Cowen 2006). However, at the same time, foreign investors provided and complemented the financial resources for building the nation. After 1914, the rapid overseas expansion of U.S. business and lending led to the maturation of an outward-looking foreign economic policy, especially on the part of the bankers. The foreign debtors were usually governments and the close ties the bankers were building with, for instance, Central and Eastern European countries made them also interested in European economic reconstruction and political harmony (Frieden 1988: 73). The interwar era also saw the construction of formal and informal institutions and networks that had a strong legacy on the U.S. foreign economic policy after WWII. A system of close cooperation between foreign policy-makers, international-oriented enterprises, and America's international bankers was formed. It became common for important figures in American international financial circles to serve on policy advisory bodies and sometimes to rotate through positions in government, usually at the State Department, the Treasury and the Federal Reserve Bank of New York. Big banks and corporations and their Wall Street lawyers also placed their own members directly in high office of the Treasury and the Federal Reserve system (Odell: 1982: 47). The Council on Foreign Relations was established in 1921 and headquartered in New York City. Its early board members were mainly directors of investment banks, manufacturing and trading companies, who were also the major proponents of Wilson's internationalism (see Frieden 1988: 73).

The First World War also equipped the Executive with a powerful tool for state intervention – the Trading with the Enemy Act – and legitimized governmental violations against international customary rules such as private property rights. The Act also marked the begin of an institutional history. At the meso-level, it created the statutory bases permitting the President to declare a state of emergency[62], and make use of delegated powers from Congress to exercise control over private international economic transactions with adversaries (Casey et al. 2019). It set the tradition to put the President and his designees in charge of assessing and securing the national security implications of international economic exchange in national emergency, which exempts from judicial review (Berg 2018). At the micro-level, the designees for regulating IFDI were the APCs in WWI with banking and/or lawyer background who knew how to interpret and reinterpret ambiguous laws as written in the TWEA. In WWII, presidents' designees of regulating foreign assets became officials of the Treasury, whose leaders often came from the Wall Street (see also Wright & Cowen 2006; Reeves 1945).

During WWII, the U.S. seized foreign assets authorized by the TWEA on a bigger scale of \$8 billion compared to \$500 million in WWI and held them after the war's end (cf.

[62] "The U.S. Constitution is silent on questions of emergency power" (cf. Casey et al. 2019: 1). In the 18th and 19th centuries, Congress and the President answered those questions in varied and often ad hoc ways. President often acted without congressional approval in a time of crisis, and Congress would decide subsequently to either ratify the President's actions or indemnify the President for any civil liability.

Coates 2018: 159). It also used antitrust law as “weapons” against firms owned by German nationals, and firms that had licensing agreements with German companies. In 1939 alone, the U.S. filed 41 antitrust cases against them (Wilkins 2004: 536). Following the German invasion of Norway on April 10, 1940, President Roosevelt issued Executive Order 8389, commonly called the “freezing order” to prohibit transactions relating to the property of Denmark and Norway and their nationals unless permitted under license by the Secretary of the Treasury. Immediately after the issuance of the Order, the Office of Foreign Funds Control (OFFC) was set up as the administrative agency within the Treasury Department. On February 12, 1941, the President formally delegated all of this authority under section 3(a) and 5(b) of the TWEA to the Secretary of the Treasury, who thereupon shared functions with the OAPC reestablished in March 1942 (see Reeves 1945: 17f). OFFC became a permanent bureaucratic apparatus in 1950 and was renamed as the Office of Foreign Assets Control (OFAC). It is located in the Treasury Department and regulates foreign assets from sanctioned countries.[63] Besides the policy realm of foreign investment, through the 1934 Reciprocal Trade Agreements Act, Congress also delegated its statutory authority over foreign commerce and tariff setting to the President (see Goldstein & Weingast 1997). Therefore, the Executive’s upper hand in foreign economic policy making was already institutionalized by the end of WWII.

The TWEA was one of the numerous wartime laws. However, its real significance went far beyond a wartime policy instrument. Had it been overturned a few years later, it would be nothing but a footnote to American economic history. The President’s power to constrain foreign assets was further empowered by Congress during the Korea War in the 1950s, and on trade and investments with the Soviet Union in the Cold War.[64] Over the

[63] OFAC acts under Presidential national emergency powers vested in IEEPA and other international mandates. See U.S. DoT, OFAC: https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx.

[64] Congress passed amendments to the TWEA that further expanded the president’s powers in 1917, 1918, 1933, 1940 and 1941, and made few attempts to rein them in afterwards (Coates 2018). In 1933, Franklin D. Roosevelt invoked the TWEA as the legal basis to proclaim a banking holiday, meaning on that day all banking transactions must be terminated. Congress further passed the Emergency Banking Act as amendment to the TWEA, which amended section 5(b) to clarify that the president could invoke the act’s power “during time of war or during any other period of national emergency declared by the president”. The amendment in 1933 explicitly enables the President’s use of TWEA, in peacetime. “From 1976 to 2004,

course of the following century, American presidents have utilized its vagueness and repeatedly used the Act to sanction economic exchanges with "loosely defined enemies virtually anywhere and at any time" (Coates 2018: 151). Until the passage of Exon-Florio Amendment to reform CFIUS in 1988, the TWEA and its later version, the International Emergency Economic Powers Act (IEEPA) of 1977 served as the main laws by which the U.S. government could regulate foreign assets for national security reasons (see Alvarez 1989: 31-42).

Establishing CFIUS vis-à-vis petrodollars from the OPEC

1. Context: U.S. hegemony and a liberal pattern 1945-1973

The Great Depression and the two World Wars forced most European firms to liquidate much of their assets in the U.S. By 1950, the stock of foreign investment in total had declined to $3.4 billion, half of the amount in 1914. A dollar-short Europe was incapable of undertaking much new acquisitions of American companies that had moved to the cutting-edge of technologies (Graham & Krugman 1993: 26). The U.S. emerged from the two world wars as the sole economic power capable of exporting capital abroad. While economics of all the other major industrial states had been severely strained or destroyed by the global conflagration, the U.S. came to a position of unprecedented international power.

As the world's leading international investor, the U.S. had a keen interest in legitimizing free capital flows (Kang 2003: 171). This interest melded neatly with the government's foreign policy goals (cf. Pastor 1980: 215). With the begin of the Cold War, American central decision-makers redefined international economic issues within the context of a global struggle with Communism. Along with the Marshall Plan of 1948, the U.S. government actively encouraged private enterprises to invest in the allied countries as

American presidents declared 38 national states of emergency (not including those that responded to domestic natural disasters). By the end of 2017, 28 separate declared national emergencies remained in place" (cf. ibid: 154).

supplement to governmental aids. The large majority of U.S. investment took place in "friendly" countries of the Western bloc. A handful of national institutions were established to provide U.S. MNCs political-risk insurance, such as the International Cooperation Administration established in 1948, the Agency for International Development in 1961, and the quasi-public Overseas Private Investment Corporation in 1971. In 1950s and 1960s, American MNCs could easily seek diplomatic and military assistance when their assets were nationalized in some developing countries (Krasner 1978b). U.S. OFDI concentrated on energy sectors such as mining and oil, as well as manufacturing. American firms' financial capacity and technological competitiveness enabled their overseas expansions, while even the largest European and Japanese firms did not develop substantial worldwide investments until the late 1960s. The position of U.S. MNCs was so dominant that according to some observers the term multinational corporation was taken as synonymous with the U.S. oligopolistic corporations (Wilkins 1974; Gilpin 1975). Cumulative U.S. OFDI increased from $7.2 billion in 1946 to $33 billion in 1960, and further to $133 billion in 1975 (Solis 2004: 38). Then Secretary of the Treasury, Fred Bergsten, noted in 1974 that "foreign direct investment and multinational enterprises had now replaced traditional, arms-length trade as the primary source of economic exchange" (1974: 149).

The globalization of production first hit the U.S. manufacturing industry. There were some outward investment controls from the mid-1960s because of the rising concerns over the persistent balance-of-payments deficits and the reducing employment in American manufacturing, as many firms were increasingly relocating their production to Asia. Domestic support for the unrestricted movement of capital and goods was waning and disaffection in other countries' protectionist investment policies was growing in the early 1970s (Krasner 1978b: 352). An "Interest Equalization Tax" was established in 1964 in an attempt to reduce the capital outflow. In addition, from February 1965, the amount of capital that U.S.-based MNCs could export was limited under the auspices of the Office of Foreign Direct Investment in the Department of Commerce (Bergsten et al. 1978). In 1968, President Lyndon B. Johnson explicitly used Truman's 1950 declaration of emergency under Section 5(b) of TWEA to limit OFDI by U.S. companies in order to strengthen the balance of payments position of the U.S. after the devaluation of the pound sterling by the British government (Casey et al. 2019: 6). However, the brief mandatory capital controls on FDI was repealed by the Nixon administration (1969-1974) (see also Helleiner 1996: 119f). The trade unions also failed to use labor law in an attempt to prevent the perceived export of jobs (see Bailey et al. 1994: 109). The International Union of Electrical, Radio and Machine Workers in 1969 and the United Automobile Workers in 1971 tried to challenge foreign investments under the National Labor Relations Act of 1935 which required all firms to consult with their employees regarding investment decisions affecting them.[65] Both were unsuccessful due to ambiguous aggregate data and a handful of unrepresentative individual cases that could not prove investment-related employment reduce (ibid; see also Bergsten 1974: 149).

While the U.S. OFDI policy gained political salience, IFDI policy remained a silent issue up to the 1970s. This was both due to the neoliberal ideology that foreign investment was something of a private decision in accordance with economic reasoning, and the insignificance of IFDI in the national economy (Kudrle & Bobrow 1982: 364; Pastor 1980: 215). "The U.S. government considered its role in foreign investments as completed after ratification of bilateral Friendship, Commerce and Navigation treaties, which promised fair and nondiscriminatory treatment of foreign businesses in the signatory country" (cf. ibid; see also Vernon 1974: 121f). By the mid-1970s, FDI stock in the U.S. was dwarfed by the large amount of U.S. OFDI and comprised only a minimal segment of the economy. According to the Benchmark Study of 1974, total IFDI stock in the U.S. was $26.5 billion at year end of 1974, equaling around one third of U.S. OFDI. IFDI stock mainly came from the U.K., the Netherlands and Canada in terms, each accounting for about one-fifth of the total.[66] "Japan's FDI position was only about 1%, as substantial outstanding loans

[65] The United Automobile Workers proposed in 1971 that the government should license outward investments made by US-based transnationals. To obtain a license, it would have to be shown that the proposed investment served U.S. economic interests (Bailey et al. 1994: 109). Conditions attached to the license would guarantee U.S. workers compensation if they suffered export loss or more imports to the American market.
[66] U.S. Senate. Committee on Commerce, *Public Hearing on Foreign Investment Study Act of 1974*. 94th

of U.S. affiliates to Japanese parents largely offset Japanese parents' investment in their U.S. affiliates […]. The Middle East's 7% share was almost entirely due to one government's participation in a U.S. incorporated petroleum company with operating assets in that country."[67] Most IFDIs came in to benefit from the skilled labor force, to gain access to the U.S. domestic market and especially its financial market. In order to compete with domestic American firms, foreign enterprises were only able to come to the U.S. market when they brought new technologies or supplied goods that complemented the domestic market (Kudrle & Bobrow 1982: 364; Pastor 1980: 215; Gerowin 1975: 615). Foreign affiliates in the U.S. employed around one million people in 1974, with about half of these engaged in manufacturing. According to the testimony of George Kruger from the Bureau of Economic Analysis, Department of Commerce (DoC), "only about 5% of affiliates' employees were non-U.S. citizens and most of them were in the professional-technical-managerial area".[68] Therefore, there were lack of reasons for unsettling feelings that domestic firms were being squeezed out of the local economy by FDI or that the local economic interests were being taken over by foreign interests (Piper 1983: 128). The very positive historical experience with foreign investment in the 19th century created a much higher ideological barrier for those who would advocate restrictions (Crystal 1998).

Up to the 1970s, the federal government welcomed FDI with a hands-off approach. The U.S. economy itself together with a stable legal environment had been attractive to and supportive of private investment (ibid). As a host country, it followed the "equal treatment" principle, also called the "national treatment" principle, that all firms operating in the United States were treated equally under American laws regardless of the nationality of ownership. There were a few policy initiates concerning IFDI for the balance of payments.

Cong., 2nd Sess., May 3, 1976, p.12.

[67] The "one company" was Aramco, which originated from the Standard Oil Company of California (SOCAL). In 1933, SOCAL made an agreement with the Saudi Arabian government to commence oil drilling and established the firm Aramco (the Arabia American Oil Company) in the late 1940s. In 1973, the Saudi Arabian government acquired a 25% share in Aramco's assets. It increased its participation interest to 60% in 1974 and acquired the remining 40% interest in 1976. See ibid: 21.

[68] Ibid. fn. 57.

In 1961, President Kennedy launched an "Invest in the U.S.A" program as part of his balance of payments policy in order to encourage the inflow of long-term capital (Pastor 1980: 221; Cohen 1986: 134). The mission was carried out in a way of supplying market, financial and legal information to prospective foreign investors. It was assigned to the Office of International Finance and Investment (later the Office of Foreign Direct Investment) at the Department of Commerce (DoC) and a team of only five officials, of which three in Washington, one in Paris and one in Brussels, were in charge. At the time, the federal states were much more active in promoting IFDI. Twelve states had established representative offices in Europe and/or Japan to attract foreign investment (cf. Culver 1974:161). In 1963, a Task Force was established and chaired by then Undersecretary of the Treasury, Henry Fowler, and included some representatives of the Department of State and the business and financial community to "design a new and positive program… to promote overseas sales of securities of U.S. companies" (cf. ibid.). In March 1965, based on reports from the Task Force, President Johnson proposed the Foreign Investors Tax Act to Congress which should lower taxation to foreign investors. However, in the 1960s, a policy of promoting investment by tax inducements or governmental assistance was not sufficient to overcome the disadvantage of an over-valued currency.

Institutionally, there did not exist a single and coherent regulatory regime. Besides the TWEA that sanctioned American companies' cooperation with firms from the Soviet bloc, the federal government could only rely on sector-specific limitations to regulate foreign ownership, such as in transportation (air & shipping), communication (radio and television broadcasting, telecommunications, satellites), and energy resources (mining, hydroelectric and geothermal power, nuclear powers). There were some federal restrictions in real estate, banking, and insurance (Crystal 1998: 523; see also Seitzinger 2013: 3). The statutory limitations on the degree of foreign ownership of stock or participation in management were not identical for these economic sectors. For instance, foreign investments in mining sector reveals its fragmented regulations. Non-nationals should not be able to acquire or exploit mineral lands owned by the Federal government, but they can control domestic corporations entitled to hold such leases, if their country allows reciprocal rights to U.S. citizens (see Culver 1974: 160). The anti-trust laws executed by the Department of Justice focus on the economic implications of M&A instead of foreign ownership. The powers of the federal states further complicated the making of a national regulatory policy. Nearly all of the laws pertaining to the ownership or transfer of land, and most of the laws concerning incorporation and operation of commercial enterprise, were state laws. Their effectiveness as controls on inflows of foreign capital was dubious if the states want to attract foreign capital for local economic development (cf. ibid: 366; Piper 1983: 128). Local communities offered incentive policies that included loans and tax abatement to attract FDI as part of their economic programs to aid economically depressed areas in the U.S. Such an institutional structure with fragmented regulations dispersed between the federal and state level, as well as among different industrial sectors contained conflict potentials between domestic interests and foreign policies.

2. Critical juncture: A surge of government-backed investments from the OPEC

The redistribution of wealth through IFDI was first felt in the U.S. in the early 1970s. The dollar imbalances produced by wars in Vietnam, deficit spending and trade surpluses being accumulated by key American trading partners had reached a breaking point by the early 1970s (Baltz 2017a: 57). These imbalances were further combined with the dollar devaluation that followed the removal of the Bretton Woods dollar-gold linkage. FDI began to pour in the United States after two consecutive dollar devaluations in 1971 and 1973,[69] which resulted in cheaper costs of American land, labor, raw materials and production for acquisitions. Coupled with inflation, labor shortages, low stock prices and a large internal market, investment in the U.S. became virtually “irresistible” (Gerowin 1975: 617; Kudrle & Bobrow 1982: 375). Between 1959 and 1973, annual FDI in the U.S.

[69] Dollar devaluation and the unilateral cancellation of the direct international convertibility of the dollar to gold were the economic measures undertaken by President Nixon in 1971 in response to increasing inflation within the United States. Together with the recommencement of the U.S.-China diplomatic relationship (the Pingpong Diplomacy in 1971), Nixon’s New Economic Policy announced in August 15, 1971 was also known as “the Nixon shock”.

rose at an estimated annual rate of 6%. In the year of 1973, it climbed abruptly by 20% and net FDIs in the U.S. reached the largest annual inflow in the post-war era to over two billion dollars (Gerowin 1975: 611; see also Hastedt 1985: 39).

A surge of investment inflows first came from its traditional trading partners in Western European countries and Japan (Kang 1997: 302; See also Griffin 2017: 1762). In 1970, there had been a few congressmen raising doubts about concentrated Japanese real estate investments (Pastor 1980: 221). However, the political climate did not change until a number of investment deals from the members of the Organization of Petroleum Exporting Countries (OPEC) was announced in the media amid the Oil Crisis in the late 1973. The oil embargoes and energy crisis caused a rapid and large-scale redistribution of wealth to some OPEC countries, which in turn led to a surge of investments with the so-called "petrodollars" in the U.S. OPEC investments mainly came from Saudi Arabia and some from Kuwait, and concentrated in American urban real estate and short-term portfolio investment. Among the OPEC members, Saudi Arabia was the world's largest exporter of crude petroleum and at the time was thought to "account for anywhere from one-half to three-quarters of Arab holdings of greenback" (cf. Cohen 2014: 36). A few M&A bids went to American energy and transportation firms that had severely suffered from the oil crisis, such as the Iranian bid to purchase 13% share of Pan American World Airways. Some efforts to acquire interests in military contractors were especially sensitive, such as Kuwait's bid to acquire shares of the Northrop Grumman Corporation which was known for its F-14 air-superiority fighter. Real estate also "used to be a sensitive and provocative area" (Gerowin 1975: 618). Land acquisition was the main feature of the British colonial era and had been long under federal and state restrictions since the late 19th century. National ownership of land was essential to the notion of sovereignty, national and local identity. Unlike manufacturing, land is a finite resource that alien control of land diminishes the opportunities for local purchase (Piper 1983: 135). Although these OPEC investments in total value were much less than from some major Western European countries, the media shed lights on the government-investors that had engaged in "economic war" with the U.S and whose actions had aided in producing a global recession (Kang 2003: 172; Gerowin 1975: 618). The media made much of the possibility that these investments were being driven by political motives to do further damage to the U.S. economy.[70] In fact, Arabian investments only began to flow in late 1974 at substantial lower and slower rates than predicted, channeling by the active intervention of the Treasury officials to diverse the investments (ibid: 622; see also Cohen 1986; Spiro 1999). Also, the quantity of OPEC-owned urban real estate was at a very modest level (Kudrle & Bobrwo 1982: 366). There were few M&As from the OPEC in technology area. The proposed Kuwaiti acquisition of Grumman was blocked by the Department of Defense in 1974 (Bailey et al. 1994: 114).[71] However, these facts were "lost in the tidal wave of public reaction" to news of the Iranian bid to purchase 13% of Pan Am, which suffered great loss during the Oil Crisis (cf. Gerowin 1975: 626).

The surge of investment happened amid the Oil Crisis reflected two major switches from the past: First, the past designs until 1973 was that American companies with more capital and advanced technologies invested abroad and acquired shares of foreign enterprises, overwhelmingly in "friendly" nations, while foreign enterprises engaged in a minimal segment of the U.S. economy. A surge of two-billion FDI inflows was abrupt that suddenly non-traditional investors came into the domestic market with a bulk of money to buy domestic assets (Gerowin 1975: 617; see also Piper 1983: 118). Taking over land and American firms simply generated less growth for the U.S. than starting up new business. A second major change was that investors from the OPEC were mainly government-controlled enterprises than private enterprises. The U.S. experience was the one that foreign investment was primarily controlled by individual decision-makers presumably interested in maximizing profits. Government-backed investments did not fit into the traditionally perceived profits-driven foreign investments (Gerowin 1975: 618).

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[70] For example, "Will the Arabs Use the Money Sword?" *Forbes*, December 15, 1973; BORCHGRAVE, Arnaud D. 1974, "We Don't' Want to Ruin You", *Newsweek*, October 7, 1974; COOPER, Richard N. 1975, "The Invasion of the Petrodollar", *Saturday Review*, January 25, 1975; and "New Invasions by Oil Money: Take-over Fears Rise Again," *U.S. News & World Report,* March 3, 1975 (org. cf. Kang 2003: fn.8).

[71] No entity controlled by a foreign government is allowed to merge with, acquire, or take over a company engaged in interstate commerce in the U.S. which is performing a Department of Defense contract, unless that company is given access to a proscribed category of information, 50 U.S.C. App. §2170a(a).

Table 4. Investment flows from OPEC members into the U.S. 1974-1980

	1974	1975	1976	1977	1978	1979	1980
U.S. government securities	3,176	4,368	4,857	4,676	-2,504	2,455	9,173
Corporate securities	216	2,137	2,221	2,127	1,472	1,195	3,255
Bank liabilities	1,979	1,133	1,796	352	-605	4,344	-897
Other liabilities	581	1,422	2,671	563	145	-1,623	1,453
Direct investment	77	6	-15	-13	100	16	212
Total	6,029	9,066	11,530	7,705	-1,392	6,276	13,196

Source: cf. U.S. Treasury Department data presented in Cohen 1986: 124f. (in millions of USD).

"Troubled for the first time in the post-war period about the potentially negative impacts of IFDI on U.S. national interests", policymakers in Congress began to examine the long-neglected rules and regulations targeting foreign investment (ibid.). The uncertainty clouded in the congressional attention had centered on whether the foreign owner would pursue policies that would be economically beneficial to the U.S. and the efficacy of the safeguards that existed to preserve domestic industrial capabilities in a new world featuring footloose multinational corporations, allies such as Japan practicing strategic trade and investment polies, and governments controlling FDI from the OPEC (Piper 1983: 120; Baltz 2019: 107).

3. Restraint of state intervention and the establishment of CFIUS

Mindful of the widespread resentment of petrodollars, policymakers in Congress – under Democratic control – began to examine the long-neglected rules and regulations targeting foreign investment (Kang 2003). Already in the summer of 1973, there were several congressional proposals pressing for a more restrictive policy, ranging "from the prudent to the xenophobic" (Bailey et al. 1994: 114). There were three kinds of proposals. The most extreme one of the congressional proposals in the 93rd Congress (1973-1975) was probably the Dent-Gaydos bill. On June 25, 1973, Democratic Representatives John Dent and Joseph Gaydos from Pennsylvania introduced H.R. 8951 Foreign Investors Limitation Act, which aimed to be the first restriction bill on foreign investment without launching any emergency act. It would prevent non-U.S.-citizens from acquiring more than 35% of the nonvoting securities or more than 5% of the voting securities of any issuer whose securities are registered with the Securities Exchange Commission. Such extreme proposals were not approved by Congress (see also Gerowin 1975: 612). The second kind of proposals were discretionary restrictions, or selective screening plans (ibid: 635). The National Foreign Investment Control Act proposed by Representative Robert Roe would have created a seven member Cabinet-level Commissions with discretionary authority to prohibit and restrict ownership, control or management of nay corporation deemed important to national and/or economic security.[72] The last kind of proposals were mere information-gathering efforts without any intent to restrict FDI, such as the Inouye-Culver bill that proposed a one-time benchmark survey of the extent of FDI and portfolio investments in all public and private corporations. Notably, the initiators who were most eager to revamp FDI policy were not domestic business or labor communities, but some members of Congress from states that received a new bulk of concentrated FDIs (cf. Kang 1997: 312f).

In January and February 1974, the House Foreign Affairs Subcommittee on Foreign Economic Policy held a series of hearings on the costs and benefits of IFDI and the efficacy of existing disclosure requirements in the U.S. Even internationalist senators like Adlai Stevenson (D-Ill), who repeatedly confessed his own "bias toward free exchange of goods, money, and investment" on the Senate Banking Committee, began questioning the beneficial effects of IFDI (cf. Baltz 2019: 107):

All investment doesn't' bring with it technology. It comes for a variety of reasons, one of which may be to promote the sales of foreign goods in the United States. I don't know what we get. We don't get capital (when funds are raised domestically), we don't get

[72] U.S. Congress. House. Committee on Interstate and Foreign Commerce. *H.R. 945 – Foreign Investment Control Act*. 94th Congress, introduced on January 14, 1975.

necessarily the skill, the ingenuity, the technology that may be present in other cases. Should we differentiate between them?[73]

The U.S.' early experience with foreign investment also gained an voice in the congressional debates. Many referred to the early history of IFDI in the United States and their contributions of America's industrial construction. Senator Daniel Inouye (D-Hawaii) stated on May 3, 1976 in the public hearing on the Foreign Investment Study Act:

Foreign investment in the United States is an old phenomenon. We owe the growth of several major industries to foreign capital. Foreign involvement here in some form has always been present even in those early post-war years when American capital appeared to dominate totally global investment, but it was the volume and suddenness of the increase which caught the public attention…We shared the belief that the Congress should not make uninformed decisions with wide international ramifications.[74]

Within the White House, the Council on International Economic Policy (CIEP) established in 1971 took the lead in coordinating and formulating the Nixon administration's interests and objectives in IFDI policy. The official mission of CIEP was to "achieve consistency" between domestic and foreign economic policy and provide focus on a full range of international economic policy issues (Baltz 2017b: 866). Peter Flanigan – an investment banker who served as a presidential assistant for Nixon – was director of CIEP at the time and oversaw the formulation of the Nixon administration's IFDI policy. In June 1973, CIEP established an Interagency Task Force on Foreign Investment in the U.S., which was composed of staff-level experts from various executive branch departments to review U.S. policy towards inward investment. According to John Niehuss' review, who himself was the Assistant Director of the CIEP, "this group met periodically during the summer and fall of 1973 and prepared policy recommendations which were considered by the Cabinet-level Executive Committee of the CIEP in

[73] U.S. Congress. Senate. Committee on Banking, Housing and Urban Affairs. Foreign Investment in the United States, Hearings before the Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs, 93rd Cong., 2nd Sess., January 23, 1974. Statement of Senator Stevenson.
[74] U.S. Senate, Committee on Commerce, Subcommittee on Foreign Commerce and Tourism, May 3, 1976, Public Hearing on Foreign Investment Study Act of 1974, p.1. Another Study was granted in October 1976 by Congress for a more extensive investigation.

December 1973" (cf. Niehuss 1975: 70). In Flanigan's report to the President, the Council first stated:

Any consideration of US policy toward foreign direct investment in the United States must be made in the context of our overall efforts to reform the international economic system. Our drive toward a liberalized system of international trade and a more realistic monetary system will inevitably be affected by our actions in the field of international investment. Our policies with respect to foreign investment here should therefore be consistent with our efforts to liberalize trade, investment and monetary arrangements throughout the world.[75]

Three conclusions emerged in the report. First, the U.S. should continue to grant foreign investors "national treatment", to freely admit foreign investors to treat them on the basis of equality with domestic investor; Second, the CIPE recognized the need for a "better system of data collection so that we can follow more closely the current amount and pattern of foreign investment in the United States;" Lastly, the CIPE opposed new restrictions on inward investment for three reasons: they would conflict with the OECD Capital Movements Code, invite foreign retaliation, and "there is no sound economic or national security ground for additional restrictions on such investment at this time."[76] All in all, the Nixon administration only agreed to the modest solution amid the congressional proposals, namely, to improve its data collection on foreign investment in the U.S.

Under the customary rules of international law regarding a country's responsibility for the treatment of aliens, a country has the right to restrict or prohibit the entry of FDI unless it has concluded a treaty with other countries guaranteeing such entry. Although the numerous trade treaties such as Friendship, Commerce and Navigation the U.S. signed with its trading partners and the OECD Code of 1961 assured investors' rights of national treatment, they should not be interpreted that the federal government had no flexibility to regulate FDI in the U.S. The international environment did not interfere with the capacity

[75] U.S. Government Printing Office. 1974. International Economic Report of the President. Together with the Annual Report of the Council on International Economic Policy, p.65, https://babel.hathitrust.org/cgi/pt?id=msu.31293025744271&view=1up&seq=3.
[76] Ibid.

of American governmental authorities to control or prohibit FDI in certain economic sectors as long as the regulations would not violate the basic provision of national treatment (Piper 1983: 130f). Moreover, there were numerous characteristics of the American economy that made the U.S. a very attractive market for FDI: the large size of the American market, the political stability, greater freedom from economic controls, the existence of an efficient and highly skilled labor force, technological leadership as well as substantial R&D capabilities, and most importantly the well-developed capital market for investment financing, etc. These gave the American government many leverages in dealing with foreign investors without influencing the general inflows.

The lack of data and knowledge about IFDI was indeed a problem that also constrained a proposer response of the state. The increased role of MNCs in the world economy and concerns of the negative implications of foreign investment had long been the research interests in the U.S. A large-scale study project, the Harvard's Multinational Enterprise Project, started in 1965 to examine the economic consequences of American MNCs both on the national economies and foreign countries. A surge of research interests in the 1970s emerged in studies of Economics, International Business and Finance, as well as Political Science (see Arpan et al. 1981: 137f).[77] Stephan Hymer's PhD dissertation written in 1960, which was a foundational work on FDI and international business, was only published posthumously in 1976, when MNC's global expansion became a research issue for many.[78] However, by the time of the IFDI surge in the 1970s, scholars did not have any general consensus on the consequences of the operations of MNCs. As Vernon himself notes in a review of his famous work *Sovereignty at Bay (1971)* one of his objects was to "test the leading propositions of the opponents with such data as could be mustered for the purpose". Both advocates and opponents of MNCs were "grossly overreaching in

[77] For an excellent summary of the early writings before the 1970s, see Wilkins, Mira. 1977. *Foreign Investment in the United States*, New York: Arno Press. For a comprehensive literature review of research on FDI in the United States by the 1980s, see Arpan, Jeffery S., Edward B Flowers, and David A Ricks. 1981. "Foreign Direct Investment in the United States: The State of Knowledge in Research." *Journal of International Business Studies* 12 (1):137-154.

[78] At the time of Hymer's writing, there was no separate theory of FDI that distinguished it from FPI (Dunning & Rugman 1985). Foreign investment was explained primarily by differences in interest rates between host and home economies (Gilpin 2001:286).

their arguments; some cases were consistent with their sweeping hypotheses, some were not" (Vernon 1981: 520). This derived from a problem by the mid-1970s that there was lack of an authoritative FDI statistic and scholarly discussions about the economic impacts of FDI were based on insufficient data.

According to the International Economic Report of the President in 1973, total foreign holdings in the United States until 1971 were around $50 billion at the end of 1971 – less than half of comparable American investment abroad. However, it turned out later in the Study Act of Foreign Investment in 1976 that the president's figure was much underestimated (see Table 5 below).[79] This observation is also reflected in an research report published in 1974, which points out that there had been a doubling in the rate of FDI in the U.S. from 1962 to 1967 and considerably more foreign investors in the U.S. than reported by the Department of Commerce.[80] Both Congress and the Executive lacked the thoroughgoing knowledge of the nature and extent of the IFDI problem that would have enabled more restrictive policies (Kang 1997). In the 1970s, political debates took place at the elite-level – at which the officials also lacked sufficient knowledge and policy tools over foreign investors – while social interest groups were rarely involved. When social interest groups and Congress are rather salient on a policy issue, the policy goals of the important Executive agencies and the interagency relationships decide the outcome of the policy tenet.

Table 5. Private Foreign Investment Position of the U.S.

	Year end			
	1950	1960	1970	1974
Direct………………………....	11.8	31.9	78.2	118.6
Portfolio…………………………	5.7	12.7	26.8	40.5
Total………………………..	17.5	44.6	105.0	169.1

[79] For estimation of IFDI in the United States by 1971, see the *International Economic Report of the President 1973,* https://babel.hathitrust.org/cgi/pt?id=msu.31293022471266&view=1up&seq=74, p.62.
[80] See Arpan, Jeffery, S., and David A. Ricks. 1974. "Foreign Direct Investment in the U.S. and Some Attendant Research Problems." *Journal of International Business Studies* 5 (1):1-7. Both authors gave testimony on the topic of foreign direct investments in the U.S. to the House Foreign Affairs Subcommittee on Foreign Economic Policy (1974: 1).

Source: Foreign Investment Survey Act of 1976 (in billions of USD). [81]

As a response to the congressional concern, a Foreign Investment Study Act was proposed by the Nixon administration on March 28, 1974 and passed on October 11. The so-called "Benchmark Study"[82], required the Commerce and Treasury Department to conduct a comprehensive review of foreign direct and portfolio investment in the U.S., respectively (see also Kudrle & Bobrwo 1982: 365f).[83] As President Ford stated when signing the 1974 Foreign Investment Study Act:

In connection with the signing of this Act, I would also like to reaffirm this Administration's commitment to the established U.S. policy of maintaining an 'open door' to foreign investors. U.S. policy with respect to international investment generally has been based on the premise that the operation of free market forces in determining the direction of worldwide investment flow will maximize the efficient use and allocation of worldwide capital resources in the international economy. Accordingly, our basic policy toward foreign investments has been to freely admit foreign investors and to treat them on the basis of equality with domestic investors once they are operating within the U.S. We intend to continue to adhere to this approach and will oppose any new restrictions on foreign investment in the U.S. except where absolutely necessary on national security grounds or to preserve an essential national interest.[84]

The Benchmark Study concluded that existing U.S. laws were sufficient to safeguard U.S. interests and there was no evidence that foreign interests may want to take over certain segments of American economy.[85] The White House believed that with the TWEA and the defense laws, it already had the delegated power from Congress to block unwanted investment and did not want Congress to reclaim an area under executive discretion (Kang 2003: 173). Just in early 1971, President Nixon citied the TWEA to declare a 10%

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[81] Executive Office of the President. 1976. *International Investment Survey Act of 1976,* https://www.fordlibrarymuseum.gov/library/document/0055/1669585.pdf.
[82] Also known as the Inouye-Culver bill
[83] Executive Office of the President. 1974. *International Investment Survey Act of 1974*, https://www.fordlibrarymuseum.gov/library/document/0055/1668752.pdf. A ten percent threshold of ownership was adopted in the Study Act for the investigation of IFDI in the U.S.
[84] Statement by the President in signing S. 2840, ibid.
[85] U.S. Senate, Committee on Commerce, Subcommittee on Foreign Commerce and Tourism, May 3, 1976, *Public Hearing on Foreign Investment Study Act of 1974*, p.11. After the public hearing on the "Benchmark Study" in May 1976, another Study was granted in October by Congress for a more extensive investigation. See Public Law 94-472, 94th Congress, October 11, 1976.

import duty surcharge, so IFDI regulations can also fall within the TWEA if needed. However, as Niehuss points out, existent anti-trust laws at the time did not apply to foreign governments. “A top Department of Justice official pointed out in connection with the Aramco rumors that U.S. anti-trust laws did not contemplate direct government purchases of U.S. industry, and that present laws apply, on their face, only to persons and corporations and not to governments” (cf. Niehuss 1975: 89).

Congressional concerns were not pacified after OPEC investments began to increase in the late 1974. Several senators pushed the debate on FDI into a second phase even before the first, symbolized by the Foreign Investment Study Act, was completed (Pastor 1098: 239). In early 1975, another wave of congressional hearings emerged, which pressured the Executive to reconsider its IFDI policy. According to Baltz’s study, newly published archives revealed divergent views between the State and the Treasury Department during a high-level meeting just before CFIUS was created on February 24, 1975. As in the congressional debates, there were several options discussed within the CIEP’s Task Force: “1) maintain existing policy and establish by executive action a new office designed to improve the coordination of federal policy and facilitate consultations with foreign investors; 2) implement option one through new legislation; 3) impose screening procedures under new legislation; or 4) impose quantitative limits on official foreign government investment” (cf. Baltz 2017a: 63). The Department of State favored some form of screening of foreign government investment and a more active role, while the Treasury opposed any kind of formal screening, even of foreign government investments. According to recently declassified minutes of the meeting, Henry Kissinger expressed the State Department’s concern over the “large amount of funds that might be used strategically” and “saw some merit in a very permissive screening procedure involving a list of strategic companies and/or industries.”[86] Treasury Secretary William Simon was skeptical to the idea that state officials could decide on the benefits of individual investment and was concerned that a formal screening mechanism “might be difficult to

[86] Org. cf. “Memo, Bennett to Simon 24 February 1975; folder CFIUS Early Days, 1975; Box 1; Council on International Economic Files, 1978-79; General Records of the Department of the Treasury (RG 56), NACP [National Archives at College Park]”, see Baltz 2017a: 64, fn. 36.

abolish at some later time". Most participants of the meeting joined the Treasury's position. Eventually, the Task Force recommended that the open-door policy should be continued, and that the administration should oppose any congressional attempt to impose new restrictions. In addition, the administration should improve its data on foreign investment in the U.S. As scholarly analyses and historical archives revealed, the issue of IFDI for the Executive was narrowly framed as an issue of increasing congressional concern over Arab investment in the U.S. (ibid: 67; see also Pastor 1980: 250).

Congress and the Executive compromised on the Treasury's solution of establishing an information-gathering agency. President Ford established the Committee on Foreign Investment in the United States (CFIUS) in May 1975 with the signing of Executive order 11858, in accordance with Section 721 of the Defense Production Act of 1950.[87] CFIUS is located within the Treasury and as it was originally staffed, chaired by the Undersecretary of Treasury and consisted of other five agencies: the State Department's Assistant Secretary for Economic Affairs, the Deputy Secretary of Defense, the Undersecretary of Commerce, the Executive Director of CIEP, and the Assistant to the President for Economic Affairs.

4. Institutional structure of CFIUS

CFIUS was initially an information-gathering agency without any authority to regulate or prohibit foreign investments. The executive order gave CFIUS primary responsibility within the Executive for monitoring the impact of foreign investment in the U.S., including direct and portfolio. It called on the committee to prepare "analysis of trend and significant developments", to "review investments in the U.S., which in the judgement of the committee, might have major implications for U.S. national interests", and to coordinate the implementation of U.S. policy on such investment. As scholars noted, CFIUS was an institutional solution that reconciled the conflict between the President's

[87] DoT. 1975. Executive Order 11858, https://home.treasury.gov/system/files/206/EO-11858-Amended.pdf; see also The Defense Production Act of 1950, As Amended. https://www.fema.gov/media-library-data/20130726-1650-20490-5258/final__defense_production_act_091030.pdf.

internationalist inclination and some Congressmen's desire to keep as much control as possible over foreign economic policy (Pastor 1987; Kang 1997: 315). The Executive reconciled the protectionist imperative to regulate foreign investors with the internationalist penchant for rule making by drawing on a principle that is compatible with both: national security (see Jenkins 1993: 88). By doing this, it prevented any substantial enhancement of regulatory capacity by slightly extending an existent presidential right granted by the TWEA.

At the micro-level, a Treasury Department official was designated the chair of CFIUS. Operational procedures were not defined and the agency did not bear any substantive right to restrict foreign acquisitions. Since CFIUS was only authorized to review "major investments", it operated in a narrow area without influencing the market. If it decided that an investment had major implications for the national interest, its chairman, Secretary of the Treasury, would inform the National Security Council, asking them to agree to notify the home country government and resolve the issue through diplomatic pressure (Bailey et al. 1994: 117). For instance, in 1979, CFIUS did its first formal review of the acquisition of American Motors by the French firm Renault. Because Renault was partly owned by the French government, the committee worried that if American Motors would become a subsidiary of Renault, it might somehow be used by the French government to advance national objectives of a noneconomic nature (Graham 2006: 125). That concern was mitigated when CFIUS sought and received an assurance from the French government that Renault would operate American Motors purely as a commercial entity.

In October 1974, the Treasury issued a set of guidelines that would determine how the Committee operate (see Baltz 2019:117).[88] The guidelines enshrined the liberal perspective that the "free inflow of economically motivated investments will be to the economic advantage of the U.S. as well as the rest of the world." CFIUS not only "has no

[88] Original source: Guidelines for Committee on Foreign Investment in the United States, October 20, 1975, Final Draft, Office of Economic Affairs, L.William Seideman Files, 1974-1977, Box 115, Gerald R. Ford Library.

obligation to make assessments as to whether or to what extent each investment relates to the national interest," but also that it "should operate on the assumption that it would be neither feasible nor desirable to establish criteria for determining what kinds of investments might have major implications for the national interests." For the Treasury officials, because economically motivated investment were assumed "to be to the economic advantage of the U.S. and indeed the world", the committee's attempts to second-guess markets would be redundant at best or destructive at worst (cf. ibid).[89] The guidelines also called for voluntary consultations with the committee not only from private investors but also government investors when they would make "significant investments" in the U.S. A number of the major potential government investors then indicated a willingness to consult in advance on their plans to invest, such as in the Iran-Pan American transaction and the Copperweld acquisition by Societe Imetal (that received financing from the French government). The Department of the Treasury also discussed the consultation process with other major government investors in the Middle East and found broad acceptance of the [consultation] concept" (cf. Niehuss 1975: 96). In 1981, the Kuwait Petroleum Company, a firm wholly owned by the government of Kuwait, took over Santa Fe International with $2.5 billion dollars, which was one of the largest providers of drilling services in the U.S. Although the deal encountered massive media critiques in 1973 and one of the subsidiaries of Santa Fe, C.F. Braun, was a contractor of a U.S. nuclear facility, the deal went through in 1981. It was also the largest single Arab investment in the U.S. at the time (Myerson 1994). At the stage of CFIUS' establishment, state interventions were based on ad-hoc diplomatic consultations conducted by high-level officials, which further impeded institutional change driven by bottom-up social forces.

At the meso-level, the Executive retained its authority in the IFDI policy. CFIUS was created by executive order instead of any legislation of Congress and the latter had no formal role in the review process. The institutional arrangement of CFIUS stressed

[89] Original source: ibid.

executive discretion. However, while the powers of CFIUS did not match what some Congressmen had expected, the establishment of CFIUS added a new bureaucratic entity to the executive branch that the President did not want at the beginning and created a potential entry point for congressional intervention in the President's conduct of IFDI policy (Kang 1997). Besides the consensus on national security, another rationale also achieved growing attention – the economic implications of IFDI on the U.S. economy. Concerned with these issues is undoubtedly related to the structural and domestic constraints that U.S. hegemony was declining and there was lack of protection measures for domestic industry in the face of FDI surges. Although the Executive, especially the President and the Treasury Department endured such pressures, CFIUS did add an operational and ideational layer in the U.S. IFDI policy. It prepared the ground – though unintended by the Executive – for the creation of a more substantial screening mechanism years later. Moreover, by the mid-1970s, in the wake of U.S. military involvement in Vietnam, revelations of domestic spying, assassinations of foreign political leaders, the Watergate scandal and other related abuses of executive power, Congress increasingly focused on checking the executive branch (Peterson & Wenk 2003). Against this background, Congress reformed the TWEA by enacting the National Emergencies Act in 1974 and the International Emergency Economic Powers Act in 1977 to place new restrictions on the manner of declaring national emergency (see Casey et al. 2019).

Institutionalizing CFIUS vis-à-vis the rise of Japanese semiconductor industry

1. **Context: The shifting position between the U.S. and Japan in the semiconductor sector**

Entering the 1980s, with the recovery of the world economy, the U.S. experienced new dramatic highs in the level of IFDI. The increase of IFDI was huge not only in absolute terms, but also in relation to the size of gross domestic investment and U.S. OFDI. The ratio of the cumulative stock of OFDI to IFDI decreased from 5:1 to 1:1 from the late 1970s to the mid-1980s (Kang 2003: 171). By the mid-1980s, the U.S. had become the world's largest debtor in terms of IFDI stock, while Japan had become the world's biggest creditor country. The dollar devaluation through the Plaza Agreement further enlarged the U.S. trade deficits with Japan. The massive trade surpluses Japan accumulated in trade with the United States during the 1980s translated into increased financial power, as the U.S. came to rely upon Japanese investments to finance part of its persistent trade and budget deficits (ibid). With the East-West conflict moving rapidly to the end, many in the U.S. became concerned that the security problem of the future could take the form of economic threat from trading partners, especially Japan (Kang 1997).

In the face of a steady deterioration in American trade performance, dollar devaluation and a drastic surge of IFDI from surplus countries (ibid: 871), the Reagan Administration first reemphasized the domestic benefits of foreign investment. In his oft-cited *Statement on International Investment Policy* on September 9, 1983, Reagan stated that "a world with strong foreign investment flows is the opposite of a zero-sum game. We believe there are only winners, no losers, and all participants gain from it".[90] The reduction of reciprocal investment barriers and encouragement of a greater role for private foreign investment in developing countries remained important political objectives in Reagan's foreign economic policy (Frieden 1991).

Using the 10% standard, the U.S. was the largest home country for OFDI in 1980 with $ 213 billion, and the second largest host country (after Canada) with $ 65 billion IFDI stock. Following a short recession of 1981/1982, foreign direct investment continued to grow from 1983 to 1987. By the late 1980s, foreign takeovers of extant U.S. firms accounted for most of the FDI coming into the U.S. instead of the construction of new firms (Graham & Krugman 1993: 20). Since 1984, coincided with the strength of Japanese yen and financial deregulation, Japan became the source for the largest number of transactions in the U.S., whereas British investment accounted for the highest

[90] Reagan, Ronald. 1983. Statement on International Investment Policy, https://www.reaganlibrary.gov/research/speeches/90983b.

aggregate value.[91] In the single year of 1987, Japanese firms conducted 490 FDI transactions in the U.S., taking up 37% of the total 1329 cases, followed by the United Kingdom with 248 transactions, Canada with 122, and Germany with 77 (see Table 6). The U.K. and Japan also accounted for the majority of the so-called "megadeals" worth at least $100 million in total, and each finished 31 and 28 transactions.

Table 6. Number of identified transactions by source country 1983-1987

Source Country	1983		1984		1985		1986		1987	
	#	%	#	%	#	%	#	%	#	%
Total	751	100.0	907	100.0	912	100.0	1051	100.0	1328	100.0
Canada	97	12.9	127	14.0	101	11.1	114	10.8	122	9.2
France	48	6.4	54	5.9	61	6.7	45	4.3	69	5.2
Germany, F. R.	72	9.6	76	8.4	69	7.6	60	5.7	77	5.8
Japan	105	14.0	198	21.8	216	23.7	351	33.4	490	36.9
Netherlands	47	6.3	38	4.0	44	4.8	42	4.0	39	2.9
Switzerland	28	3.7	26	3.0	36	3.9	39	3.7	37	2.8
United Kingdom	159	21.1	171	18.8	176	19.3	176	16.7	248	18.7
All Others	195	26.0	217	24.1	209	22.9	222	21.4	247	18.5

Source: U.S. Department of Commerce, International Trade Administration. [92]

At the time, Japanese firms not only began to equal but also surpass their American counterparts in traditional industries such as automobile and steel, as well as in high technology areas such as semiconductors and automated machine tools (Mastanduno 1991: 82). Japanese IFDI especially in the U.S. semiconductor industry provoked political controversy for the industry's perceived importance (Crystal 2003: 59). Semiconductors was seen the "crude oil of the twentieth century" and "an essential element of a giant "electronic food chain" extending from upstream materials and production equipment manufacturers to downstream systems producers such as computer and office equipment manufacturers (ibid; Brown & Linden 2009). Accordingly, the competitiveness of these end-product sectors – their rate of innovation, their export

[91] U.S. Department of Commerce, International Trade Administration, Foreign Direct Investment in the United States, 1987 Transactions, December 1988, p.5, https://fraser.stlouisfed.org/title/854/item/33325.
[92] Ibid, p.9.

performance, and their productivity growth- depended on their ability to incorporate the best, most advanced, and least expensive chips. The semiconductor technology was initially developed for computers used in military purpose. As costs fell with large-scale military procurement in the 1970s, initial commercial applications spun-off into the computer industry, which was first dominated by the firm of IBM and AT&T. American policy (especially antitrust) prevented both from monopolizing the technology to dominate all of electronics, and in fact helped to set an industry-wide pattern of technology cross-licensing. Both firms became technology pumps, widely spreading into start-ups, promoted basic technological innovations on which the chip industry was built and established producers and users in this sector. Through the 1960s and 1980s, specialized producers of semiconductor equipment and materials emerged also in Western Europe and Japan, while producers of software and systems integrators in the U.S. further upgraded the value chain and kept the U.S. at the upper end.

Table 7. High-technology acquisition in the U.S. by country, Oct. 1988 – Apr. 1992

Country	Number of acquisitions
Japan	399
United Kingdom	65
France	41
Germany	17
Canada	14
Switzerland	14
Taiwan	11
Australia	7
South Korea	4
Netherlands	3
Other	33
Total	608

Source: cf. Kang 1997: 320. Ogr. Cf. Economic Strategy Institute Database, May 1992. Appended to the testimony of Linda M. Spencer before the House Armed Services Committee, Subcommittee on Investigations, Defense Department's Role in Reviewing Foreign Investment in U.S. Defense Companies, 102d Cong., 2d sess., August 12, 1992.

Since the 1960s, powerful government agencies of Japan such as the Ministry of International Trade and Industry demanded tough terms on technology transfers from foreign companies such as IBM and Texas Instruments that wanted access to the growing Japanese market. The Japanese government also pursued an active policy of subsidizing research and promoting cooperation between competing business groups, which helped them close the technology gap with U.S. firms in chips and related technologies. Most importantly, a major source of the Japanese advantage in the semiconductor industry was its vertical integration with large electronic firms, such as Fujitsu, Hitachi and Toshiba, which were in turn linked to banks belonging to a common business group (keiretsu). A company's internal electronics division could become a source of cross-subsidies when chip sales were down, and a related bank afforded a ready source of funds that most U.S. chip companies could not match (Brown & Linden 2009: 16). In 1980s, the market share of leading U.S. companies in the semiconductor sector took up 43% of the global market, while Japanese firms took up 14%. In 1990, American firms yielded 25% of the global revenues, while Japanese producers took up 31%. Particularly in the market segment of memory chips, Japanese companies went from a share of 5% to 90% in the early 1980s (Rempel & Walters 1987). Given the small size of most American companies, a number of them, unable to weather the Japanese competition, put themselves up for sale (Crystal 2003: 67). The growth rate of Japanese firms in the semiconductor industry was obviously faster in comparison to U.S. firms and the relative gains for Japan would be even larger if it could further take over leading U.S. firms.

Table 8. Change in industry leadership of semiconductor

1980: Total market \$9.4 billion		1990: Total market \$44.6 billion	
Company (Headquarter)	Market share	Company (Headquarter)	Market share
Texas Instruments (US)	14%	NEC (Japan)	8%
National Semiconductor (US)	7%	Toshiba (Japan)	7%
Motorola (US)	7%	Intel (US)	7%
Philips (Germany)	7%	Hitachi (Japan)	7%
Intel (US)	6%	Motorola (US)	6%
NEC (Japan)	6%	Texas Instruments (US)	6%
Fairchild (US)	5%	Fujitsu (Japan)	5%
Hitachi (Japan)	4%	Mitsubishi (Japan)	4%
Toshiba (Japan)	4%	National Semiconductor (US)	4%
Mostek (US)	4%	Philips (Germany)	3%

Source: Brown & Linden 2009: 18.

2. Critical juncture: The Fairchild-Fujitsu case

In October 1986, the Japanese technology company Fujitsu Ltd. proposed to buy 80% stake of Fairchild Semiconductor Co. for $200 million, which was a supplier of microtechnology for sophisticated weaponry. This happened just after two stunning acquisitions, one is of the American Firestone Tire and Rubber Company by the Bridgestone Corporation of Japan for $2.6 billion in the same year, and the $110 million sale of New Hampshire Ball Bearings to MinebeaoMitsumi in 1985 (Hicks 1988). Both American companies were leading manufacturers and military contractors. [93] CFIUS did not intervene in the first case, but reviewed the second one on national security grounds and allowed the sale. However, the Fairchild bid touched the nerve of the U.S. industry, since the company was one of the founding members of Silicon Valley and a symbol of America' superior position in the semiconductor industry. A scandal revealed in 1987 that Japanese Toshiba Machine Company supplied several computer-guided propeller mining machines to the Soviet Union between 1982 and 1984 also increased public fear that sensitive technology will be shared with Warsaw Pact nations by Japanese companies (Greidinger 1991: 113). Throughout the 1980s and early 1990s, the security question remained at the center of the debate over what policy to adopt toward IFDI in America's high-value industry (see also Daniels 2018).

As analysts and pundits commented, the Fujitsu purchase marked one of the most important foreign investment involving the transfer of cutting-edge American technology, research, and expertise to Japan in decades and created the first major controversy over a foreign investment from U.S. allies (Tolchin & Tolchin 1989: 10; Kang 1997; Crystal 2003). However, Fairchild was indeed already bought by the French company Schlumberger in 1979, so the transfer only meant that one foreign investor replaced

[93] Firestone established in the early 1890s was one of the largest suppliers of automotive tires in North America by the mid-1970s. During WWII, the company was also a military contractor for the government. New Hampshire Ball Bearings was a producer of precision bearing and complex bearing assemblies for aerospace, defense, medical, and other high technology markets.

another. Fairchild was not a sole supplier of components to any defense contractors, nor had it been involved in any classified projects since 1979 (cf. Crystal 2003: 64). The antitrust angle was muddled by the fact that, technically, the product lines of the two companies did not overlap: Fairchild, like many other U.S. companies, produced logic chips instead of memory chips. The two companies could have complemented each other economically through the deal. However, as soon as the proposal was announced in October 1986, fellow Silicon Valley CEOs, including many Fairchild alumni, announced their opposition. Industry opposition centered on a domino theory that the Japanese would take over the electronics industry and U.S. companies would eventually market and distribute Japanese products (cf. Alvarez 1989: 58). "The Fujitsu bid could signal the start of a trend, and it could also create the trend itself; If the deal went through, Hitachi, Toshiba, and NEC would have to react in order to remain competitive." LSI Logic chairman Wilf Corrigan warned that if Fujitsu's probe succeeded, it would lead to "wholesale attacks on U.S. companies by cash-rich Japanese zaibatsu" (cf. Crystal 2003: 63).

In October 1987, CFIUS met to plan an investigation, but it did not block the investment due to insufficient statutory. Media reports and scholarly reviews pictured the process of a bounded state intervention (see Rempel & Walters 1987; Crystal 2003: 62-65). Then Commerce Secretary Malcolm Baldrige played an important role in breaking the deal. In media reports, he expressed the message that "America's high-technology industries, already bloodied by what he regarded as predatory trade practices, had to be protected from Japanese acquisition and the battle would start here, with the Fairchild-Fujitsu deal" (cf. Rempel & Walters 1987). It was reported that during internal CFIUS debates, Baldrige was joined by the Deputy U.S. Trade Representative Michael Smith, who aligned with security advisers of the President to highlight the security implications of the transfer of semiconductor technologies (ibid). Smith took a reciprocal stance that Japan's protectionist trade policy should be considered sufficient grounds for economic retaliation – including investment restrictions (ibid). Deputy Under Secretary of Defense Stephen Bryen hammered at the national security issue. He pointed out that Japan's failure to take security seriously had allowed some sensitive U.S. technology to transfer to the Soviet Union. The Justice Department antitrust review was headed for a mid-December deadline and its anticipated ruling in Fujitsu's favor would clear the way for the sale.

Amid growing negative publicity,[94] Fujitsu withdrew its offer in March 1987 and Fairchild was acquired some months later by American National Semiconductor Corp. for 122 million, considerably below the $200 million offer of Fujitsu. Fairchild's CEO resigned a few weeks later and industry analysts were predicting eventual employee layoffs of as many as fifty percent of the Fairchild workforce. For the private economic actor Fairchild, the sale was not an economic gain in face of the higher price bid from Japan and the failed combination of capital and technologies from both companies. However, government and public intervention made the security implication of the deal salient and forced the private economic actor to forgo economic benefits.

The Fujitsu case was the only case singled out for CFIUS investigation in 1986 from among $209.3 billion IFDI. The $200-million sale represented less than 0.1% of that total. Also, Fairchild was already owned by a French firm (Schlumberger), whose purchase in 1979 was not a problem for the U.S. government. However, analysts agreed that CFIUS' investigation of the Fujitsu-Fairchild acquisition was an important turning point of the U.S. IFDI policy (see Alvarez 1989; Jenkins 1993; Kang 1997). This highly symbolic case and the prolonged and public controversy at the highest levels of government helped to galvanize the opposition to status quo that had been growing for several years, especially within the Defense and Commerce departments. The deal thus opened another window for institutional change.

3. Bounded reform and the Exon-Florio Amendment of 1988

The Fujitsu case made Congress aware that the President did not have adequate authority to block foreign acquisitions, unless he resorted to invoking emergency powers. "Exercise

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[94] For a review of representative media reports on the Fujitsu case, see Alvarez 1989: 56, fn. 306.

of emergency powers, however, would have caused a diplomatic crisis with Japan, because application of the President's emergency powers would necessitate labeling the Japanese acquisition of Fairchild an 'extraordinary threat'" (cf. Greidinger 1991: 114). Further complicating the problem is that Fairchild was a French holding company, which raised questions of whether the use of emergency powers would be appropriate (ibid). The Fujitsu deal thus provided much impetus to the institutional change of CFIUS in 1988. The political discussions also went beyond the semiconductor to the broader declining industrial base of the U.S. mainly as a result of American OFDI.

Congress members again offered a range of proposals to reform CFIUS. Ahead of the Fujitsu case, Democratic representative John W. Bryant from Texas proposed a bill in May 1986 that would require most foreign investors to file certain proprietary information with the Department of Commerce for public disclosure, if they intended to obtain more than 5% ownership of an American firm. It also proposed that the Federal government should share FDI information with state governments. Beyond the disclosure objective, Bryant proposed to restrict any new foreign investment unless U.S. citizens were able to invest in the foreign investors' home country on equal terms.[95] This was a demand of reciprocity in the face of the great disparity that existed between the ever increasing size of Japanese investment in the United States and the meager amount of American-owned assets in Japan (Encarnation 1992: 1-35). President Reagan's strong objection to the reciprocity provision forced the bill's sponsors to drop the provision and resubmit the bill in January 1987 as the Foreign Ownership Disclosure Act.[96] The House voted 230 to 190 to approve the measure, while the Senate rejected it by 83 to 11. The Bryant disclosure engendered "a storm of criticism" for its discrimination on foreign corporates, "which would chill foreign investment at a time when foreign capital was most needed to finance the budget and trade deficits" (cf. Tate 1990: 2029). Undersecretary of the Commerce

[95] As scholars note, although labor unions supported the Bryant proposal in principle (Tolchin & Tolchin 1988: 238), their effort was not obvious, since interest remained split between those who viewed foreign investment as a potential source of jobs and those who feared that foreign firms, particularly in the manufacturing sector, would displace union with nonunion jobs (Kang 1997: 322). They made little effort to make FDI restrictions to meaningful political action.
[96] U.S. Congress. H.R. 312- Foreign Ownership Disclosure Act, introduced on January 06, 1987.

Robert Ortner commented that the “discriminatory” registration requirements would also disobey the national treatment principle which the U.S. had accorded foreign investors.[97] In fact, the Bryant Act was not an unreasonable proposal to improve the information collection measures on FDI, because at the time, investments in more than 5% of a publicly-held corporation registered at Securities and Exchange Commission were reported only alphabetically by company or individual name, not by nationality, making the research of foreign ownership very difficult.[98]

At the time, there were even several attempts from different federal states to regulate FDI or discriminate foreign ownership in taking part in local economy. For instance, Texas passed a state regulation that imposed a screening requirement on entities with any amount of foreign government ownership that seek to acquire a petroleum-related business. Approval would depend on an assessment of the “best economic interest of the state”, while domestic corporations do not surrender such assessment (cf. ibid: 2035); California imposed a property tax on Japanese cargo containers; These state attempts were rejected by courts because they infringe on the proper domain of Congress and the federal government in regulating affairs with foreign nations (ibid). While many local governments can act on corporate regulations, they are not entitled to search for reciprocity with other countries. Although reciprocal policy proposals never became effective state laws, they served to prod the White House into pursuing more aggressive policy actions and coop with some congressional proposals it otherwise might not have pursued (see Kang 1997: 329f).

This time, political struggle also arose within the Executive. Interagency conflicts emerged between the Treasury on the one side, and the Department of Commerce and Defense on the other. The Department of Defense (DoD) entered the debate in 1988 with

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[97] U.S. Congress. House. Foreign investment in the U.S.: Hearing Before the Subcommittee on International Economic Policy and Trade, 100th Cong., 2nd Sess., Testimony of Robert Ortner.

[98] See Senate. Federal Collection of Information on Foreign Investment in the U.S.: Hearing Before the Senate Committee on Commerce, Science, and Transportation, 100th Cong. 2d. Sess., March 24, 1988, Statement of Representative John Bryant.

two reports, stating the risks of escalating foreign acquisitions of vital U.S. assets and both recommended substantial changes in trade, technology and investment policies to preserve these assets in national interests.[99] In *Bolstering Defense Industrial Competitiveness*, the DoD claimed that the issue of foreign ownership of American manufacturing facilities had not received adequate attention. The report argued that "from the national security perspective, foreign dependencies in technologies essential to defense production are inherently risky, and minimizing them should be a Department of Defense and national priority."[100] Moreover, it took a skeptical view of the Reagan administration's position that IFDI was always beneficial:

The most common view is that the rapidly increasing level of foreign ownership is beneficial to the United States. [...] This view overlooks economic issues, such as the long-term impact on the current account of a continuing flow from the U.S. of repatriated profits and other fees. More importantly, it overlooks the fact that ownership tends to dictate the geographic location of the underlying technologies. Security concerns are not resolved by domestic manufacturing facilities that are dependent on technologies controlled by other nations.[101]

Supported by the prestigious Center for Strategic and International Studies, high ranking Pentagon officials specialized in acquisition reform argued strongly for halting the steady acquisitions of the nation's defense industry from foreigners (Tolchin 1989: 5; Moran 1990). The hawkish stance towards the protection of national industry backed by the Department of Energy and several major national labs received substantial backing from Capitol Hill. One of their vocal supporters was Senator Jeff Bingaman, Democrat from New Mexico, who sponsored legislation requiring the DoD to identify critical industries and to report on their status every year (cf. Tolchin 1996: 2). Setting the stage for a national debate on what government should do about protecting its critical industries, Bingaman asked:

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[99] U.S. Department of Defense (DoD). 1988. *Bolstering Defense Industrial Competitiveness: Preserving Our Heritage, Securing Our Future*, Report to the Secretary of Defense by the Undersecretary of Defense, July 1988; Defense Science Board. 1988. *The Defense Industrial and Technology Base*, Final Report of the Defense Science Board 1988 Summer Study, October 1988.

[100] U.S. DoD. 1988. *Bolstering Defense Industrial Competitiveness: Preserving Our Heritage, Securing Our Future*, P. 28-30, https://apps.dtic.mil/dtic/tr/fulltext/u2/a202840.pdf.

[101] Ibid.

If semiconductors are [a critical industry], should we be disturbed when Monsanto sells the only silicon-wafer production plant in the U.S. to a German firm?... [or what] about the Hitachi-Texas Instruments joint venture on sixteen-megabit D-RAMs? (cf. Tolchin & Tolchin 1992: 28).

The Department of Commerce (DoC) with an expertise in monitoring the performance of individual sectors and was thus most attuned to the competitive challenges these sectors faced joined the DoD's dissent from the prevailing neoliberal orthodoxy. For example, electronics sector specialists at the International Trade Administration, with the assistance of Commerce's Foreign Commercial Service, issued a controversial report on the electronics industry. It advocated learning from the experience of countries like Japan and Korea and contended that "some of the elements of success in the case of foreign government and private sector involvement may be adaptable to the U.S. environment in order to stop the erosion of the U.S. competitive position." Released in April, 1991, the report cited the negative impact of IFDI on even minority investments "through technology transfer and potential policymaking power" and its long-term impact on producer-supplier relationships.[102] Similar skepticism toward the benefits of all forms of IFDI were also expressed in a report on semiconductor component suppliers that was prepared by the Strategic Analysis Division of Commerce's Office of Industrial Resource Administration. As Baltz notes, "after all, these hawkish views were coming mainly from a small, albeit vocal and committed minority of technocrats swimming against strong currents within their own departments" (Baltz 2017a: 86). However, they made up for their relationships and network ties with the staff and the leadership of key Senate and House committees (ibid).

The ideas of setting a more restrictive IFDI policy resonated with chairman of the House Subcommittee on Commerce, Consumer Protection and Competitiveness. During the

[102] U.S. DoC. 1991. National Security Assessment of the U.S. Semiconductor Wafer Processing Equipment Industry, Washington, DC: GPO, https://www.bis.doc.gov/index.php/documents/technology-evaluation/58-natl-security-assessment-of-the-u-s-semiconductor-wafer-processing-equipment-industry-1991/file.

course of several committee hearings held in 1987, Florio appeared skeptical about the power of "open" IFDI policies to automatically deliver prosperity. He stressed the governmental supports of America's trading partners in industries that were once dominated by American firms:

Although the U.S. investment in research and development is considerably larger than any of our major trading partners, a greater share of our investment is military related, and the investment in research by all of our major trading partners is growing at a far faster rate than is ours. This situation has created new challenges to a broad range of our cutting edge industries – telecommunications, electronics, computers, others as well.[103]

In Florio's view, relative gains – faster growth rate – of America's trading partners resulted from their institutional arrangements in which the government played an active role in supporting the national industrial development. Accordingly, Florio's solution was to bring the U.S. more in "conformity" with the practice of other countries. His solution appeared among the Energy and Commerce Provisions of the pending Omnibus Trade Legislation, under a section titled "National Security and Essential Commerce". As originally submitted, Florio's House legislation (and Exon's Senate version) mixed economic and defense objectives in its three main provisions. First, it empowered the Secretary of Commerce – not the Treasury– to investigate mergers, acquisitions, joint ventures, licensing and takeovers by or with foreign persons to "determine the effects on national security, essential commerce, and economic welfare"; Second, it gave the President the power to "restrict, suspend, or prohibit" any transaction that "threatens to impair the national security and essential commerce". Furthermore, the legislation established a broad set of criteria – namely the "economic welfare of individual domestic industries, and any substantial employment, decrease in revenues of government, loss of skills or investment" – to be used in evaluating each transaction. The term "essential commerce" drew immediate opposition of President Reagan, who argued that the amendment would undermine its objective of reducing trade-related investment measures

[103] U.S. Congress. House. Committee on Energy and Commerce, Trade and Competitiveness, Part II: Hearing before the Subcommittee on Commerce, Consumer Protection, and Competitiveness of the Commerce on Energy and Commerce. 100th Cong., 1st Sess., March 10, 1987, statement of James J. Florio.

in the Uruguay Round of the GATT (see also Kang 1997: 325; Jenkins 1993: 93). In response to the President's opposition, the amendment's sponsors removed the "essential commerce" clause, while inserting the phrase "harm to national security" into the final statute. Also, the provision permitting the Congress to enact a joint resolution to disapprove of Presidential action was omitted (Alvarez 1989: 77). Eventually, the President was given the requisite authority to block deals, not the Secretary of Commerce, who was considered too prone to act to protect U.S. industry (ibid: 75).

Congressional debates showed that Treasury Department officials again made the most important efforts to change the language of the Exon-Florio bill before it went to the House-Senate conference committee. By the late 1980s, the U.S. had pressed both bilaterally and multilaterally to reduce investment barriers and protect MNCs. A number of international activities relating to international investments conducted after WWII focused on the arbitral perspective.[104] Two intergovernmental discussions were undertaken in the 1970s at the United Nations Conference on Trade and Development (UNCTAD) on drafting a code of conduct for MNEs. However, the Carter and Reagan administrations did not agree to any binding codes for any measures resulting from the UNCTAD that would discriminate against US-based MNCs (Graham 2006: 117). The U.S. was thus faced with a long record of consistent opposition to investment restrictions and turning to a restrictive path would be costly. Most importantly, as the U.S. was the world's largest outbound foreign investor and the majority of MNCs were based in the U.S. at the time, any foreign reaction to unilateral controls would let the U.S. lose the most – a view the Treasury in particular emphasized repeatedly in the early debates about the U.S. IFDI policy.[105]

As Senator Exon acknowledged:

[104] For a list of early main international instruments dealing with FDI in the 1980s, see UNCTAD.1999: Examination and Review of Existing Regional and Multilateral Investment Agreements and Their Development Dimensions in Pursuance of the Mandate of Paragraph 89(b) of "A Partnership for Growth and Development", https://unctad.org/en/Docs/c2em3d2.en.pdf.

[105] See also U.S. Senate. Committee on Commerce. Hearings on the Impact of Foreign Investment in the United States Before the Subcommittee on Commerce and Tourism, 93rd Cong., 1st Sess., 1973.

We have been working very hard to try and bring the administration, particularly Treasury, on board. And so, we have tentatively agreed in the interest of getting this measure through and locking it in place because I think national security has such a key role to play in the future that we have agreed to allow the President to appoint whichever agency he feels would be most responsible and responsive to a threat of a takeover or a sale that would adversely affect our national security. We have gone that far.[106]

After years of salience of the IFDI topic in the U.S., on August 23, 1988, Congress passed the Exon-Florio Amendment as Section 5021 of the Omnibus Trade and Competitiveness Act of 1988. Its statutes lied in Title VII of the Defense Production Act. The Amendment granted the President the authority to investigate and block mergers, takeovers, and acquisitions that could result in foreign control of domestic companies.[107] Through Executive Order 12661, President Reagan delegated his authority to administer the Exon-Florio provision to CFIUS, particularly to conduct reviews, to undertake investigations, and to make recommendations, although the statue itself does not specifically mention CFIUS.

4. Restraint of CFIUS intervention in Sematech

The attempted acquisition of Fairchild Semiconductor by the Fujitsu Corporation in 1986 galvanized support not only for what became the Exon-Florio Amendment in the policy issue of IFDI, but also for other state interventions in securing the position of the U.S. in the semiconductors sector. High-tech and economic experts, experienced government officials, especially those who were engaged in the defense sector, began to build additional organizations to watch foreign acquisitions of American companies in the semiconductor industry. For instance, immediately after Exon-Florio's passage, counselor to the Secretary of Commerce in the Reagan Administration, Clyde Prestowitz, founded the Economic Strategy Institute. The Institute began creating its own database of foreign acquisitions to monitor the implementation of the law. The semiconductor industry's

[106] U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Federal Collection of Information on Foreign Investment in the U.S.: Hearing before the Committee on Commerce, Science, and Transportation. 100th Cong., 2st Sess., March 24, 1988.
[107] The law only applies to controlling investments in existing U.S. business, such as M&A or takeovers. It does not apply to greenfield investment.

interests also got particular support from the DoD. In 1987, the Defense Department formed a consortium – Sematech – with 14 U.S.-based semiconductor manufacturers to regain competitiveness of the domestic industry that had been surpassed by Japan in the mid-1980s (Brown & Linden 2009: 20). With the renewal of the Defense Production Act in 1987, Congress officially established Sematech. Sematech and the Exon-Florio Amendment thus emerged from the legislative process as different responses to regain the U.S. prior position in the semiconductors industry.

Originally, Sematech restricted membership to firms that were primarily owned and controlled by U.S. citizens with a domestic headquarter and that had a domestic manufacturing base (including fabrication and a substantial proportion of R&D) (Crystal 2003: 65). Although Japanese firms were the major competitors to Sematech, it was a German company that set off the major IFDI controversy after the Exon-Florio Amendment by attempting to purchase a local contractor to Sematech. In December 1988, Monsanto agreed to sell its electronics material division – the last major U.S.-owned silicon wafer producer (which provided nearly 30% of the silicon used by U.S. chipmakers – to the German chemical company Huels AG (ibid). According to a report of the Government Accountability Office, "with the sale of this U.S. firm, the share of the world [silicon and wafer] market held by U.S.-owned firms would drop from 14% to 4%, and their share of the U.S. market would drop from 48% to 8%" (U.S. GAO 1990: 20). The report also referred to the result of the 1987 Defense Science Board study that "the U.S. was leading its closest competitor, Japan, in only 1 of the 14 materials and processing technologies the Board had studied" (ibid). Officials from Sematech opposed the sale and petitioned CFIUS to recommend to President Bush to block it. The Treasury Department first refused Sematech's request. Instead, it informally encouraged Huels to voluntarily provide written assurances in the form of a letter sent to Treasury Secretary Nicholas Brady. The letter (of dubious legal enforceability) assured Brady that Huels would continue to supply Sematech, maintain production facilities in the United States for at least a period of five years, and continue to conduct research and development activities. With such assurances, President Bush followed CFIUS's unanimous recommendation that the transaction be approved. It was also the first full CFIUS investigation to take place under the Exon-Florio Amendment (ibid).

In 1990, CFIUS collided again with Sematech in handling another semiconductor-related FDI: the acquisition of Semi-Gas Systems by the Japanese firm Nippon-Sanso. Sematech again objected to the sale, and was also allegedly not consulted on the mitigation agreement that CFIUS negotiated with Nippon-Sanso. This time, Sematech did not accept CFIUS's decision quietly, and its representatives publicly and forcefully aired their grievances at several committee hearings, including two held by the Senate Subcommittee for Science, Technology and Space chaired by then Senator Al Gore.

The Treasury Department was hardly coy about the ideological premises of its position in CFIUS. For example, in congressional testimony justifying its handling of the Semi-Gas Systems deal, representatives of the Treasury clearly stated that "the theory behind our investment policy is that capital is used most efficiently when its flow is guided by market forces unhindered by non-market considerations. This benefits the world and U.S. economies and results in higher standards of living." Moreover, the Treasury officials also actively expressed their view of the Exon-Florio Amendment: "It is clear from the legislative history that the Exon-Florio provision was not intended to be used as an instrument of industrial policy. Government review of foreign investment should not be used to try to direct the economy or the flow of capital."[108]

The Treasury's reluctance to state intervention did not help to stop further foreign acquisition in semiconductors. According to the Economic Strategy Institute, between October 1988 and April 1991, foreign firms had acquired 46 semiconductor companies and 37 semiconductor equipment companies, with Japanese firms accounting for 41 and 27 of the respective totals (Spencer 1991: 10). This result triggered further critiques

[108] U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Decline of the U.S. Electronics Industry: Hearing before the Subcommittee on Science, Technology, and Space of the Committee on Commerce, Science, and Transportation. 101st Cong., 2nd Sess. August 1, 1990, 60.

within the Executive. D. Allan Bromley, the head of the White House Office of Science and Technology Policy, alleged that during his tenure at the White House, a leaked list of priority recipients supported by the Small Business Innovation Research grant program was being exploited by Japanese firms for “systematically buying the top companies on the list.” He further complained that “My efforts to insist that our government find out whether these purchases were parts of coordinated and targeted MITI business programs were never implemented,” and that CFIUS “missed all evidence for integrated, coherent efforts to procure technology in broad related areas such as semiconductors” (Bromley 2004: 464). Archives of congressional hearings also revealed the conflict within the state. Gore expressed the stakes of the conflict bluntly with regard to Sematech:

I am a great believer in Sematech, but if the rest of the government is going to actively undermine Sematech and hurt Sematech, refuse to listen to Sematech, refuse to consult with Sematech, refuse to give Sematech a chance to protect itself against a hostile effort by the Japanese to harm Sematech, then how can we have confidence as a country that we can make a consortium approach like this work?"[109]

Representatives from the Government Accountability Office also noted “an apparent inconsistency” between the U.S. defense technology policy and the CFIUS process:

On the one hand, the U.S. Government had established a national goal, through Sematech of developing U.S. capabilities in the semiconductor materials and equipment sector and has supported it with DOD funds. On the other hand, some U.S. companies with the most advanced semiconductor technologies have been acquired by competing foreign firms without U.S. Government objection.[110]

In the face of the rising competition with Japan in high-tech sectors, the U.S. government initiated a range of industrial programs that were directly relevant to the U.S.’s economic competitiveness. These programs did not took place without controversy or reversals (see Fong 2000). As the Exon-Florio Amendment shows, when it came to capital regulation

[109] Ibid.

[110] U.S. Congress. House. Committee on Energy and Commerce. Foreign investment in the United States: Hearings before the Subcommittee on Commerce, Consumer Protection, and Competitiveness of the Committee on Energy and Commerce. 101st Cong., 2nd Sess. June 12 and July 31, 1990, 151.

and acquisition control, institutional reform to defend industrial competitiveness was very difficult, since it deviated from the traditional post-war economic ideology and the broader laissez-fair paradigms.

5. Institutional continuity and change

The Exon-Florio Amendment of 1988, like the establishment of CFIUS in 1975, was preceded by similar structural changes in the global economy: A steady increase of trade deficits, dollar devaluation, a drastic surge of IFDI from trade surplus countries. There were even two more important reasons for a more radical policy change. First, as the Cold War tensions dwindled in the late 1980s, rationale to tolerate protectionism from allies in exchange for geopolitical support attenuated; Second, acute competition from allies like Japan in high-tech sectors – especially the strategic semiconductor industry – long dominated by American firms came into sharper focus. The political logic of globalization was first activated in the debates by a network of incumbent government officials and congressional members who were concerned about American industrial competitiveness. Due to the dual-use of semiconductors and its high economic contributions to the industrial base, it was inevitable that national security concerns were salient in this sector. However, the relative gains concerns towards Japan did not translate into a major institutional change, even when there were additional social pressure and interagency conflicts. The Executive's solutions to congressional pressures on a more restrictive IFDI policy was to establish CFIUS in a way that deliberately avoided the participation of U.S. Congress and thus any possible constituent influence. This institutional arrangement was also influenced by the dominant role of the Treasury in the policy-making process, as well as the broader project of the American government to reform the international trade and investment system that could best benefit American MNCs and financial bankers. Institutional constellations empowered the incumbent Treasury to steer transformative change and set specific rules that made it more difficult for "losers" of previous institutional fights (in Congress) to challenge the institutional arrangement. In the mid-1980s, the Reagan administration sought to solve the trade deficit with Japan and other trading partners by improving the expansion opportunities of U.S. firms that were retained by barriers imposed by other countries. It's main goal in launching a new round of multilateral trade negotiations, the Uruguay Round, was to bring the so-called "new issues" – service, investment and intellectual property – into the jurisdiction of GATT. Therefore, the neoliberal premise and international constraints concerted with American MNCs' overseas interests, which, in turn, locked the Executive into the trend towards a neoliberal path.

In scholarly reviews, the Exon-Florio Amendment was deemed a key turning point in the institutional history of CFIUS (Alvarez 1989; Jenkins 1993; Kang 1997). It expanded the agency's authority and posed a contraction to its official mission – evaluating the economic impacts of foreign investments. However, a close analysis (below) rather shows the "contained capacity" as noted by Baltz (2017a: 53). What the Exon-Florio Amendment achieved, was rather an institutional basis that set stage for another round of reform in 2007, which I would describe as an "unintended consequence" of the Executive. At the micro-level, the most important change is that the DoD and DoC became more active actors in evaluating the economic and security impacts of IFID. However, CFIUS continued to be located in and staffed by the Treasury's Office of International Investment. At the meso-level, CFIUS' institutional limitations – an interagency committee with no permanent staff or budget of its own and no line responsibility – were consistent with more White House control. Secretary of the Treasury was retained as its normal chair, and representatives of the Justice Department and the Office of Management and Budget (OMB) were added to the membership. Similar to a project office, the OMB exerts a centralized authority over agencies' budgets to Congress and is empowered to resolve interagency jurisdictional disputes (see also Li 2015: 729). The additional membership of OMB thus strengthened presidential control over the committee (Kang 1997: 326f). Congressional attempt to increase the role of the Congress did not succeed but resulted in a quasi-judicial bodies at the Executive. CFIUS continued to operate without information disclosure to Congress and the public (U.S. GAO 2005: 45).[111]

The theoretical part suggested five aspects to analyze the capacity of the regulatory regime. To summarize here, 1) intelligence-gathering capabilities; 2) a lead agency with strategic orientation and decision autonomy; 3) well-defined authority and operation areas; 4) coherence of the bureaucracy; 5) institutional linkage with domestic firms. At the time of 1988, CFIUS could barely fulfill the five criteria, but its capacity was increased to some extent in all these aspects. First, the data that CFIUS collected was on a “case-by-case” basis and not about analyses of foreign investment by industry sector. According to an investigation of the Government Accountability Office (GAO) in 1990, CFIUS “tried to learn” whether acquisitions would entail foreign control over “a scarce supply of goods that bear on national security” and that it “sought information on the U.S. and foreign firms' market shares and on the availability of alternate suppliers, both domestic and foreign, for the U.S. firm's product.” But such information was not systematically available and must be gathered in an ad-hoc basis and only when available from analysts from other government’s agencies or private research institutes (ibid: 19). Poor quality of data, the GAO found, even extends to information directly relevant to national security threats, such as the health and reliability of the suppliers of components to defense contractors. However, some research institutes such as the Economic Strategy Institute established in 1989 began to pay close attentions to foreign investments in key American industries and offer “strategic and competitiveness assessment.”[112] With or without CFIUS, the monitoring capacity over foreign investments was largely increased after the political debates in the 1980s.

Second, CFIUS continued to be located in and staffed by the Treasury’s Office of

[111] In the 1980s, Congress got more progress in the U.S. trade policy. The Omnibus Trade and Competitiveness Act of 1988 further expanded Congress’s role in the trade-making process by requiring increased consultation. It requires USTR to make annual reports to both the House and Senate outlining its trade objectives and to seek advice from the existing congressional advisers on trade policy. The Act allows for “reverse fast track” if both the House and Senate separately pass disapproval resolutions condemning the president’s trade actions.
[112] See Economic Strategy Institute. Who We Are, https://www.econstrat.org/about-us/who-we-are.

International Investment. This particular office is significant because its primary organizational mission was to promote the Treasury Department's open investment policies abroad (U.S. GAO 2005: 14). It is thus unusually sensitive to the agenda of breaking down barriers to investment abroad and upholding their interpretation of international treaty commitments at home. Moreover, the primary responsibilities of the Treasury Department as a whole was to fund the federal government, and, especially since the 1980s, finance its budget deficits. This institutional mission has meant that it is attuned to the sensitivities of foreign investors. However, the DoC and DoD also became the lead agencies with strategic goals besides the DoT in the political debates.

Third, concerning the operational rules, a preliminary operational procedure was established. The law requires CFIUS to follow a three-step review process. First, notifications of a pending investment would trigger a 30-day review during which time CFIUS could decide it fi required further investigation; If so, CFIUS then had an additional 45 days to investigate the proposed transaction and make a recommendation to the President; Last, the President would then have 15 days to "suspend or prohibit any acquisition, merger or takeover" on the ground that it "might threaten to impair the national security. Undefined rules constrained CFIUS to act much differently than before 1988. The term "national security" appears several times in the Exon-Florio provisions to describe the standard of review, to identify essential points for the President to apply the law. Nevertheless, neither the Amendment nor the Defense Production Act itself defined "national security" at the time.[113]Technically, the President's authority was also ambiguous. He or she can only block investments when other U.S. laws were inadequate or inappropriate to protect the national security. Even if CFIUS approves an acquisition by a foreign company, U.S. government agencies with export-control authorities – the Department of State, Commerce, Defense, and Energy – could still deny that company a license to export a particular technology. Referring to other regulations also implies that CFIUS itself did not have much regulatory capacity. According to a General Accounting

[113] See 50 U.S.C. app. § 2170(a), (c), (d)(1), (d)(2), 2170(e)(3), https://law.justia.com/codes/us/2001/title50/app/defensepr/sec2170/.

Office investigation conducted after the Exon-Florio Amendment, "CFIUS in practice took a very narrow view despite the ambiguous definition of "national security" (U.S. GAO 2005: 11). Its main interest was to learn the nature of the U.S. firms' relationship with defense-related work, whether it performs classified work for DOD, what percent of its production is defense-related, etc. (ibid: 13-19). At the time of increased IFDI in 1990s, the lack of a formal definition of national security in Exon-Florio and the freedom of CFIUS to negotiate mitigation agreements with foreign firms without extensive oversight left many members of Congress questioning the consistency of reviews performed (Travalini 2009: 792).

However, the continuous lack of a clear definition of the operational range also means that CFIUS could investigate IFDI in all industries because the law mentioned no rules or tests that could be used to determine unequivocally what products, services, or technologies were critical for national security. This increased the possibility for some members of Congress and domestic industry rivals fearing foreign competition or those failed to get reciprocal treatment abroad to recast foreign policy, antitrust, or anti-competitive concerns as national security issues (Alvarez 1989: 105). Notifications, while still voluntary, surged from 14 in 1988 to 204 in 1989 and 295 in 1990.

Fourth, with the Treasury as the lead agency and its liberal approach, bureaucratic coherence was not particularly increased. Fifth, at the time of 1988, the linkage with business groups was limited. CFIUS notice of a proposed acquisition that was given to the Committee by a third party, including shareholders, was not considered to constitute an official notification. Notifications provided to the Committee would be handled confidential and the information should not be released by the Committee to the public. A 45-day investigation could only be activated with the endorsement of an agency's staff chairman and *three* agencies must support the decision to initiate an investigation. Between 1989 and 2006, CFIUS received a total of 1,828 notifications, of which only 37 resulted in investigations (Graham & Marchick 2006: 57), which means only about 2% submitted security-related investment transactions were investigated. According to

Tolchin's investigation by 1996, more than 900 acquisitions went through unimpededly, including companies involved in the manufacture of nuclear triggers, gas cabinets for semiconductors, space technology, advanced ceramics, and silicon wafers (Tolchin 1996: 5). CFIUS was known around government circles as a "paper tiger": it rarely meet and rather spoke for government complacency toward foreign investment (Tolchin & Tolchin 1989: 9).[114] In fact, there was only one transaction from 1988 to 2006 that the President formally blocked using his power under Exon-Florio (see Graham & Marchick 2006: 102). In 1990, President Bush directed the China National Aero-Technology Import and Export Corporation (CATIC) to divest its acquisition of a Seattle-based firm producing metal parts and assemblies for aircraft, because of concerns that CATIC might gain access to technology through Mamco Technology that it would otherwise have to obtain under an export license. This forbit is widely perceived as a U.S. rebuke against the Chinese government's oppression of the Tiananmen Square protests in 1989, because no real security threat should exist given the low level of technology involved (Tolchin 1996: 5).

Although the Exon-Florio Amendment did not divide the Executive from its power, the interagency conflict, congressional attention and media exposure all indicate that the issue of IFDI was no more an issue of "quiet politics". Most importantly, the informal institution – the neoliberal approach to governing IFDI in the U.S. – was severely challenged by the ideas of protecting strategic sectors and national competitiveness. A consensus was reached on the protection of national security and institutionalized by the Exon-Florio Amendment. However, vague definitions entailed potential for misuse.

Strengthening CFIUS vis-à-vis Chinese telecommunications company

1. Context: The revival of a liberal pattern

When Bill Clinton entered the White House in 1993, some expected that CFIUS might be turned into a powerful screening agency. Given that both the President and Vice

[114] Although its chairman, Fred Bergsten, then U.S. Treasury Assistant Secretary for International Affairs, disputed this. He stated to a US Congress Subcommittee in 1978 that a great deal goes on in informal meetings and discussions within the agencies and between the agencies.

President Al Gore talked much about the high technology challenge facing the country during the presidential campaign, many expected that the Clinton administration would adopt a more mercantilist foreign economic policy (Kang 2003:185). However, the policy tenet of the Clinton administration was just as liberal as that of earlier Republican administrations (ibid). With the sharp deterioration of the Japanese economy and the resulting decline of Japanese acquisition of assets in the U.S., the window of opportunity for institutional transformation and aggressive policy action on IFDI had effectively closed. By the mid-1990s, the image of the Japanese juggernaut crushing the U.S. economy dwindled, as the U.S. enjoyed a period of robust and sustained economic growth. With the end of the Cold War, the Clinton administration also took a philosophical change that Reagan had pushed on the civilian economy, and moved it into the defense arena. In July 1993, U.S. Deputy Secretary of Defense, William Perry, gathered CEOs of top defense contractors and told them that they would have to merge into larger entities because of reduced military spending in the post-Cold War era. Perry's warning to the defense contractors that they should either "consolidate or evaporate" was aimed at restructuring the U.S. defense industry. The number of prime contractors reduced from sixteen to six. It did nurture a few potent players such as Lockheed Martin and the Boeing Co., yet the others had to find their other financial resources such as through mergers with other firms, which resulted in thousands of employees with deep knowledge of defense contracting leaving the public sector (Stoller & Kunce 2019).

Upon this change, in 1992, Senator Robert Byrd initiated an amendment to the Exon-Florio statute through Section 837 (a) of the Defense Authorization Act, known as the "Byrd Amendment".[115] The Amendment mandates an investigation "in any instance in which an entity controlled by or acting on behalf of a foreign government seeks to engage in any merger, acquisition or takeover which could result in control of a person engaged in interstate commerce in the United States that could affect the national security of the

[115] For the full text of the Byrd Amendment, see §837(a)of the National Defense Authorization Act for Fiscal Year 1993 (PL 102–484), Title VIII. H.R. 5006 – 102nd Congress, https://www.congress.gov/bill/102nd-congress/house-bill/5006.

United States.” In comparison to the Exon-Florio statute, the Byrd Amendment explicitly added the “control of foreign government” into the first clause for the decision of commencing an investigation or not. When an entity cannot overcome the presumption of state control, in other words, when it satisfies the first prong of CFIUS’s test for applying the Byrd Amendment, further analysis of whether the acquisition “could affect the national security of the United States” will be initiated. However, there was no definition in the statue so far of what means “an entity controlled by or acting on behalf of a foreign government”. Until today, CFIUS’ test of state control is very broad, with a threshold of 10% stock control of a corporation. This provision was not mainly targeted at Chinese investment which was almost nonexistent in the U.S. at the time, but rather other companies with partial governmental involvement, such as the bid of purchasing the missile and aerospace division of Ling-Tecmo-Vought from the French defense contractor Thomson-CSF in 1992.[116] The Byrd Amendment thus further broadened the review arrange and added another implicit regulation for economic reasons besides the antitrust laws. On September 3, 1993, President Clinton issued the Executive Order 12860 and added three members to CFIUS: the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, and the Assistant to the President for Economic Policy.

With the end of the Cold War, American policymakers again actively protected the outflow of American capital. A significant development in the area of foreign investment was the increased contracts of Bilateral Investment Treaties (BITs) primarily with developing countries in the 1990s. Throughout the 1990s, governments across the globe followed the U.S. lead in lowering trade and investment barriers and adapting themselves to the neoliberal form of globalization. The trend was compounded by the formation of a series of key international institutions integral to an overall policy of promoting free

[116] Thomson-CSF was merged from two French electric companies in 1968, Thomson-Brandt and Compagnie Générale de Télégraphie Sans Fil (General Wireless Telegraphy Company, CSF). The former was merged from two French companies Compagnie Française Thomson-Houston (CFTH) and Hotchkiss-Brandt which were originally set up by American managers. The French government owned 60% of Thomson’s share.

market policies throughout the world. The number of BITs has quadrupled in the 1990s, covering nearly 10% of all country dyads (Simmons 2014). U.S. and many Western companies sought to offshore (via direct investment or outsourcing) the production of tangible goods, assuming a role in the international division of labor that concentrated on product design, marketing, consulting and intellectual property, while physical production moved to low-wage developing countries. Most significantly, America secured the passage of the North American Free Trade Agreement (NAFTA) in 1994; the establishment of the Asia Pacific Economic Co-cooperation (APEC) in 1995; the formation of the World Trade Organization (WTO) in 1995. The 1990s witnessed a transition at the international level from the "embedded liberalism" under the Bretton Woods system to the "Washington Consensus" of the post-Cold War world (Drezner & McNamara 2013: 157). During Bretton Woods, it was assumed that states facing balance of payments crises would respond with a mixture of domestic macroeconomic adjustments and external assistance from the IMF. "In terms of embeddedness, the Bretton Woods system was set up such that global finance was subordinated to trade integration and domestic policy autonomy. Under the Washington Consensus, however, capital market openness had greater priority over domestic macroeconomic policies" (ibid). The 1990s ushered in a period of almost unanimous agreement that stock markets and economies around the world were best promoted by a "hands-off" attitude to financial sector firms so that they could best and most efficiently use the market logics to distribute capital efficiently throughout the economy.

2. Consecutive critical junctures and changes of rules 2001-2007

Prior to the next major legislation in CFIUS' history, a liberal approach to IFDI revived in the 1990s. Between 1992 and 2001, the statutory authorization for CFIUS and its regulatory implementation went untouched, despite several attempts at reform by concerned groups in Congress (Graham & Marchick 2006: 46-49). However, the terrorist attack on September 11, 2001 fundamentally altered the way the United States views national security, including economic security, which also influenced the realm of U.S.

IFDI policy (Sauvant 2009; Hasnat 2015). In the heightened security environment after the attacks of September 11, a security network led by the DoD gained the upper hand in foreign policy issues and managed to specify some vague terms that constrained CFIUS' operations. As noted in numerous studies, in the altered environment for the U.S. in the wake of the 9/11, security and intelligence priorities of the U.S. shifted from well-defined targets toward more diffuse threats associated with nonstate actors and the spread of nuclear, chemical and biological weapons (Weiss 2014: 64f). Since most innovation occurs in young high-tech firms, developing links with entrepreneurial companies and preventing them from cooperating with MNCs from hostile foreign countries were clearly in the interests of the defense sector. Against this context, the Patriot Act of 2001 granted a large scope of "critical industries" for CFIUS review. "Critical industries" were defined as "systems as assets, whether physical or vital, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters". With this law, the U.S. included economic activities as a separate identifiable component of national security (Hasnat 2015: 188). Recognition of the power and influence of non-state actors also collapsed the distinction between internal and external security: Threat assessment may come to rely on a more fluid baseline characterized by individual and organizational relationships rather than investor nationality. Furthermore, the Department of Homeland Security was added to CFIUS' membership in 2003 (Stagg 2007: 342). Two major government-backed investments in 2005 and 2006 increased the national security concerns towards foreign investment.

On April 4, 2005, a California-based multinational energy giant, Chevron Corporation (Chevron), announced its intention to acquire its competitor, Unocal Corporation, with a bid of $ 16.8 billion (Steve 2005). Following antitrust approval from the U.S. Federal Trade Commission, negotiations had proceeded smoothly until China National Offshore Oil Corporation (CNOOC) made an $18.5 billion bid for Unocal on June 23, 2005 that topped Chevron's offer.[117] CNOOC was created by the Chinese government in 1982 to be a joint venture partnering with foreign oil companies for exploring offshore oil reserves. Upon its offer, CNOOC filed a CFIUS notice independently of Unocal.

News of the Chinese acquisition quickly initiated a media firestorm, engaging members of Congress, national security analysts, and business commentators in vigorous debate over the appropriateness of this international business transaction (ibid). On June 24, 41 members of Congress sent a letter to Treasury Secretary John W. Snow, urging a thorough CFIUS review of the Chines deal. On June 30, the House of Representatives had overwhelmingly approved (by a vote of 398 vs. 15) a non-binding resolution sponsored by representative Richard W. Pombo from California who urged the Bush administration to formally block the proposed acquisition as a threat to the national security.[118] On July 13, 2005, the House Armed Services Committee held a hearing on the proposed CNOOC acquisition. Among the witnesses was former CIA director Jim Woolsey, who called the proposed deal a "takeover attempt of a U.S. company by the most powerful communist dictatorship in the world" and stressed that "oil can be used as a weapon of war" (cf. Graham & Marchick 2006: 132). Before CFIUS commenced its investigation, Unocal's board of directors had recommended that shareholders accept Chevron's bid which was approximately $2 less than CNOOC's bid. At the time, Chinese FDI in total was a trickle in comparison to the one U.K., Japan and UAE.[119] However, China's rapid rise as an economic power, its new military ambitions and American job losses to the Chinese manufacture sectors were among the concerns.

In late October 2005, it was reported that the UAE-based port operations firm Dubai Ports World (DPW) had entered talks to acquire commercial port operations of the British-

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[117] The bid was also the third acquisition bid by a Chinese company of a prominent US firm in less than a year (Hemphill 2007: 61). Analysts note that the bid was advised by the American investment bank Goldman Sachs (Ng 2006).
[118] U.S. Government Publishing Office. 2005. Congressional Bills 209th Congress, H. Res. 344., https://www.congress.gov/bill/109th-congress/house-resolution/344/text.
[119] Inward FDI flows from China was around $146 million in 2005, , which accounted for less than 1% of total FDI coming to the U.S., whereas those from Japan were about $28 billion, from UAE about $1.1 billion.

owned Peninsular and Oriental Steam Navigation Company in six ports in the U.S. DPW was one of the world's largest port operator and owned by the Dubai government, running facilities in 14 countries. The company filed a voluntary notice with CFIUS on December 16, 2005 and went through the customary 30-day review on January 17, 2006. Deputy Secretary of the Treasury Robert Kimmitt revealed that DPW and CFIUS had informally talked about the review throughout the case and none of the CFIUS member agencies raised any national security concerns (see Graham & Marchick 2006: 137). CFIUS only did a 30-day review and concluded that the transaction "could not affect the national security" and the CFIUS board voted unanimously not to conduct the next step of a 45-day investigation.[120] It is not hard to sense the dissension between Congress and CFIUS on the interpretation of the Byrd Amendment and whether the DPW takeover required a formal review in the subsequent congressional hearing. While some Congress members understood a mandatory 45-day investigation from the latest Byrd Amendment, if the prerequisite of "foreign government control" is fulfilled, Treasury officials argued that the Byrd Amendment rather gave CFIUS discretion to decide on investigation or not.[121] Republicans joined Democrats in criticizing the Bush administration for supporting the deal, as Senator Lindsey Graham said: "I don't' think now it's the time to outsource major port security to a foreign country." Republican House member Curt Weldon charged that the deal "would transfer a vital defense asset to a foreign nation in an unstable region." The scenarios congress members pictured included the shutting down of the critical port facilities, moving classified or/and sensitive data offshore; transferring or copying critical technology overseas; economic (and government-supported) espionage; aiding enemies of the U.S, despite the fact that UAE was an ally in the war on terror and security requirements were imposed as conditions for the completion of the acquisition.[122] In Congress, the DPW acquisition resulted in more than 25 bills in the second session of the

[120] U.S. Senate. Committee on Armed Services. Briefing by Representatives from the Departments and Agencies Represented on the Committee of Foreign Investment in the United States (CFIUS) to Discuss the National Security Implications of the Acquisition of Peninsular and Oriental Steamship Navigation Company by Dubai Ports World, A Government-Owned and -Controlled Firm of the United Arab Emirates (UAE), 109th Cong., 2nd Sess., Feb 23, 2006.
[121] Ibid.
[122] Ibid.

109th Congress that addressed various aspects of foreign investment. “The proposed acquisition had all of official Washington on the edge of its seat for much of early 2006, blanket front pages of newspapers, and was the subject of countless hours of talk radio and cable television programming”. According to a Pew survey, this transaction ranked seventh in terms of news interest generated in the past two decades (Graham & Marchick 2006: 15). As a result of the public and Congress attention, DPW decided to sell off the US port operations to an American owner — a unit of American International Group — that had no portfolio in port operations.

The intense public and congressional reaction upon the CNOOC and DPW acquisitions spurred the Bush administration to change the way in which CFIUS reviewed foreign investment transactions (Jackson 2018: 8). One important move of the Executive branch was the use of a “Special Security Arrangement” (SSA) as the prerequisite in the approval of the merge of Lucent Technologies, Inc. with the French company Alcatel SA in December 2006 (see Berg 2018: 1770). SSA introduced so-called “mitigation agreements”—transaction-specific agreements imposing conditions with which parties to the transaction have to comply to receive CFIUS approval. The Department of Homeland Security takes the lead on monitoring compliance for those agreements (U.S. GAO 2005: 19F). Although CFIUS approved the acquisition, SSA restricted Alcatel’s access to sensitive work done by Lucent’s research arm, Bell Labs (Berg 2018). While mitigation measures provided CFIUS with enhanced flexibility to approve deals, SSA allowed CFIUS to reopen a review of the deal or to overturn its approval at any time if the company “materially fail to comply” with the terms. Prior to Lucent merge, CFIUS reviews and investigations were considered to be final. As a result, firms had been willing to subject themselves voluntarily to a CFIUS review, because once approved, the firm could assure American partners that the cooperation would not cause future troubles (ibid). Prior to the Lucent merge, on the eve of the midterm elections in 2006, CFIUS had already re-investigated the purchase of an American voting machines firm, Sequoia Voting System, by a Venezuelan software company headquartered in Oakland, Smartmatic, due to suspects that the company might have ties to the Venezuelan government of Hugo

Chávez (Golden 2006). In December 2006, CFIUS dropped the review when Smartmatic agreed to sell Sequoia, which it had purchased in early 2005 for $16 million (Davis 2006).

3. The Foreign Investment And National Security Act of 2007

The ongoing fear of terrorism, the special identity of DPW from the UAE and the rise of sovereign-wealth funds' investments in the U.S. stimulated strong bipartisan support for more scrutiny towards foreign investments. This time, the range of the debate and the options to further strengthen CFIUS was very narrow in comparison to the debates in the 1970s and 1980s. In the 1970s and 1980s, the debates ranged from whether to establish a regulatory regime at all to how to protect "essential commerce." In the debates about FINSA, the focus was merely on how to improve and broaden the regulations that would better protect U.S. national security and critical technologies. Recurring sources of congressional criticism during the 2006 and 2007 debates over the proposed legislation were CFIUS' infrequent use of the forty-five-day investigation period and the President's more infrequent use of power to block a transaction (Weimer 2009: 673). On January 17, 2007, in the first session of the 110th Congress, Representative Carolyn Maloney (D-New York) introduced the National Security Foreign Investment Reform and Strengthened Transparency Act of 2007. With slight amendments, the full House approved it on February 28, 2007 by a unanimous vote of 423 to 0. On June 13, 2007 Senator Chris Dodd (D-Connecticut) introduced the Foreign Investment and National Security Act of 2007, the so-called FINSA. Again, within one month and with strong bipartisan support, the Act passed the Senate by unanimous consent on June 29. On July 11, the House accepted the Senate's version of H.R. 556 by a vote of 370 to 45 and sent the measure to President Bush, who signed it on July 26, 2007. On January 23, 2008, President Bush issued Executive Order 13456 implementing the law.[123]

FINSA codified the CFIUS, granting it the statutory authority, which makes CFIUS a quasi-independent executive department that has its own financial capabilities (see

[123] U.S. Congress. H.R. 556 – Foreign Investment and National Security Act of 2007, https://www.congress.gov/bill/110th-congress/house-bill/556.

Jackson 2018:6). At the micro-level, CFIUS membership became permanent and the Secretary of Energy was added as a further member to this interagency committee[124]; Along with the Department of Labor (DOL), the Office of the Director of National Intelligence (ODNI) was added as ex officio members providing intelligence analysis; It also granted the President the authority to add members on a case-by-case basis. Still, there was no agreement on an explicit definition of "national security" and the methods that are used to assess the impact of foreign investment on the national security left unresolved in FINSA (Jackson 2008; Weimer 2009). Like the term "national security", many factors for launching a review are intentionally left open to interpretation by the Executive (Weimer 2009: 674).

FINSA also incorporated the Byrd Amendment of 1992 and the SSA mitigation arrangement of 2006. CFIUS first has 30 days to conduct a review of a transaction and determine wither it would pose a national security threat if consummated (see Jackson 2018). If national security risks (investments backed by government or in critical sectors) are found or if CFIUS is not satisfied with the results of its review, CFIUS will move onto the second stage of investigation which lasts with a maximum of 45 days. In the investigation stage, CFIUS may negotiate, impose, or enforce a mitigation agreement (Jackson 2008: 13). If national security risks are found, CFIUS may recommend the President to block the transaction within a 15-days window. More controversially, the FINSA regulations allow CFIUS to *reopen* a review of deal and to overturn its approval at any time if CFIUS believed the companies "materially fail to comply" with the terms of the arrangement. "This marked a significant change in the CFIUS process. Previously, CFIUS reviews and investigations were portrayed and considered to be final" (ibid: 8). Thus, the benefits for reviewees came out from a voluntary report under the Exon-Florio Amendment were replaced by a constant insecurity during the transaction process and

[124] Under FINSA, CFIUS is chaired by the Secretary of the Treasury and includes voting members from the Departments of Commerce, Defense, Energy, Homeland Security, Justice, and State; and the Offices of the U.S. Trade Representative, and Science and Technology Policy. Besides the two nonvoting ex officio members (the ODNI and DOL), various White House offices including the OMB, Council of Economic Advisors, National Economic Council, National Security Council as well as Homeland Security Council may also observe and, as appropriate, participate in CFIUS activities (see GAO 2018: 3).

even afterwards. Buyers would rather retreat the acquisition proposal once it enter a CFIUS review process, since the investment can be re-checked and re-stopped any time after the transaction. This unpredictable process increases the investment risks for foreign buyers and thus also their scrutiny in the buying process.

At the meso-level, FINSA added reporting requirements to the Congress and generated a major long-lasting effect on the regulatory regime. It required that any individual CFIUS member whose working level is no lower than an Assistant Secretary-level must certify to Congress that a reviewed transaction has no unresolved national security issues. For investigated transactions, the certification must be made at the Secretary or Deputy Secretary level. CFIUS is obliged to provide Congress with confidential briefings upon request on cleared transaction and annual classified and unclassified reports. As a result, Congress largely increased its oversight of CFIUS and regional and sectoral data on CFIUS covered transactions have become public since 2007. By granting access to such information, FINSA may also enable mischief by special-interest groups that encourage their congressional constituents to thwart or delay the review or approval process.

The institutional change quickly came into effect. Between 1989 and 2007, CFIUS investigated only 2% of its total notifications (37 out of 1828 cases) (Baltz 2017b: 875). In 2008 and 2009, although the number of notices declined significantly, the number of investigations continued to rise. While no deals were blocked, six were subject to investigation in 2007, and 23 in 2008, 25 in 2009. Respectively, investigations took up 4%, 14%, and 38% of total notices in the three years. The 65 notices in 2009 alone equaled the number from 1988 to 2005 combined (Hasnat 2015: 190). Although the number is dwarfed in comparison to number of IFDI deals in the U.S., it signals that the regulatory dimension for FDI changed (Sauvant 2009: 11). Before the next round of Chinese investments came in, and this time in the telecommunications sector, FINSA had set the stage for a more comprehensive CFIUS reform.

4. Shifting relative gains to China in the telecommunications equipment sector

4.1 The telecommunications equipment sector

Telecommunications equipment (TE) is a strategic sector that has large externalities into other sectors of a country's economy and serves to be the backbone of the complex global economy. The international industrial supply chain of telecommunications consists of upstream electronic component providers, original equipment manufacturers and vendors that supply synthesized telecommunications networks to downstream telecommunications service providers, who connect users. The TE sector can further be divided into networking equipment and consumer equipment, and telecom software systems and services (since 3G). The former includes wired technology such as switch networks and broadband, and wireless technologies such 5G. Consumer equipment refers to handsets and end user products, These TE products can be allied to a range of areas, public and private organization. TE manufacturers source raw materials from electronic component suppliers, conduct their R&D, create and design their devices and their distribution channels. By delivering more sophisticated equipment and solutions to service providers, TE manufacturers and vendors maximize profits in the industrial supply chain. In the past decade, the TE sector develops much faster than the other components of the supply chain driven by factors such as economic growth, increased consumer demand, the growth of internet and wireless communications (Zhu & Pasadilla 2016: 314). Most importantly, TE manufacturers have evolved from simply manufacturing switches to develop their own equipment and integrate their services with their products. In recent years, the development of the wireless technology has become the source of new business models that use it to create new markets, sometimes with explosive growth dynamics and disruptive effects.

For most of the twentieth century, American Telephone and Telegraph (AT&T) maintained an exclusive monopoly in the provision of telecommunications services and through their procurement practices, extended that dominant position into the equipment industry. This position was achieved initially by having control of the telephone patent, but AT&T's dominance in the equipment market was maintained by its requirement that any equipment that was attached to the Bell system network had to be supplied by AT&T itself. Prior to AT&T' divesture in 1984 ordered by the U.S. Department of Justice, Western Electric, AT&T's wholly-owned manufacturing subsidiary, supplied around 90% of AT&T's equipment purchases (Olley 1992:8). Given the fact that AT&T was the monopoly for the provision of telephone service in the U.S., Western Electric was in effect the dominant player in telecom equipment manufacturing. The famous Bell Labs was created in 1925 as the R&D firm of A&T as a dual ownership by AT&T and Western Electric. The American telecom industry was once called the "crown jewel of American manufacturing."

The defining feature of the telecoms supply chain has been the transformation of the international division of labor since the 1980s, including a near total shift in the supply chain to Asia (with China and Japan being the dominant players) and the U.S.' dramatic decline in competitiveness. At the time, production in Asia concentrated on the simpler parts of the TE, mainly electronic components and assemblies. In the U.S., the 1996 Telecommunications Act removed all remaining restrictions on the serve scope of an operator and fully liberalized the American market. As a consequence, AT&T spun off its Bell Labs into a telecom equipment company – the Lucent Technologies. At the time, it was the biggest initial public offering in history, which marked the begin of a relationship with financial markets that led to its eventual collapse. Furthermore, and more significantly in its effect on foreign investment in the U.S. was the Basic Telecommunications Agreement of WTO signed by the U.S. and 68 other countries. This is a landmark agreements in the WTO to open markets for basic telecommunications services. It established principles of nondiscrimination and national treatment for telecommunications providers throughout the world.[125] To implement its open-market commitments, the Federal Communications Commission (FCC) adopted two policies in the late 1990s, one on the foreign participation in the U.S. telecoms market, the other on special rules to increase competition in the U.S. satellite market. They created open entry

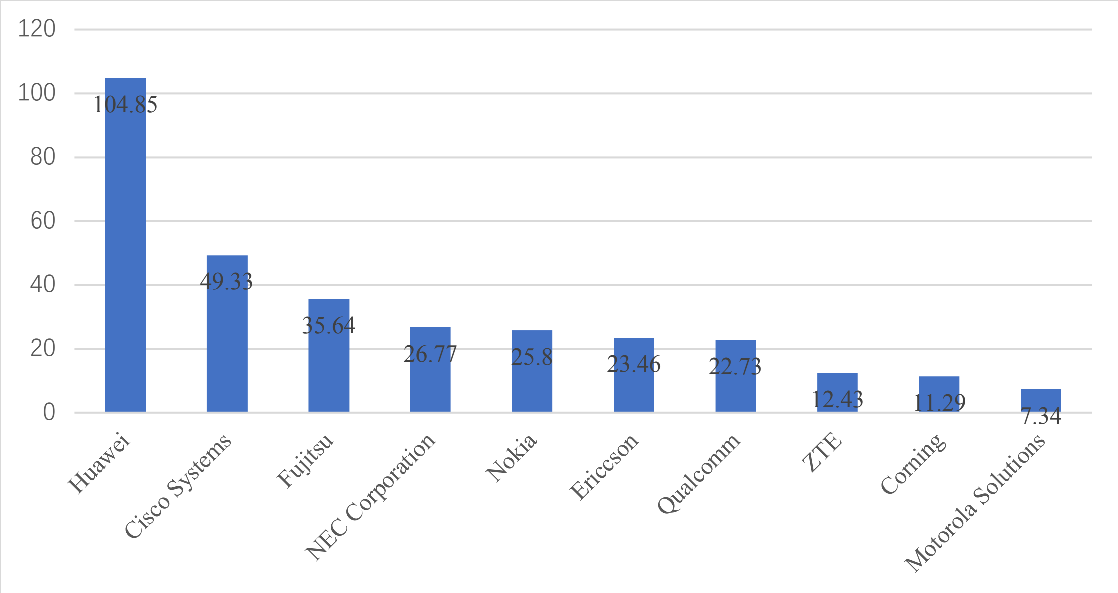
[125] China has not joined the Basic Telecommunications Agreement, yet it has bilateral agreement with the U.S.

principles for carriers from WTO member countries. In essence, an investment in the U.S. from a company based in a WTO member country would be presumed to be procompetitive by the FFC because the WTO Agreement on Basic Telecommunications also created more competition in that country's home market, thereby reducing the risk of cross subsidization from foreign carriers that were monopolies in their home markets (Graham & Marchick 2006: 60f). Since these regulatory changes in 1996, the FCC approved numerous FDI transactions in multiple telecom subsectors including the equipment sector. When the U.S. Congress and FCC adopted the regulations in 1996 and 1997 to liberalize investment restrictions, terrorism was still far from the minds of most Americans, the U.S. economy was booming, and the perception that the rise of China posed a serious economic and political challenge to the U.S. had not yet taken root. In a report on the Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, the FCC noted that that "during our two years in administering the Foreign Carrier Entry Order, with approximately 140 authorizations granted to carriers with foreign ownership, the Executive Branch [had] never asked the Commission to deny an application on national security or law enforcement ground" (U.S. FCC 1997: 29). The commission concluded: "We expect this pattern to continue, such that the circumstances in which the Executive Branch would advise us that a pending matter affects national security, law enforcement, or obligations arising from international agreements to which the United States is a party will be quite rare" (ibid). Entering the 2000s, the U.S. government held the free market policy by allowing U.S. telecom industry to succumb to global market forces even as Chinese companies such as Huawei and ZTE began to enter the U.S. market. Also in the basic service sector, a range of foreign firms has acquired large shares of U.S. operator companies, which caused little debate on national security issues (ibid).

Since September 11, 2001, national security concerns about the telecommunications sector grew for CFIUS agencies, especially the DoD. Investments in the telecom services areas have encountered tougher rules. However, acquirers based in countries considered to be close strategic and political allies to the U.S. were deemed a lower security risk

(Graham & Marchick 2006: 66). In the early 2000s, American TE champion Lucent was brought down by a string of mergers and acquisitions of European companies. In 2006, the U.S. company merged with France's Alcatel to become Alcatel-Lucent. This intra-company event effectively signified the end of American control of Bell Labs. A decade later, Nokia acquired Alcatel-Lucent and merged it into Nokia Networks division. Motorola, which like Lucent was once a major U.S. network equipment maker, eventually also had its wireless network assets acquired by Nokia. It was around the same time that Huawei was able to expand globally, initially offering its networking equipment at cheaper prices to international customers in developing countries as a way to gain a foothold outside China. The development of China's telecom sector is a textbook example of effective industrial planning, but also of the liberalization of IFDI that intermeshed with deregulations in the technology-advanced countries, which, in turn, allowed China to become the world's default supplier (see Part V). Policy deregulation and split of American monopoly AT&T converged with the economic opening of China, low labor-costs, a huge market, as well as an interventionist state. Since the 2000s, the market share and global revenue of leading TE manufacturers have increasingly shifted to China. The statistic below shows a ranking of telecommunication equipment companies worldwide by total revenue in 2018. Huawei was the largest telecommunications equipment company (revenue across all business segments) in the world in 2018 with revenues of more than $104 billion. During the past 20 years, the global TE market shifted from American firms to Finland's Nokia, Sweden's Ericsson and China's Huawei and ZTE, as well as South Korea's Samsung (all but Huawei are publicly traded). The U.S. now depends mostly on Nokia and Ericsson, with a smattering of Huawei deployment in low-density rural areas (Tonahue 2020). It still has one major TE firm – Cisco Systems, with sales of $49,33 billion in 2018 compared to $104,85 billion for Huawei, which included sales of its branded smartphones. In hindsight, the global telecom industry has experienced a shocking turnaround in the last twenty years.

Figure 2: Telecom equipment companies ranked by total revenue of 2018



Source: Statista, edited by the author (in billions of USD).
https://www.statista.com/statistics/314657/top-10-telecom-equipment-companies-revenue/

However, despite the striking progress Chinese firms have achieved in the TE sector, they are still dependent on their upstream semiconductor suppliers. Although the center of gravity of semiconductor demand and manufacturing has shifted to China, following China's role as a major global manufacturing hub, and the with the presence of many of the world's major semiconductor companies with operations in China, the fact is that much of the production activity is at the lower end of the value chain. A recent report on semiconductors to the U.S. President notes that Chinese industrial policies pose a real threat to semiconductor innovation and U.S. security.[126] It specifies those areas in which China is lagging behind the U.S. and Taiwan in this sector, such as the manufacturing of advanced logic chips. Also, all advanced memory chips companies in China are foreign-owned. Its domestic companies are technologically lagging and focus mainly on low-end and mid-range parts of the market, making tailored products for the domestic market. The huge disparity between the global production and consumption of semiconductors reflects some of the major challenges which China must yet face in seeking to become an

[126] White House. 2017. Ensuring U.S. Leadership and Innovation in Semiconductors, January 9, https://obamawhitehouse.archives.gov/blog/2017/01/09/ensuring-us-leadership-and-innovation-semiconductors.

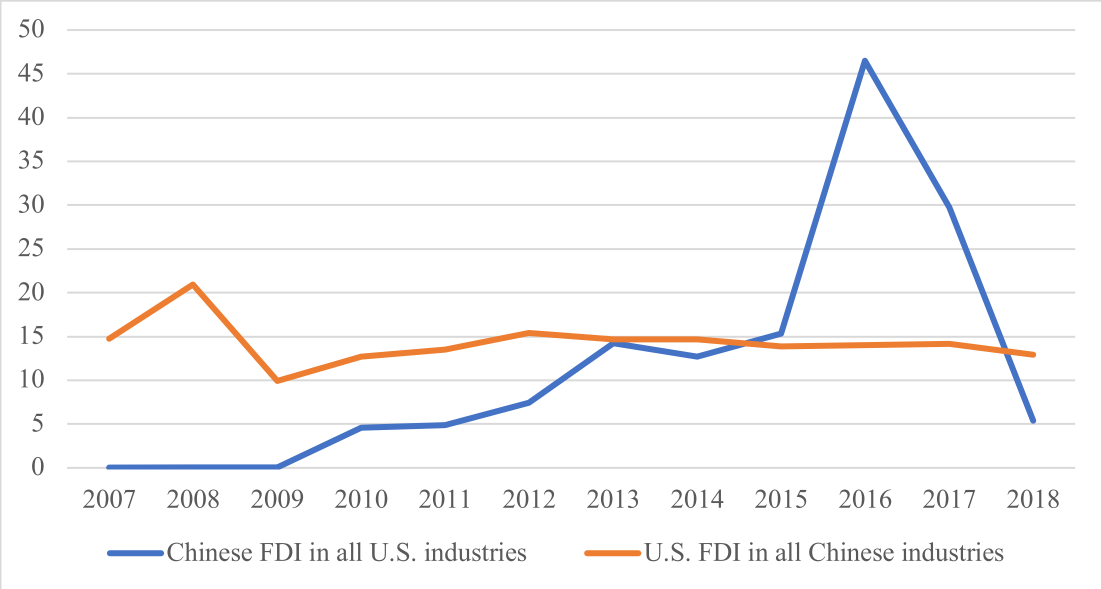
important player in high-technology sectors (Sun & Grimes 2017: 76). Numerous state initiatives have been made to boost indigenous innovations and foreign acquisitions. In September 2014, for instance, the Chinese government established a the China Integrated Circuit Industry Investment Found with a $22 billion investment fund to promote the development of the domestic semiconductor industry. Its largest shareholders include the Ministry of Finance (36%), the National Development Bank (22%), China Mobile (5%) and several SOEs. By 2016, 81% of the fund had been invested in domestic equity, but 19% went into overseas mergers and acquisitions and other funds (van Hezewijk 2019).

4.2 CFIUS' focus on Chinese TE firms

While FDI into the U.S. decreased largely after the GFC, it is after the 2008 GFC that China entered into place as a leading source of foreign investment in the U.S. In the year of 2007 when Congress passed FINSA, Chinese investment in the U.S. totaled about $356 million. By 2012, total Chinese FDI for the year increased to $7.6 billion, an increase of more than twenty times the amount only five years prior (Rhodium Group 2019). Annual growth rate from 2010 to 2015 averaged 32%. Those significant numbers were dwarfed by 2016, which marked a breakout year in which Chinese FDI in the U.S. jumped to $45.2 billion, roughly triple that of 2015. The annual value of acquisitions increased dramatically since 2008, yet still lower than the value of greenfield investment. A surge of investments in 2016 concentrated on the ICT, energy, and the real estate sector (ibid). Besides the increased direct investment, China also displaced Japan as the largest foreign holder of U.S. debt (including Treasury bills, bonds and equities) in September 2008. As quoted by Drezner (2009: 16), National Intelligence McConnell declared in early 2008 that "concerns about the financial capabilities of Russia, China and OPEC countries and the potential use of market access to exert financial leverage to achieve political ends represent a major national security issue." In 2013, China surpassed the United Kingdom as the country with the most investments reviewed by CFIUS.[127]

[127] CFIUS. 2015: Committee on Foreign Investment in the United States Annual Report to Congress, Report Period CY 2013, p. 17:
https://www.treasury.gov/resource-center/international/foreign-investment/Documents/2014%20CFIUS%20Annual%20Report%20for%20Public%20Release.pdf

Figure 3. Bilateral FDI flows between China and the U.S. 2007-2018



Source: Rhodium Group, edited by the author (in billions of USD).

Following FINSA, a number of Chinese deals were blocked or mitigated on national security grounds. The Chinese telecommunications champion Huawei already came under intense scrutiny of CFIUS in 2008 when its American subsidiary partnered with Bain Capital to acquire 3Com, an American company that built internet routers and advanced networking materials. CFIUS intervened because 3Com was an anti-hacking software contractor for the U.S. military. Huawei pursued a mitigation agreement with CFIUS, but both sides failed to reach a mutual agreement. In 2011, Huawei again offered to an insolvent technology start-up, 3 Leaf, in California. While the Bureau of Industry and Security at the Department of Commerce initially permitted Huawei to purchase and export 3Leaf's technology, CFIUS immediately decided to intervene in the transaction and launched an investigation into its potential national security ramifications (Griffin 2017: 1779). Huawei complied with CFIUS's investigations, but the latter recommended Huawei formally in February 2011 to drop its attempted acquisition of 3Leaf. Congress also launched an investigation into the accusations levied against the company. In a report that accused Huawei for its lack of transparency about its internal governance structure, Congress noted that:

Its preliminary review highlighted the potential security threat posed by Chinese telecommunications companies with potential ties to the Chinese government or military. In particular, to the extent these companies are influenced by the state, or provide Chinese intelligence services access to telecommunication networks, the opportunity exists for further economic and foreign espionage by a foreign nation-state already known to be a major perpetrator of cyber espionage..[128]

On October 8, 2012, the House Permanent Select Committee on Intelligence published a report on security threat posed by Chinese telecommunications companies Huawei and ZTE doing business in the U.S.[129] The report gives a number of policy recommendations affecting CFIUS, including to block acquisitions, takeovers and mergers involving Huawei and ZTE. The Report also recommends Committees of jurisdiction in the U.S. Congress to consider potential legislation to better address the risk posed by telecommunications companies with political ties. Congress noted in its report that the telecommunications sector plays a critical role in the safety and security of the nation.[130] One month later, the U.S.-China Economic and Security Review Commission issued a report that detailed concerns over Chinese investments by U.S. industries, arising from China's system of state-supported and state-led economic growth. Specifically, the report claimed that many Chinese companies had invested for strategic rather than economic considerations and received massive state subsidies. Also, it recommended legislation to add a test of "economic benefit" in CFIUS' review process towards Chinese investments in the U.S., including greenfield investments. In November 2016, the U.S. China Economic Security Review Commission released its annual report, in which it recommended to completely ban on investment from Chinese SOEs.

In December 2016, President Obama prohibited the acquisition of the German company Aixtron by the Chinese investment fund Fujian Grand Chip Investment Fund, which

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[128] Staff of Permanent Select Committee on Intelligence, 112th Congressional Investigation Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE.

[129] U.S. House. Permanent Select Committee on Intelligence, 112th Congress. 2012. *Investigative report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE,* https://republicans-intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20(final).pdf.

[130] Ibid: IV.

offered a $717 million bid. Aixtron builds equipment for the production of gallium nitride semiconductors, which are used in some civilian technologies such as light-emitting diodes (LEDs) used in consumer electronics and in the automobile industry. Given their resistance to heat and radiation, gallium nitride semiconductors have military applications as well, including in anti-ballistic missile systems (Mozur & Perlez 2016). Even though Aixtron is not a defense contractor, the government cited national security concerns in order to block the takeover. CFIUS concluded in its review that "the national security risk posed by the transaction relates, among other things, to the military applications of the overall technical body of knowledge and experience of Aixtron, a producer and innovator of semiconductor manufacturing equipment and technology, and the contribution of Aixtron's U.S. business to that body of knowledge and experience"[131] In other words, the President denied the possible transfer of the company's know-how to China (U.S. DoT 2016; see also Daniels 2018: 45). On December 2, President Obama directed the purchasers and Aixtron to abandon the deal. In the same month, more than 20 U.S. Congress members wrote to U.S. Treasury Secretary Jack Lew arguing to block the acquisition of Lattice Semiconductor by Canyon Bridge Capital Partners which was funded partly by China Venture Capital Fund (CVCF). Lattice was known for making logic chips, which have a wide range of uses because their attributes can be changed using software. The deal had been announced in early November 2016 and it quickly emerged in the media that CVCF was ultimately owned and funded by a Chinese SOE – China Reform Holdings – linked to China's State Council (Roumeliotis 2016). President Trump vetoed the deal in September 2017 based on a CFIUS recommendation that national security concerns "cannot be resolved through mitigation", including the integrity of the "semiconductor supply chain …and the use of Lattice products by the U.S. government", as well as "potential transfer of intellectual property to the foreign acquirer [and] the Chinese government's role in supporting the deal (U.S. DoT 2017). Furthermore, in 2018, President Trump block the Singapore-based Broadcom's bid to acquire shares of Qualcomm. In CFIUS' decision (U.S. DoT 2018), it cited Qualcomm's leading position

[131] Department of the Treasury, "Statement on the President's Decision Regard- ing the U.S. Business of Aixtron SE," December 2, 2016, https://www.treasury.gov/press-center/press-releases/Pages/jl0679.aspx.

in 5G and precisely pointed out:

Reduction in Qualcomm's long-term technological competitiveness and influence in standard setting would significantly impact U.S. national security. This is in part because a weakening of Qualcomm's position would leave an opening for China to expand its influence on 5G standard-setting process. Chinese companies, including Huawei, have increased their engagement in 5G standardization working groups as part of their efforts to build out a 5G technology […]. While the U.S. remains dominant in the standards-setting space currently, China would like compete robustly to fill any void left by Qualcomm as a result of this hostile takeover. Given well-known U.S. national security concerns about Huawei and other Chinese telecommunications companies, a shift to Chinese dominance in 5G would have substantial negative national security consequences for the United States"

This statement clearly shows that in the era of Chinese investment in the U.S., relative economic gains have converged with national security concerns.

4.3 Overall interventions in Chinese investments

CFIUS interventions into Chinese investments also went beyond the telecoms sector, yet the criteria for intervention were not consistent. In March 2012, Ralls Corporation (hereafter Ralls), a private Chinese company incorporated in 2010 as a subsidiary of SANI Group CO., Ltd., purchased four American wind farm companies in Oregon near a naval air base.[132] In June, after consummating the transaction, Ralls submitted a voluntary notice to CFIUS, informing the Committee of its recent acquisition (Wakely & Windsor 2014: 107f). Within a month, CFIUS issued an interim order on July 25, determining that the acquisition fell within CFIUS' jurisdiction, and that the transaction presented national security risks. The order further imposed "mitigation measures" such as requiring Ralls to "cease all construction and operations", "remove all stockpiled or stored items from the sites", and "cease all access to the project sites" except for removal of items by U.S. citizens" (ibid: 108). Subsequently, President Obama issued on order on September 28, 2012, prohibiting the transaction and ordering Ralls to divest the assets.[133]

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[132] Bloomberg Company Overview of Ralls Corporation: https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=206889484.

[133] Order Regarding the Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, 77 FR 60281 https://www.federalregister.gov/documents/2012/10/03/2012-24533/regarding-the-acquisition-

The order also blocked the future of any turbines made by Sany at the project sites. It was the first time in 22 years (after the block of the Mamco acquisition in 1990 by President Bush) that an American president blocked a foreign business deal. Consequently, Ralls Corp. sued first in district court and then appealed in a federal court against CFIUS. While FINSA's judicial review exemption prevents acquirers or target companies from appealing the prohibition of the transaction, it does not prohibit judicial review of "the *process* preceding such presidential action."[134] The U.S. Court of Appeals, District of Columbia Circuit issued in 2014 that the Presidential Order deprived Ralls of significant property interests (valued at $6 million) and Ralls was not given any of these procedural protections and evidences at any point. "This lack of process constitutes a clear constitutional violation, notwithstanding the Appellee's substantial interest in national security(…)".[135] Reportedly, the case was then settled confidentially between the U.S. government and Ralls. The first formal presidential veto since 1990 was overturned and the U.S. government subsequently approved two deployment of Sany windfarms, one in Colorado and one in Texas (CGTN 2015).

In 2013, China's largest pork-food producer, Shuanghui International, announced plans to acquire America's famous meat-processing company Smithfield with a bid of $7.1 billion, which would be the largest acquisition in history by a Chinese company of an American counterpart. Smithfield became a wholly-owned subsidiary of Shuanghui. Moreover, the acquisition of Smithfield's 146,000 acres of land made Shuanghui one of the largest overseas owners of American farmland. CFIUS quickly approved the deal. "This outcome was unsurprising as the pork industry does not quite fit into the rubric for analyzing national security threats" (ibid: 1759). However, a number of senators from midwestern states with substantial farming industries expressed concerns that the deal would endanger U.S. food security and urged strict oversight of the deal (Griffin 2017: 1758). In a hearing held in July 2013, the Senate Agriculture Committee urged CFIUS to

of-four-us-wind-farm-project-companies-by-ralls-corporation.
[134] Ralls Corp. v. CFIUS in the U.S., 758 F.3d 296, 311 (D.C. Cir. 2014).
[135] U.S. Court of Appeals, District of Columbia Circuit No. 13-5315: https://caselaw.findlaw.com/us-dc-circuit/1672928.html.

review the merger and expand the scope of national security review by considering the "broader issues of food security, food safety, and biosecurity".[136] Chairman of the Committee, Senator Debbie Stabenow from Michigan proposed a CFIUS reform to evaluate the "economic and cultural ramifications" of proposed foreign investment (see Stanley 2015: 1061). National security concerns went beyond the traditional defense and high-technology industries to agriculture due to concerns over food security.

The inconsistent decision towards the Sany Group case as well as the congressional disputes over the Smithfield case suggest the politicization of CFIUS process. "National security" has not only become malleable but also been used to cover protectionist policy in various sectors. Key actors of CFIUS, such as the Department of Defense, CIA and Congress view certain Chinese investment with great suspicion. As Daniel Rosen and Thilo Hanemann, founders of the Rhodium Group that tracked Chinese FDI in the U.S. commented, "nowadays, whenever a Chinese investment proposal is announced, the first question the media poses is not how many jobs it might create, but whether groups in Washington will try to block it, with little regard for whether there is actually any threat entailed" (2011: 8). Chinese SOEs are seen as "trojan horses", through which the Chinese government may acquire increasing power and influence abroad, potentially obtaining access to sensitive information or technology, or conduction economic espionage (see also Du 2014). Notwithstanding CFIUS's presumption, whether the Chinese government controls a particular Chinese company is not always a straightforward question in reality. Many Chinese companies are at least partly owned by the state, frequently at a provincial or local level. CFIUS does not distinguish between national and local control by a foreign government. Although the composition of Chinese firms was changing rapidly (see Part V) and the Chinese government has retreated largely by selling state-owned stocks to private companies and individuals, most post-SOE companies seeking approval from CFIUS still face a strong presumption of state control. Both academic researches and

[136] U.S. Senate Committee on Agriculture, Nutrition and Forestry. 2013. Bipartisan Group of Senators Urge Appropriate Oversight of Proposed Smithfield Purchase, https://www.agriculture.senate.gov/imo/media/doc/0894_001.pdf.

media reports have taken notice of the government and the People's Liberation Army's supportive role in the OFDI of Chinese SOEs (see Joske 2018). To be sure, a cut-off from strategic asset-seeking investments in the United States cannot cripple the Chinese innovation system in an aggregate sense. In the short run, not all innovation in the country is coterminous with cutting-edge technological progress, but rather customer-oriented and efficiency-driven (Khanapurkar 2020: 231). Nonetheless, an inability to acquire U.S. tech firms deprives the Chinese economy of a potent growth catalyst at the frontiers of technological applications where domestic capabilities are most lacking. Some would argue that a stronger investment regulation regime will simply cause Chinese investors to focus their attention on alternative methods of acquiring technology from US rms. However, since they confer firms with high degrees of control over technology and know-how, strategic asset-seeking investments generate benefits that other channels of technology transfer do not (Knoerich 2017). Moreover, not only does the regulatory regime apply to China but also an entire set of laws and regulations governing enterprises, particularly those related to corrupt practices, corporate governance, financial practices, foreign trade, occupational health, labor safety, civil rights, and so on (Sauvant 2009: 14).

5. History's heavy hand on the Trump administration

China's growing investment activity fueled another round of CFIUS reform. On November 8, 2017, U.S. Senator John Cornyn introduced a bill to expand the authority and operations of CFIUS. With strong bipartisan support, the bill was passed as the Foreign Investment Risk Review Modernization Act (FIRRMA) in June 2018. For the first time in CFIUS' legislative history, a reporting requirement on investments from a specific country (the PRC, see Section 18) is incorporated.[137] In explaining the act's background, Cornyn (2017) precisely refers to the Made in China policy published in 2015:

China targets at ten strategic sectors, including next-generation information technology,

[137] U.S. S. 2098 – Foreign Investment Risk Review Modernization Act of 2018, https://www.congress.gov/bill/115th-congress/senate-bill/2098/text.

aviation, rail and new energy vehicles, giving preferential treatment to Chinese companies. Left unchecked, I believe that China's investments have the potential to degrade our nation's military superiority and to undermine our U.S. defense industrial base, including significant damage to our long-term national security and other longstanding effects. [...] As I said, CFIUS was created not with China in mind—I think we've talked a little bit about the Dubai ports issue and other issues other countries have presented at different times in our history—but, again, now we are focused on the most aggressive country in terms of gaining that technology edge or closing that technology advantage we have—China. CFIUS has simply fallen out of date and needs to be modernized.

The attention to Chinese investment and concerns about the adequacy of CFIUS have received attention from multiple cabinet officials. Indeed, the senior leadership of the U.S. intelligence and defense communities appear to be in general agreement that concerns about Chinese investment require reform to CFIUS. Attorney General Jeff Sessions stated that CFIUS "is not able to be effective enough" and that "[FIRRMA] has great potential to push back against the abuses and dangers we face."[138] Secretary of Defense James Mattis likewise concluded that CFIUS is "outdated" and "needs to be updated to deal with today's situation." Director of National Intelligence Dan Coats echoed those comments, stating that the United State should undertake "a significant review of the current CFIUS situation to bring it up to speed." The White House also formally endorsed FIRRMA, issuing a public statement on January 25, 2018 that "the Administration supports House and Senate passage of . . . [FIRRMA]. Modernizing CFIUS in line with FIRRMA would achieve the twin aims of protecting national security and preserving the longstanding United States open investment policy."[139] In a statement on the FIRRMA legislation on June 27, 2018, President Trump threatened that should Congress fail to pass strong FIRRMA legislation that "better protects the crown jewels of American technology and intellectual property from transfers and acquisitions that threaten [U.S.] national security", he would direct his administration to "deploy new tools, developed under existing authorities, that will do so globally" (White House 2018b). While the support for CFIUS

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[138] Office of Sen. John Cornyn. 2017. Press Release. Cornyn, Feinstein, Burr Introduce Bill to Strengthen the CFIUS Review Process, Safeguard National Security, https://www.cornyn.senate.gov/content/news/cornyn-feinstein-burr-introduce-bill-strengthen-cfius-review-process-safeguard-national.

[139] Ibid.

reform swelled in the first year of the Trump Administration, as illustrated above, the concerns about the national security effects of foreign investment had already been heightened at the end of the Obama Administration. Thus, the desire to reform CFIUS is neither a partisan effort, nor an issue for only some Congressmen and a few single agencies as it was in the 1980s. The pass of FIRRMA was even commented by Heath Tarbert, the Treasury's Director of CFIUS, as "the most important largest bipartisan legislative victory of the [Trump] administration."[140]

During the legislative process of FIRRMA, the most controversial clause in Crony's bill was about CFIUS's review of joint ventures (including greenfield investments). FIRRMA's momentum derived from concerns not only about increased Chinese firms' acquisitions of American companies but also about certain investments that have traditionally circumvented CFIUS review due to their structure – minority investments, some joint ventures, and greenfield investments, among others (ibid). A report of the U.S. DoD in 2017 raised concerns about Chinese greenfield investments in American start-ups. According to the report, Chinese firms with strong ties to Chinese governments have increasingly invested in companies with cutting-edge technologies, of which many have potential military applications, being developed by small-sized companies in the Silicon Valley.[141] According to reports, there were some lobbying efforts of U.S. tech companies and trade groups, such as the International Business Machines Corporation and the Information Technology Industry Council. They wanted to remove the bill's emphasis on joint ventures and instead counter technology transfer by using export controls. An IBM policy executive, Christopher Padilla, said in congressional testimony in January 2018 that the Cornyn bill "could constitute the most economically harmful imposition of unilateral trade restrictions by the United States in many decades" (Mohsin & Brody

[140] Heath Tarbert. 2018. Closing Keynote, CSIS Event: Putting FIRRMA into Practice: What CFIUS Reform Means for Foreign Investment in the United States. September 25, https://www.csis.org/events/putting-firrma-practice-what-cfius-reform-means-foreign-investment-united-states.

[141] Brown, Michael and Pavneet Singh. 2018. "China's Technology Transfer Strategy: How Chinese Investments in Emerging Technology Enable a Strategic Competitor to Access the Crown Jewels of U.S. Innovation," Defense Innovation Unit, Department of Defense, https://admin.govexec.com/media/diux_chinatechnologytransferstudy_jan_2018_(1).pdf.

2018).

However, the major lawmakers of FIRRMA, such as John Cornyn, did not perceive export controls as an adequate solution and contended that greenfield investments in the small-sized tech-firms are “essentially acquisitions by another name,” “which is why CFIUS should be able to review them for national security risks." The provision would also allow the Commerce Department, with input from the State Department and Defense Department, to review foreign joint ventures, instead of the Treasury Department. Upon that, Heath Tarbert, the Assistant Treasury Secretary for International Markets and Investment Policy, indicated that a compromise was possible. “If CFIUS doesn’t review joint ventures, another process that has input from the intelligence community could be put into place to protect the transfer of sensitive technology” (cf. ibid). In public discussions and reports, Tarbert has always stressed the openness of the U.S. government towards foreign investments and their benefits to the U.S. economy.[142]

Promotors of FIRRMA such as the Chairman of the House Financial Services Committee, Jeb Hensarling, were vigilant of the “unintended consequences” of FIRRMA (CSIS 2018). During a high-level conversation at the Center for Strategic and International Studies shortly after FIRRMA came into law, Hensarling stressed that the legislation “could not be abused by future administrations as a potential tool of industrial policy, protectionism or economic control” (cf. ibid). He acknowledged that “as originally drafted FIRRMA likely would have represented the single largest expansion of executive authority over foreign commerce in decades both in respect to inbound and outbound investments” (ibid). In order to constrain CFIUS’ power, the House version of the FIRRMA legislation removed CFIUS’ ability to name new critical technologies outside of export controls altogether – an option that was available to CFIUS before FIRRMA was enacted. The

[142] In his keynote speech at CSIS on September 25, 2018, Tarbert cited Alexander Hamilton’s support of foreign capital in the U.S. The irony is, as discussed above in the beginning of this chapter, that Hamilton’s openness towards foreign capital was rather in accordance with his industrial policy and developmentalist ideas that the state should support and gather more money for America’s industrial development, than with a liberal ideology.

House also rejected labeling entire businesses as 'critical infrastructure companies' which would made CFIUS a tool of industrial policy" (ibid). Accordingly, the House's aim was to use congressional oversight, such as annual hearings, to constrain governmental abuse of CFIUS's power and take back more power from the Executive in deciding America's investment policy.

As it turns out, with FIRRMA of 2018, CFIUS largely increased its capacity to regulate IFDI in the five aspects discussed in the theoretical part and above over the Exon-Florio Amendment. First, considering the monitoring capacity, there have been not only well-established information-gathering agencies within the members of CFIUS who work on the general investment inflows, the intelligence work on the investment deals was also strengthened by the participation of the Director of National Intelligence, who acts as liaison between CFIUS and the U.S. intelligence community. The newly established Office of Mitigation, Monitoring and Enforcement will be out to look for non-notified transactions that have not been filed with CFIUS but nonetheless are subject to CFIUS' jurisdiction; Second, although CFIUS continues to be housed in the Treasury, the latter is no more the only lead agency in the review and investigation process. Instead, with FIRRMA, any other government agency can be designated as a lead agency. Agencies with more strategic orientations such as the DoD, Department of Energy, Homeland Security and the Office of Science of Technology Policy are now also active members of CFIUS; Third, operational procedures have been specified and well-practiced, while the range of covered transactions vastly increased. According to the 2018 GAO Report, CIUFS now meets weekly at a staff level and has three core functions: 1) review transactions that have been submitted to the committee and take action as necessary to address any national security concerns; 2) monitor and enforce compliance with mitigation measures; and 3) identify transaction of concern that have not been notified to CFIUS for review. CFIUS' scope now is beyond M&As, covering also "joint ventures" and "any other transaction, transfer, or agreement of which the structure is designed or intended to evade or circumvent […] the regulations prescribed by the Committee." The Committee has also expanded its staff and established three new working offices – the

Office of Reviews and Investigations, the Office of Policy and International Engagement, and the Office of Mitigation, Monitoring and Enforcement – besides the existing Office of Investment Security. The Office of Mitigation, Monitoring and Enforcement can look out for non-notified transactions and either invites the transaction parties to file or it itself files an agency notice to bring the transaction in CFIUS process. If the mitigation agreements are not complied with by the transaction parties, CFIUS will have an enforcement function. While FINSA only points out the review need of investment in critical infrastructures, FIRRMA extends the scope to protect America's important technology leadership. According to "the Sense of Congress", CFIUS should primarily considers "critical technology or critical infrastructure that would affect U.S. technological and industrial *leadership* in areas related to national security."[143] The word "leadership" never emerged in former legislations related to CFIUS process. The Sense of Congress is clearly beyond security concerns to cover industrial-economic goals in strategic sectors; Fourth, the coherence between the agencies are consolidated with the specified operation procedures. FIRRMA also recommends CFIUS to establish a process for exchanging information with U.S. allies and partners to facilitate coordinated action with respect to trends in FDI and technology that pose national security risks. The Office of Policy and International Engagement is now in charge of communicating with U.S. allies for understanding their regulatory regimes and reaching out in particular cases where information-sharing is needed; Fifth, the linkage with domestic firms and social groups is institutionalized. FIRRMA modifies CFIUS' annual confidential report to specified Members of Congress and nonconfidential reports to the public to provide for more information on notified and investigated investment transactions. By granting access to such information, CFIUS may also enable mischief by special-interest groups that encourage their congressional constituents to thwart or delay the review or approval process.

[143] FIRRMA, Section 2. Sense of Congress (7).

The United States has a longstanding policy of promoting international trade and being open to foreign investment. When reviewing the official IFDI policy from Nixon to Trump, every president explicitly stated a policy of openness to foreign investment. Even the Trump Administration stressed the "longstanding open investment policy" by issuing its support to FIRRMA (White House 2018a). In overview, national security concerns were rather the exceptions. However, recent CFIUS process rather shows a different treatment to Chinese investments. In the first year of the Trump Administration, CFIUS conducted 172 investigations – the largest amount in a single year in CFIUS' history – of which China accounted for 60 cases (U.S. DoT 2018, see also Table 9). The percentage of covered Chinese transactions of total notices in CFIUS processes increased from 2% in 2007 to 31% at its peak in 2016. In comparison, Figure 4 below shows that the number of CFIUS investigations of Chinese investments outpaced and increased much more faster than of investments from other major acquirer countries for the U.S. From 1988 to 2018, four of the five presidential vetoes were on Chinese investors. As the former Treasury Director of CFIUS Clay Lowery admitted in a public panel discussion at CSIS in September 2018 that an investment bid from a Chinese investor is definitely treated differently than from a Canadian investor in the first place, and there is going to be more scrutiny on Chinese investments for a while.[144]

Table 9. CFIUS notices, investigations and covered transactions by Chinese investors

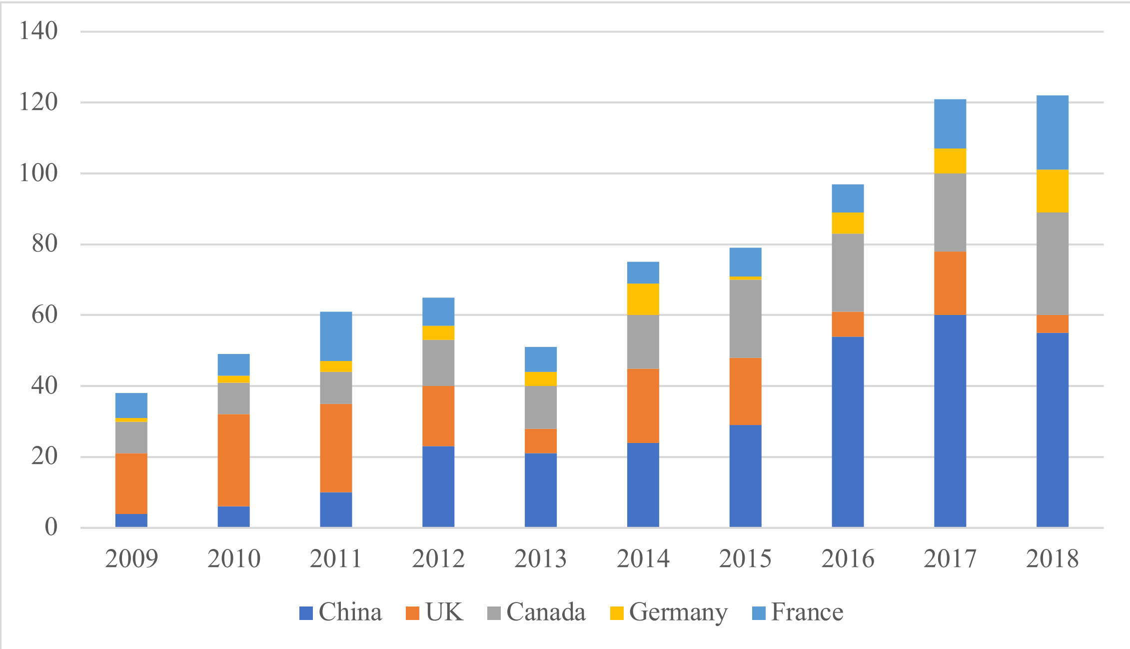
Year	Number of notices	Number of investigations	Covered transactions by Chinese investors	Percentage of covered Chinese transactions of total notices
2007	138	6	3	2%
2008	155	23	6	4%
2009	65	25	4	6%
2010	93	35	6	6%
2011	111	40	10	9%
2012	114	45	23	20%
2013	97	48	21	22%

[144] Clay Lowery. 2018. Statement in the Q&A session, CSIS Event: Putting FIRRMA into Practice: What CFIUS Reform Means for Foreign Investment in the United States. September 25, https://www.csis.org/events/putting-firrma-practice-what-cfius-reform-means-foreign-investment-united-states.

2014	147	51	24	16%
2015	143	66	29	20%
2016	172	79	54	31%
2017	237	172	60	25%
2018	229	158	55	24%
Total	1472	590	240	16%

Source: the author, with reference to U.S. DoT. CFIUS reports and tables 2008-2019.

Figure 4. Number of CFIUS covered transactions by acquirer home country 2009-2018



Source: the author, with reference to U.S. DoT. CFIUS reports and tables 2010-2019.

Since its establishment in 1975, CFIUS has had its powers elevated and procedures reformed through legislation passed in 1988, 1992, and 2007 and 2018. At the micro-level, the Treasury changed from the decisive agency in the U.S.'s IFDI policy and the CFIUS process to one of the eleven members. At the meso-level, Congress has largely increased its supervision role in this policy area. At the early stage of its development, the Executive first shielded CFIUS from Congress – the more politicized site of decision-making – to bureaucratic and quasi-judicial sites in the name of protecting national security. Now under FIRRMA, CFIUS decisions are under the scrutinization of Congress members. Upon completion of a review, the Secretary of the Treasury and the head of the lead agency are required to transmit a certified notice to Congress. After the completion of an investigation, they are required to transmit a written report to related committees within Congress. Each certified notice and report should confirm that, in the determination of the CFIUS, there are no unresolved national security concerns.[145]

From 1975 to 1978, CFIUS was reported to meet only six times and considered just two transactions. In contrast, from 2015 to 2017, CFIUS conducted 317 security reviews, taking up 57% of the 552 noticed transactions. Over the years, the agency has evolved from a "paper tiger" to a "bulwark" against foreign investment, or "Tech Office", as analysts noted (Berg 2018; Zimmerman 2019). It was created haphazardly in 1975 and became an important part of the national security apparatus not by design but by circumstance. Authors who initiated CFIUS would never anticipate that while annual IFDI inflows never exceeded 5$ billion before 1975, they now reach several hundreds of billions, peaking to an all-time high of $476 billion in 2015.

Globalization has continuously generated a political logic for the state and significant impacts on the preferred rules, practices and institutional arrangements in the U.S. in the area of IFDI policy. My study of the institutional origin of the U.S.' IFDI policy in the WWI shows that the political logic of globalization and relative gains concerns have had a strong enabling effect on the U.S. state, "but not exactly as it chooses" (cf. Weiss 2014: 16). The historically institutionalized role of the Treasury and the President determined the early development of CFIUS in the 1970s and 1980s. Faced with the structural changes, two waves of IFDI flows, congressional pressure and even interagency conflicts, the Treasury managed to shield the policy-making authority from Congress and ensure that the specific rules and practices of CFIUS would not deviate from a neoliberal approach. However, the compromises made in the 1980s also set stage for the institutional layering years later. After a revival of the liberal pattern in the 1990s, contingent historical

[145] Related congressional committees include: The Committee on Banking, Housing, and Urban Affairs; the Select Committee on Intelligence; the Committee on Armed Services; the Committee on the Judiciary, and the Committee on Homeland Security and Governmental Affairs of the Senate; and the Committee on Financial Services, the Permanent Select Committee on Intelligence, the Committee on Armed Services, the Committee on the Judiciary, and the Committee on Homeland Security of the House of Representative, see FIRRMA, Section 17 (6).

events in the 2000s, such as the terrorist attack on September 11, and support offered by the security and intelligence network led to a major reform breakthrough in 2007 that vastly increased CFIUS's powers and responsibilities. After having encountered at least three "adversaries" – Germany, the OPEC and Japan, China's rise again enabled the state to build additional domestic institutions for the protection of national competitiveness. Since 1914, history has evolved into "a heavy hand" on the Trump administration.[146] An information-gathering agency established in 1975 has fledged into an efficient regulatory agency. The IEEPA and CFIUS now serve as two major institutions to address national security risks of foreign investments. The seemingly limited laws and institutions designed for wartime or ad-hoc events went dormant rather than expiring. They have become to justify state authority for a widening array of powers in regulating international business. Even if the U.S. seeks to preserve the open-door policy in the preambles of legislative acts and speeches, the set of criteria approved in the 2007 and 2018 reform indicates that regulations have incorporated new concepts that express changes in the sense of a protectionism policy. Apparently, there is a disharmony between the traditional neoliberal approach to foreign investment in the U.S. and the fierce political debates in Washington on different approaches to preventing technology transfer in a globalizing era. And obviously, if the incumbent government can hardly find out nuanced measures that can impede technology transfer within the global capital and technology webs and chains, the simplest way to retain critical technologies at home is to decouple them from the webs and chains.

In the commercial sector, rebuilding the country's industrial base also requires an aggressive national mobilization strategy. This means active investment by government to gather financial resources and creation of jobs, including the participation of capable international investors. The Obama administration made several initiatives such as the Select USA program of 2011 to facilitate job-creating business investment into the U.S. A surge in FDI followed Obama's 2013 announcement of an aggressive enhancement and

[146] The "heavy hand" metaphor that describes history's lasting influence on present politics comes from Ikenberry 1994.

expansion of his Select USA program. It is reported that more than 1300 companies joined the program, which was expected to create more than 32,500 jobs (White House 2015). However, investment decisions are very related to tariff policies and sensitive to political environment. As the trade war escalated, the economic uncertainty led to a sharp decline of FDI inflows in the U.S, falling from a record $ 486 billion in 2016 to $ 292 billion in 2017, a 40% decline. While inward FDI globally declined by 23% over the same period, this still leaves the U.S. underperforming in attracting long-term investment from abroad (UNCTAD 2019). Trump's trade policy thus generated a negative effect on foreign investors, who are wary of the potential disruption of global supply chains. At the same time, the uncertainty of CFIUS process would only chill the investment climate further. The constraining effects and the economic logic of globalization – exposure to global capital markets, the exit power of multinationals and participation in the multilateral trade regime – seem to wither away, while the political logic of insecurity and competition has gained currency in the Trump administration.

It is also not only the fear that Chinese corporations now powerful enough to shake the power balance in strategic sectors that worries American leaders, but also their inadequate institutional tools to allay the fears and compensate losses from the international market. Until the mid-2000s, the three major advanced economies (the U.S. the EU and Japan) regularly brought cases against one another within the WTO framework. From 1995 to 2005, over 40% of the cases filed by the U.S. were against Japan, the EU or one of its member states. Nearly half of the cases filed by the EU were against the U.S. and two-thirds of the cases filed by Japan were against the U.S. Between 2009 and 2015, however, China-related cases accounted for 90% the case brought by the four largest economies against each other.[147] Since 2008, China has accounted for half of the cases filed by the U.S. While China's share of WTO disputes rises naturally with its increased share of global trade, it is also reconfiguring WTO dispute settlement as "WTO litigation has increasingly bifurcated into an 'established Power(s) versus China' dynamic" since the

[147] WTO. Find Disputes, https://www.wto.org/english/tratop_e/dispu_e/find_dispu_cases_e.htm.

GFC (Wu 2016: 264). With the resurgence of state sector in China in recent years, the efficacy of WTO will also be tested, since international institution has its limit in influencing domestic change. Besides, under President Xi Jinping, China has grown more assertive in its efforts to shape regional and global international relations and build China-led international economic institutions as alternatives to U.S-led ones, such as the Asian Infrastructure Investment Bank (see Li W. 2017). Therefore, we see rapid domestic institutional changes and policy reactions to Chinese investments in the U.S. since 2006. The next chapter will turn to the Chinese strategy and policy of regulating foreign direct investments, showing how a "late, late developer" of the twentieth century has utilized foreign capital and technology to catch up and yield relative gains in the global value chains.

V: IFDI and the Chinese state catching up in the world economy

1. Historical context

1.1 The first hit of globalization and historically constituted sovereignty threat from foreign capital

When the Chinese Communist Party (CCP) won power in 1949, China had weathered some hundred years of nearly continuous armed conflicts since the first Opium War (1839-1842). In the hundred years, foreign firms had played an important role in China's economy, whose existence was yet based on economic privileges and sovereignty cessions to foreign powers beginning with the Nanjing Treaty of 1842. In contemporary China, official narrative seldomly makes an institutional link between the late Qing dynasty (the "Old China") and People's Republic of China (PRC) (the "New China"). The political, judicial and economic system after 1949 is fundamentally different from the one in the dynasty history.[148] One exception, besides the uninterrupted cultural link, is the "path of national rejuvenation" in the public history narratives, which refers to the restoration of national wealth and power. On the 60th anniversary of the National People's Congress in September 2014, President Xi traced the beginning efforts of China's national rejuvenation back to an economic reform led by the ruling elites in the late Qing dynasty after the Second Opium War (1854-1860) – the so-called "Self-strengthening Movement" (yangwu yundong). It was a state-led development strategy to build China's own industry by learning from Western technology and using foreign capital. Despite the official interpretation of its failure "due to the lack of political change", narratives of history in the Xi-era have appreciated the foundational role of this Movement for China's national industrial and commercial development (Xinhua Net 2019). In a history review of the China Merchants Group, one of the largest Chinese SOEs and the major shareholder of China Merchants Bank, its Director Li Jianhong traced the organization's history back to the China Merchants Steam Navigation Company (CMSNC) established in 1872 by the Late Qing official Li Hongzhang. The purpose of the CMSNC was to capture part of the

[148] This study posed questions about the role of the contemporary Chinese state of the PRC, which is not the same state as in the dynasty history.

logistic business of China's foreign trade, which was then virtually monopolized by foreign companies based in the treaty ports granted by the unequal treaties after the Opium Wars. The establishment of the CMSNC in 1872 was described by Li Jianhong as "the first whistle of China's national industry and commerce." (Li 2017). Although the social group "merchants" had existed in China for some hundred years by the Late Qing, Li's narrative elegantly added "national" or "Chinese" ahead. It is indeed true that the domestic merchant group only began to have this distinctive role in the face of a strong foreign economic presence after the first Opium War.[149] This view is also reflected in contemporary Chinese-language studies of China's economic history (see Zhu et al. 2018; Yu 2019).

Not only in the Xi-era, according to Yu Heping (2019), Director of China's Modern History Studies of the Chinese Academy for Social Science, the economic impacts of foreign economic activities in late Qing China and the "Self-Strengthening Movement" were extensively debated at the onset of Deng Xiaoping's Reform and Opening-up Policy (ROP) in 1978. The establishment of the Special Economic Zones in the 1980s was compared by some conservative Party leaders with the "Self-Strengthening Movement." Such comparison even continued to emerge in media during a wave of mergers and acquisition of Chinese SOEs by foreign MNCs in the early 2000s (People. cn. 2006a). Scholars also noticed its footprints in the writings of Mao Zedong and his economic ideas. When the state was pursuing a heavy industry-oriented economic policy amid its economic backwardness in the 1950s, Mao appreciated the role of Late Qing official Zhang Zhidong who established the Hanyang Steel Company and the first military factories in China. He once wrote that "when talking about China's heavy industry, we should not forget Zhang Zhidong." In the Western understanding, the economic idea of state-led development to boost China's own wealth and power in the "Self-Strengthening Movement" is a synonym for "economic nationalism" endorsed by Friedrich List and Alexander Hamilton in the late 18th and early 19th century's America (see Crane 1999;

[149] Merchants in a hierarchical Confucian society – literati/scholars (shi) peasants (nong), artisans (gong), merchants (shang) – had been placed at the bottom of the social hierarchy.

Breslin 2011; Hu 2015; Pettis 2017). In a recent article, Eric Helleiner and Wang Hongying argue that ideas expressed in the "Self-Strengthening Movement" were rather rooted in China's own ancient thoughts in the time of the Warring States. China's vibrant ancient history, culture, and writings illuminate important aspects of the norms and values that guide its conduct (Pye & Leites 1982; Schwartz 1985). A discussion of the similarities and differences between the Listian and Chinese thoughts in the Late Qing reform is beyond the scope of this study. However, the scholarly interest of a comparison between them does reveal the fact that both countries had a period of similar development paths and similar economic ideas in the history.

In the 17th century, the international expansion of British and Dutch firms not only reached the American continent, but also the southern coast of China (Meng 2008: 29-31). In contrast to their settlement and colonization elsewhere, European merchants' trade requests with China were first rejected by the Qing court. In 1685, the Qianlong Emperor opened four ports (Guangzhou, Zhangzhou, Ningbo and Yuntaishan) in East and South China to pacify trade requests from Great Britain and established customs to manage foreign trade. From 1756, only the Guangzhou port was open for foreign trade. Imported silver from Britain was paid for traditional Chinese exports of silk, tea, and porcelain. In the early 1800s, British merchants began to export opium to China to redress the steady drain of silver into China and the trade imbalance. Despite a few trading companies such as the British East India Company in Guangzhou, there were rare business run by non-nationals in China until the outbreak of the first Opium War (1839-1842).

Britain's military response to the Qing court's attempts to suppress the profitable opium trade in the first Opium War demonstrated the weakness of the latter and the strength of foreign resolve to force China into the arena of international trade. The Nanjing Treaty of 1842 was the first in a series of "unequal treaties" between foreign powers and the Qing court that codified territorial cessions and foreign economic and political encroachment in China. With the Nanjing treaty, the Qing court ceded the Hongkong Island to the British government and opened five treaty ports on the Eastern and Southern coast (Guangzhou, Xiamen, Fuzhou, Ningbo, and Shanghai). Customs revenues at the treaty ports were then collected and controlled by Britain. A number of countries including France, Belgium, Sweden, Russia and the U.S. subsequently acquired the "most favored nation" status and the related economic privileges in the 1840s. Western trading firms and banks entered the treaty ports and the so-called "rent areas" created after the Nanjing Treaty, such as the British Sassoon Bank established in 1844, the Oriental Bank in 1845, the German trading company Carlowitz & Co.in 1845, whose houses are still standing on the Shanghai Bund. Starting with the 1858 Treaty of Tianjin, foreign trade vessels gained authority to conduct domestic trade along the Chinese coast and inland waterways. After the Second Opium War (1856-1860), eleven treaty ports were granted to foreign powers, which became the primary windows for foreign trade and investment in China. Although there were no rules until the Treaty of Shimonoseki in 1895 allowing the establishment of foreign manufacturing factories in China, a large number of them had been set up in the treaty ports. For instance, China's then telecommunications industry was dominated by Danish and British companies until the early 20th century. In June 1871, the Danish Great Northern Telegraph Company (GNTC) constructed a cable line from Vladivostok in Russia via Nagasaki in Japan to Shanghai, which was the first ever telegraph circuit in China (Xu & Pitt 2002: 10). It then shared with the British Eastern Extension Australia the rights of telecommunications provision in the coastal area between Shanghai and Hongkong. When the Qing court was preparing to build a own telegraph network in 1881, GNTC claimed exclusive rights for providing telegraph services in areas where it had installed submarine and land cables. The shipping business in Northeastern China was divided by Japanese and Russian companies. The infrastructure in Shanghai such as water and electricity supply was managed by British firms.

After the First Opium War, foreign firms changed from trading services companies to banks and real companies with tangible assets. Foreign investment projects concentrated in Shanghai and Northeastern China, covering a range of critical sectors such as transportation (railways, shipping), the extractive industry (mining and iron refinery), utilities (water and electricity supply), services (banking, insurance and real estate), as well as manufacturing (textiles, foodstuffs, brewery). China's first stock exchange, the Shanghai Share Broker's Association, was founded in 1891 by foreign businessmen. It initially only traded shares of foreign-registered companies and, according to historical archives, until 1935, Chinese were prohibited from joining transactions there (Goetzman et al. 2007). Maritime customs revenues that could be used to pay for war indemnities were in the grasp of foreign powers. The Qing court borrowed large foreign loans to meet the indemnity demands, such as from the British Hongkong and Shanghai Bank Corporation established in 1865. The pattern of interaction in the late Qing was one in which foreign powers demanded, the Qing court conceded. China's forced opening to the outside world thus coincided with a prolonged period of "national humiliation" from 1839 to 1949.[150] Since foreign companies enjoyed extraterritorial rights (not subject to Chinese law), there did not exist a Chinese regulatory regime to administer them. They were only loosely registered at local chambers of commerce (shanghui） organized by local Chinese business groups and at the embassies and consulates of the foreign governments (Zhang 2002: 348). According to estimations of Chinese researchers based on historical archives, by 1894, foreign capital (mainly in the form of foreign loans) was estimated to be $1.09 billion in China (Xu 1962: 10; Meng 2008: 49). It should also be noted that the majority of the so-called "foreign capital" was accumulated through local business operations in China instead of from their home countries.

In the wake of the two Opium Wars, some high-level Qing court officials such as Li Hongzhang, Zeng Guofan and Zhang Zhidong, supported a new priority of boosting the country's wealth and power through an outward-oriented, state-led development strategy. In this above-mentioned "Self-Strengthening Movement", the Qing reformists created a number of state-sponsored firms to compete with Western ones and to "recover China's rights to profits" in national economy. They paid attention to the capital expansion of the Western countries and used phrase such as "commercial warfare" (shangzhan) to describe the British taxing commerce to support war efforts (Helleiner & Wang 2018). These early

[150] See for instance, People's Press Cartography Office. 1997. *Atlas of the Century of National Humiliation in Modern China (近代中国百年国耻地图)*, Beijing: People's Press.

reformists supported a central role of the Qing court to play in the industrial construction, including sponsoring and subsidizing modern firms. In order to strengthen China against foreign powers, the Qing court decided to learn from the Western techniques and knowledge in manufacturing, especially in military manufacturing. Since the Qing court itself was short of financial strength, these early manufacturing companies relied on private and foreign loans for operations (Xu & Wu 2003). Most of these firms were established in a form described as "government-supervision and merchant-operation" (guandu shangban). They were controlled and overseen by state officials, but their management was left to private merchants who had experience with foreign firms and company management (Helleiner & Wang 2018: 464; Meng 2008: 47-55; Ju et al. 2012).

Economic encroachment of European countries, the U.S. and Japan in the form of FDI in enlarged after the Sino-Japanese War (1894-1895) (Pearson 1991:40; Xu & Wu 2003). The Treaty of Shimonoseki granted to the Japanese rights to build industrial plants in the treaty ports, which also accrued to the other foreign powers. Large foreign loans also dragged China into a debt crisis in the late 19th century. After the war, many manufacturing companies established by the reformists were mortgaged to Japan for war indemnity. A symbolic event was the mortgage of the Hanyang Steel Company. Hanyang was established in 1890 by Zhang Zhidong (then governor of Hunan and Hubei) and initially sponsored by Chinese businessmen. The Company hired British geologists to for mining detections and imported finery forges from Great Britain. Due to financial shortage in the 1900s, Zhang Zhidong borrowed from German, British and Japanese banks to support the company's operation, which did not save it from being mortgaged to Japan in 1904 (Yuan 2011). By 1914, foreign capital is estimated to have accumulated to $9.6 billion, which was nine times as of the estimated figure in 1894 (Meng 2008:73).

In China studies, a general consensus is that the "Self-Strengthening Movement" failed with the Sino-Japanese War. China was chronically in debt in the late 19th and early 20th century as a result of massive indemnities, which gave the foreign powers more leverage in negotiations to expand their spheres of territorial influence. Many industrial companies established during the "Self-Strengthening Movement" were mortgaged to the Japanese and other foreign banks and firms. There was a capital market in China, yet playing by its own rules and to the weakening of the Qing court's control over its own economy (Goetzman et al. 2007). Against this background, aggressive foreign economic encroachment contributed to a backlash against foreigners and foreign ownership in China. Anti-foreignism was expressed frequently in mass peasant protests and violence against foreigners in the late 19th century, such as during the Boxer Rebellion (1898-1901). The Qing dynasty fell in 1911 and the recognition of the Republican government was partially conditioned upon honoring the debts of the previous government. On the one hand, the desire for an end to the economic and political presence of foreign powers in China became stronger in the Republican era (1912-1949). Protests by intellectuals and students against imperialism in general, and the rent-area system and foreign enterprises in particular, constituted a major part of the May Fourth Movement in 1919. On the other hand, foreign investment was allowed for national economic development (Zhou & Long 2008; Ma 2011). Sun Zhongshan's idea of "saving the nation by engaging in industry" (shiye jiuguo) encouraged the development of domestic private enterprises and learning from Western science, modern technology and organizational methods. Many plants and companies established in the Republican era also laid down the industrial foundation for the PRC. For instance, the Nanjing government established a joint venture in 1929 – China National Aviation Corporation – with the American Curtiss Wright Corporation. In 1931, it cooperated with the German Lufthansa company to form another airline joint venture, the Eurasia Aviation Corporation, which was later confiscated by the Chongqing government in 1943 and became the Central Air Transport Co. Both companies were taken over by the PRC government in 1949 and merged into the Civil Aviation Administration of China in 1952.

China in the Republican era was characterized by fragmented sovereignty. Besides the changing governments and disintegrated ruling by different warlords, the country was one nation among many, whose relations with other countries were articulated by the rules of international and foreign laws (see Carrai 2019: 109-129). Although remarkable progress in rebuilding the national sovereignty was made in the Republic Era, foreign economic activities in China continued to enjoy the extraterritorial rights. Foreign investors registered at their national consulates and ran business under foreign laws (Zhang 2002). It was not until the abolishment of the extraterritorial rights during and after the Second World War that China had an effective Company Law that also applied to foreign companies (see Meng 2008: 151-155).[151] During the second Sino-Japanese War (1937-1945), there was a larger number of Japanese companies operating in China, especially in the heavy industry such as steel and chemicals in the Manchuria. These business were part of the colonization process and could not be counted as "foreign direct investment" in the contemporary definition. Despite the great state-building efforts in the Republican era, there did not exist an effective regulatory regime to govern foreign business.

The spirit of "self-strengthening" was to ensure China's economic development and sovereignty. The ideas of the reformist officials were to utilize private capital, import foreign technology to build the national industry. However, foreign capital in the U.S. and Chinese early national industrial development left very different historical legacies. The U.S. economy originated from the international expansion of European firms, its related capital and technology transfer, as well as labor immigration. The presence of colonial business in the U.S. was not interrupted by the Independence War and many European businessmen settled down and became American entrepreneurs. In China, despite the positive economic implications of foreign firms such as laying down some industrial bases for the country's later development, foreign economic activities in the second half of the 19th century and the early 20th century were based on the extraterritorial rights granted by the unequal treaties and a symbol of national humiliation.

1.2 Techno-nationalism in the Mao-era

Decolonization and the Civil War (1945-1949) in China following WWII created

[151] The Qing court had already established China's first Company Law in 1904, which entailed some registration and approval rules.

significant political discontinuities, which in turn led to fundamentally altered class relations, external relations and more nationalist development choices (see Kohli 2016: 172). In order to establish a new state under ruling of the communist party, a dramatic shift from private ownership to state ownership was completed in the early years of the PRC. Land reform was one of the most important measure to set up the state, since "traditional land-owning elites not only limited the reach of the state into the countryside but comprador classes often had their roots in landed wealth" (cf. ibid). When the state was established in 1949, some 10,000 private companies existed in different industrial sectors in China. By 1956, China had transformed virtually all private business into joint state-private enterprises. Some individual firms were restored in the wake of the Great Leap Forward (1958-1960), only to be suppressed again during the Cultural Revolution (1966-1976) (McNally 2007: 116). Enterprises were transferred to be owned and managed by different industrial ministries and some of them directly by the CCP (Li C. 2016). By 1962, the government closed and confiscated all foreign business in China (MOFCOM 2018). China's 1975 Constitution recognized socialist ownership only and this change in property rights was realized through the coercive reform and institutional arrangement by the central government (Yang 2006: 44).

As Janos Kornai notes, public ownership of the means of production is the defining characteristic of the political economy of classic socialist systems (1992: 433). A state-owned enterprise is not a solely economic organization, but an important ingredient in the power institution. Its operational goals were not confined to the pursuit of profits and innovation, but driven by political motivation. The central government controlled the distribution of physical goods and state-owned enterprises operated in a protected environment with government-set prices. Economic benefits of SOEs were then pumped into the government by the fiscal system, providing them with enormous rents such as prestige and employment opportunities (Naughton 2008: 92). The Party managed SOEs, as in other managerial fields, through the *nomenklatura* system (bianzhi xitong) that controlled the appointment and promotion of cadres at the SOEs and different hierarchies of the polity (Li C. 2016). Urban workers in public firms, and government and military officials were all incorporated within the hierarchical organization and the nomenklatura system. Rich peasants, private business owners and intellectuals were further cast out in the Cultural Revolution with those former party elites accused of being "agents of the bourgeois class." Groups in the society can expect representation of their interest from their patrons at the leading positions, but could not form independent economic interest groups or political organizations outside the system. There was no independent economic actor and the kind of "interest group" in the Western terminology was not developed because of the frequent campaigning and resulting socio-political turmoil (Yang 2006: 46f). The lack of organized expression of interests from the public reinforced a disparate distribution of power between state and society. Within such a political context, major policy changes came primarily from within the Party and primarily from top leaders (Zhao 1995:241; Naughton 2008: 93).

The Chinese experience with foreign economic activities from the first Opium War until the end of WWII naturally caused its leadership to be deeply suspicious of the Western economic institutions and ideologies. According to the history narrative of MOFCOM, foreign capital in the Mao-era was divided into "socialist" and "non-socialist capital" (MOFCOM 2018). Non-socialist western capitalism was represented as exterior to China and it was to be struggled against. The use of "non-socialist capital" was limited to investment of overseas Chinese or technology import from some Western European countries and Japan after the Sino-Soviet Split (ibid). At the time, the U.S. had stringent regulations banning high-tech exports to China to prevent its military use. Foreign investment in the Mao-era was almost exclusively from the Soviet Union, which was rather development aids than interest-oriented private investments. Decolonization and the Civil War (1945-1949) in China following WWII ended the sovereignty infringement of foreign powers, yet the new regime of the Chinese Communist Party (CCP) continued to be under external security threat. In the face of the immediate Korea War (1950 – 1953) after the PRC's establishment and the transfer of substantial U.S. aid and investment to Japan and South Korea as part of the U.S.'s cold war strategy in Asia, CCP leaders (as well in other countries) were constantly in the mode of preparing for war in the 1950s and

1960s. Foreign economic policy and internal technology development were thus linked to national security concerns. As early as in December 1949, a number of economic agreements on aids and technology transfer from the Soviet to China was signed during Mao's visit to Moscow. According to the documentation in *the Diplomatic History of the PRC* (1998), from 1950 to 1955, the CCP received about 5.67 billion Ruble debt (or aid) from the Soviet Union (see Shen 2002). Development priority in the 1950s and 1960s was given to heavy industrial sectors such as iron, steel and petrochemicals and very sophisticated technologies such as nuclear technology, instead of agriculture and light manufacturing industries in the view of scare resources. Military and capital-intensive sectors absorbed much of investment. The development of advanced weapons such as nuclear weapon happened amid poverty and backwardness, but linked to the country's position in the world and its relative prestige. The Soviet-oriented "catch-up" strategy had placed power in the hands of a central planning apparatus.

The Soviet government and some Eastern European countries sent complete sets of equipment and monetary aid, as well technical and management advisors to help with more than 300 projects, especially in the building of industrial plants (MOFCOM 2018; Yin 2006). However, since the mid-1950s, the Soviet party ideology came into conflict with that of Mao's plan to chart out a development course free from Moscow's influence. In the ensuing Sino-Soviet split, the latter withdrew their personnel from China, who took many of the blueprints for half-completed projects with them. A drift towards autarky accelerated after the Sino-Soviet split and withdrawal of Soviet assistance in 1960 (Feigenbaum 1999: 108). Besides the positive economic effect of the Soviet aids, the CCP leadership could not be unnoticed that the most recent episode of other countries' intense involvement in China's economy was not reliable. Scholars such as Even Feigenbaum described China's industrial development in the 1950s and 1960s as "techno-nationalism". It refers to the idea that "technology is a fundamental element of both national security and economic prosperity, that a nation's development policy must have explicit strategic underpinnings, and that technology must be indigenized at all costs and diffused system-wide" (cf. Feigenbaum 1999: 286). It also favored national autonomy in developing new technologies, avoiding or minimizing technological dependence on foreign countries.

1.3 Historical legacy and a strong state prior to the economic opening

Throughout the modern history (1839-1949), China had a state-led development path that was consistently driven by sovereignty threat. The end of WWII had eliminated the influence of Western and Japanese colonial powers from China and the socialist revolution in the early years of the PRC had cast out the capitalist class and private economy. Having intentionally dissolved all competing centers of power within society, the communist states were no doubt much more autonomous from their societies than countries in the Western bloc did. The ensuing period of isolation after the Sino-Soviet Split further deepened China's economic isolation, which marked a contrast to other Asian developmental states that relied on the Western countries for export and joined the international economic organizations in their post-war development. China was also different from many developing countries in Latin America and South Asia which, despite decolonization, continued to be strongly influenced by the business presence of the colonists (see also Kohli 2016). From 1949 to 1978, the state-led development path was further reinforced by the international power position, external security threat and socialist ideologies. The "new state" in the Mao-era was continuously reinforced by motives of survival and competition and engaged forcefully in late development (Zhu 2017). When Deng Xiaoping initiated the Reform and Opening-up Policy (ROP) in 1978, the state had already been well consolidated. The party-state, its industrial ministries and state-owned-enterprises tightly controlled the economy. Therefore, state intervention in China was extensive, penetrating into almost every aspect of social and economic life (Wang 1991: 8).

In comparison, the chart below presents the sequence of historical phases in the U.S. and China beginning with the expansion of European capitalism and IFDI in both countries since the mid-19th century.[152] As illustrated below, the sequence in the U.S. goes along

[152] As mentioned above and in the U.S. Part (IV), European merchants and colonists had emerged in both countries in the 17th century. Yet their economic activities at the time were more about exploitation of natural resources, trade and lending than a form of *overseas production.* It was not until the mid-19th century,

with the historical phases presented by the blue boxes each coded with an abbreviation, while the sequence in China proceeds with the red boxes. The sequence in the U.S. case is: 1) Capitalism and a substantial amount of IFDI from Europe after the Civil War (C) – 2) the formation of national market and industrial development in the second half of the 19th century (M) – 3) international expansion of American firms and capitalism in the late 19th and early 20th century, as manifested in the "Open Door Policy" towards China (C) – 4) Two World Wars and the Depression 1914-1945 (W) –5) International expansion of American firms and capitalism after WWII (C) – 6) A dominant position in the international market (D) – 7) a market-oriented neoliberal approach for development in the 1970s (M).

The sequence in China as illustrated below following the red boxes is: 1) capitalism and a substantial amount of IFDI from Europe after the First Opium War (C) – 2) Survival and efforts of state-building in the second half of the 19th century (S) – 3) continued expansion of capitalism and IFDI in China in the late 19th and early 20th century, and the encounter of American "Open Door Policy" C) – 4) Two World Wars and the Depression 1914-1915 (W) – 5) Continued survival and efforts of state-building in the Mao-era (S) – 6) economic backwardness and very late reintegration into the international market (L) – 7) A state-led development model in the 1970s (S). Obviously, the survival motive and the role of the state (coded with S) were much more salient in China's engagement with globalization since the mid-19th century, whereas the sequence of the U.S. was dominated by a market logic (coded with M).[153]

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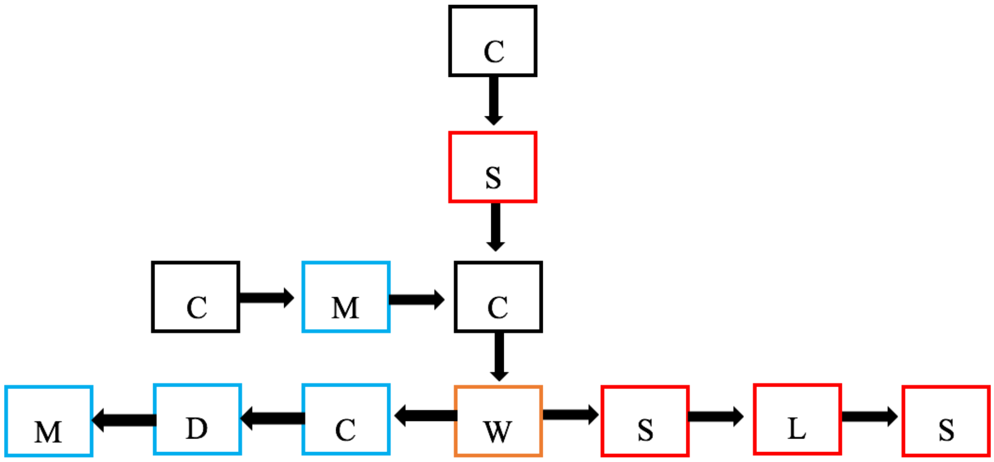
after Great Britain first finished its industrial revolution and owned the ability to commercialize the new technologies, that a substantial of IFDI emerged in both countries.

[153] The sequence presented here is rather a temporally ordered sequence with some causal relations between the historical phases. Obviously, the international expansion of European capitalism alone – the C at the beginning of each sequence – could not cause all the subsequent events.

Figure 5. Sequence in comparison



Source: the author.

2. The initial design and the reformist-conservative compromise

Many scholars of China studies, including Chinese scholars, noted that the Reform and Opening-up policy was mainly motivated by internal security concerns in terms of "regime crisis" (Naughton 1996; 2008; Stubbs 2005; Xu 2011; Yao 2014). The chaos of the Great Leap Forward and the Cultural Revolution created a pressing need to regain legitimacy for the CCP (Xu 2011: 1078; Naughton 2008: 94; Yang 2006: 51). Against this historical context, the only choice left for the CCP was perceived to gain legitimacy through performance, i.e. delivering tangible benefits to the population. China's domestic reforms in the 1970s has been described as "crisis-induced institutional change", which aimed to address development and regime security as one task (Bell & Stephen 2013: 34). This study does not underline this view and rather draw attention to the primary influence of international imperatives (both geopolitical and geo-economic). The internal political turmoil and the death of Mao Zedong and Zhou Enlai in 1976 might raise questions about the successor leadership, yet all the members of Standing Committee of the Political Bureau of the 11th Central Committee (1977- 1982), such as Deng Xiaoping, Ye Jianying, Zhao Ziyang, Li Xiannian, had revolutionary experience and worked in leading positions in the Mao-era. They belonged to the elder generation party leaders and enjoyed the legitimacy inherited from the Mao-era. Most importantly, when Deng initiated the

Reform and Opening-up Policy, external security threat had dwindled. After rapprochement with the U.S. and Japan in the early 1970s, China cleared away two potential threats while checking Soviet pressure through new strategic relationships with the West. For a regime that had bet on comparative security in the international politics, the breakthrough in China's nuclear development and diplomatic relations must give the post-Mao leadership "sufficient confidence to bet publicly" after nearly thirty years in a survival-state posture (Feigenbaum 1999: 98).

When the contact and travel barriers lowered in the 1970s after Mao Zedong's reorientation of China's diplomatic and strategic relations towards the U.S. and Western European countries, Chinese political and economic elites began to travel abroad and discovered the disparity between China's technological and economic backwardness in comparison to other countries. "They were not surprised by the gap between China and the U.S. and Europe, but they were shocked and humiliated by the gap with Japan and other Asian countries to which they had traditionally felt superior" (cf. Shirk 1996: 192). Beginning as early as the 1960s, a number of economic developments within the Asia-Pacific region made economic participation in the region more attractive. Japan was the first to join international trade and Taiwan, the Republic of Korea and Singapore followed the suit (Haggard 1990). By the late 1970s, Japan had transferred its labor-intensive manufacturing offshore to Korea and Taiwan to move up to technology- and knowledge-intensive industries. Thus, it was clear to the CCP leadership that China had lost the race not only to Western capitalist countries, but also to its neighbors (Yao 2014: 982). That China must reform to catch up with Asian neighbors became a basic consensus broadly held among Party leaders. Therefore, this study underlines the view that the economic opening was rather driven by external power and security concerns than internal security threat. Moreover, as Harry Harding argues (1987: 2), "the post-Mao reforms should not be seen as an inevitable consequence of China's condition at the time. Instead, the reforms have been the result of extraordinary political engineering by a coalition of reform-minded leaders led by Deng Xiaoping".

Analysts frequently interpret China's divisive leadership dynamic in terms of ideological tendencies. As Margaret Pearson (1991: 46) summarizes, the historically constituted sovereignty threat of foreign economic activities in China left two kinds of ideological legacies. The first was anti-foreignism or anti-imperialism. It was characterized by an extreme hostility towards a foreign presence in China. The second ideological legacy was self-strengthening against foreign aggression through selective use of foreign ideas and goods. In the late 1970s, Party elites were split into three groups according to different, oft-conflicting views on the content and pace of reform: conservatives, radical, and reformers (Solinger 1984; Pearson 1991; Fewsmith 1994; Zweig 2002; Jiang 2004). The ideological legacy of anti-imperialism was most evident in the group labeled as radical, who found their way into leadership positions during the Cultural Revolution. In hindsight, there were a huge gap between the formal and informal social-economic institutions and the idea of inviting foreign investors to bring in new capital and technology. The radical group rallied around Hua Guofeng, the successor Chairman of the CCP after Mao's death in 1976, and was supported by a bureaucratic group called the "petroleum clique" under the leadership of Li Xiannian. They preferred a development strategy centered on rapid growth of the heavy industries, particularly the Daqing oil field, during 1977 and 1978 (Fewsmith: 1994: 57). Their claim to legitimacy was tenuously hinged on their capacity to interpret the Mao Zedong Thought. As late as 1977, the state media blasted an external strategy called "Five Nevers": never permit the use of foreign capital; never assume undertakings in concert with foreigners; never accept foreign loans; and by implication never join the capitalist international organizations; and never borrow money from foreign countries (cf. Kim 1981: 426f). The liberalizing policies that had been initiated by the leaders Liu Shaoqi and Deng Xiaoping in the post-Great-Leap-Forward recovery period were detracted by the leftist radicals as promoting "slave mentality," "profits-in-command," and constituting "a reactionary platform for dismantling socialism and restoring capitalism" (cf. Jiang 2004: 98f). Hua then campaigned for a "new leap forward in national economy" – a Ten Year Plan made in 1978 aimed to construct and complete 120 large development projects in the iron and steel, oil and coal, as well as transportation. To pay for them, the government relied on insufficient oil sales and foreign debt, which eventually led to China's "largest deficit since 1949" (Zhu 2017: 7). By 1980, the government had to put the whole plan on hold and the radicals had been in eclipse since Hua's demise of power in 1978.

Returned to power as a leader twice purged by Mao, Deng Xiaoping could not secure legitimacy through allegiance to Maoism. The challenge for him lied in how to propose a new political line in direct opposition to Hua but not in direct opposition to Mao. Deng ingeniously employed a tactic of using a basic postulate of Mao's teaching, "seek truth from facts (*shishi qiushi*)" to refute the Maoist policy paradigm (Tang 2014: 186). He insisted that historically understood "self-reliance" was compatible with the principle of "mutual assistance and benefits." In early June of 1978, Deng expressed his appreciation of the "practice is the sole criterion to truth" argument at a PLA work meeting. The prolonged Cultural Revolution threw many Chinese into different life trajectories with some riding on the tide of career advancement while most suffering through the adversities. Epitome of the Cultural Revolution victim himself, Deng became a symbol and center of power toward which the formerly purged leaders, pro-reform cadres as well as popular forces gravitated.

The inner core of the reformist coalition consisted a group of party elders who regained their position in the post-Mao era due to their personal stature as revolutionary war heroes and founders of the PRC. In fact, Deng owed his return to power in 1977 to this group of senior "rehabilitated cadres" against Hua Guofeng's wish. Allying with Chen Yun, Li Xiannian and Bo Yibo who had extended authority in the State Council, the chief officer in charge of legal work and state security Peng Zhen, senior military officer Wang Zhen, Deng's power networks sprawled across the Party, the government, and the military (see Zhang & Zhang 2011; Wang 2011). Deng's coalition also bracketed the provinces, sectors, and social segments that could see their fortunes turned by economic development. Coastal provinces such as Fujian and Guangdong with historical links to overseas Chinese communities had a particular interest in the reform policy of establishing the Special Economic Zones. The reformists around Deng Xiaoping viewed that the positive impact of foreign investment could be distilled from the negative elements, which mirrors the "self-strengthening" idea. They supported the use of foreign capital and technology import, and to learn from the experience of overseas Chinese in Hongkong, Macau and Taiwan. In May 1978, the State Council set up a working group on "importing foreign advanced technology" which was led by then Vice Premier Gu Mu and consisted of high-level officials. The group traveled in Western European countries upon the request of Deng Xiaoping to learn about their industrial development experience. In July 1978, on an economic conference within the State Council, Vice Premier Gu Mu reported on his visiting experience and expressed the view:

All Western European countries had the experience of using foreign capital and advanced technologies in their economic take-offs. Why shouldn't we do the same? [...]. Today's international situation offers a good opportunity for us. We should have the courage and capability to use the advanced technologies, equipment and managerial skills to help our development. That would largely accelerate the development process than closing the door and just relying on ourselves.[154]

In the same year of 1978, the State Planning Commission (SPC) and the Ministry of Foreign Economic Relations also formed a joint research team to conduct local investigations of the economy in Hongkong and Macau. Their report suggested to establish "economic cooperation districts" in the neighboring cities Baoan and Zhuhai in Guangdong. Then Party Secretary of the Guangdong, Xi Zhongxun, and Vice Premier Gu Mu played an important role in the decision of economic opening and decentralization. Conservative leaders within the Party were alarmed by the ideological consequences of liberal reform and opening up to the capitalism. Though anxious to promote modernization, they were less certain of the value of foreign capital and technology but more concerned with the historical lessons. Conservatives had been both prime supporters and beneficiaries of China's centralized economic structure. As Chinese historical archives noted, "when Xi Zhongxun asked the central government to delegate more

[154] See Li, Jie. Year Unknown. *Deng Xiaoping Launched the Report and Laid Down the New Foundation for the U.S.-China Relationship （邓小平启动改革开放与中美关系新基础的奠定）*, http://cpc.people.com.cn/GB/85037/138912/142552/142554/8631050.html.

economic regulatory authority to Guangdong and learn from the ‘Four Asian Tigers’, a vice president strongly opposed Xi’s suggestions. He said if Guangdong opens, a thousand-meter long wire mesh must be built up to separate Guangdong from its neighboring provinces to prevent them from capitalism” (cf. Gong et al. 2013). In 1982, the central government issued an internal document to Guangdong and Fujian on dealing with the smuggling problems. As then Vice Premier Gu Mu recalled, “one top Party leader suggested to attach a study on the history of the Shanghai ‘rent area; in the Opium War” (ibid). Deng Xiaoping’s opening of the Special Economic Zones (SEZs) in the coastal area was compared by some conservative Party leaders to the “Self-strengthening Movement” (see Yin 2006: 61f). In the face of a relatively very weak national economy after twenty years’ political turmoil and a large inefficient state sector dominated by SOEs, domestic firms were in very vulnerable position in the face of foreign competition. At the same time as wishing for China to gain from engaging in international trade and investment, and participating in global institutions, opponents to China’s integration in the early reform era also warned its threat to China’s sovereignty and social culture vis-à-vis foreign firms. Thus, from the inception of China’s economic opening, decision makers had to balance the gains and losses such as simultaneously attracting capital and technology without impairing the national sovereignty and domestic stability.

As the ideological debate shows, by 1978, there did not really exist a liberal faction within the Party, nor a liberal coalition in the society. The reformists around Deng rather inherited the spirit of “self-strengthening” by utilizing foreign capital and technology. The conservative leaders held a hostile position towards capitalism, which was more or less a downgraded version of anti-foreignism and anti-imperialism. From their perspective, the “Self-strengthening Movement” provided enough lessons of dependence on foreign capital, which led to the infringement of China’s economic and political sovereignty. The conservative and reformist leaders seemed to compromise on Chen Yun’s “bird cage” theory, who was then the head of the Central Finance and Economic Commission and rather a conservative leader in the economic reform. Chen Yun believed that the operation of markets should be kept within tight limits: The plan-economy system is the cage, while the market is the bird (People.cn 2006b; Li 2013). Chen's ideas was of maintaining the leading position of the state-run sector, while promoting the complementary role of the market.

Therefore, the early reform era was rather a compromise between the reformists who held a more developmental idea to utilize foreign trade and capital to modernize China's economy and the conservatives who warned of the historical lessons. The historical legacy of foreign capital expansion in China and of a strong socialist state with a plan-economy, as well as the political and ideological conflicts surrounding China's economic opening all suggest that the process of economic opening could not be metaphorized as a leap of faith into the "free market" (Bell & Feng 2007). Instead, the process has been gradual, regulated and aimed all along at shoring up ongoing political support for the reforms (Shirk 1993; 1996).

The Reform and Opening-up Policy announced at the 3rd Plenums of the 11th Party Congress in 1978 inserted China into the global economy at the height of international capital movement and the ideological movement of liberal reforms in developing countries (see Guthrie 1999, 2006; Gallagher 2002, 2005; Simmons & Elkins 2004; Zweig 2002). The relationship between the state and MNCs had been accommodated to the international norms of free capital flows and protect of private property rights. Intellectual property rights that provided some firms with this competitive advantage were institutionalized by the late 1970s at the international level. In order to attract foreign investment for its own development, China needed to follow these rules. Yet there did not exist a legal status for private corporation and any law to serve as a viable institutional framework for governing foreign capital in the country (Meng 2008). The first Company Law of the PRC was not enacted until December 1993.[155] Thus, globalization at the time had a strong constraining effect on the latecomer.

[155] MOFTEC. 1993. China Company Law, promulgated by on December 29, 1993, effective as of July 1, 1994, http://www.npc.gov.cn/wxzl/gongbao/2014-03/21/content_1867695.htm.

3. Institutionalizing the compromise: A pattern of bifurcation

3.1 Gradual opening and active state interventions 1978-1989

China's IFDI policy reform in late 1970s and 1980s mirrors the ideas of both the reformist and conservative leaders. Its tenet was "exchanging market for technology"—using part of China's huge domestic market for sale as a bargaining chip for the introduction of advanced technology, while guarding against loss of control to outside forces (see Pearson 1991; Fu 2002; Huang 2003; Hsueh 2011). This policy was first experimented in the Special Economic Zones. To carry out socialist transformation and to enforce authoritarian rules, the state had to construct elaborate set of state agencies throughout the nations. As the center's agents, their missions were to implement whatever orders they received from the top and ensure a restrictive regulatory regime. However, in order to attract foreign capital and technology for domestic development in the late 1970s and 1980s, the Chinese state must wear a tight "gold straitjacket."

Globalization's straitjacket was manifested in the standalone creation of foreign investment-related laws in the early reform-era. After the announcement of the Reform and Opening-up Policy in 1978, the National People's Congress first codified a commercial law and established a legal status for foreign investors – the Chinese-Foreign Joint Ventures Law of 1979 (JVL).[156] The JVL has only sixteen articles expressed in very broad general terms, giving little legal guidance to foreign investors. According to Jiang Ping's review, who himself was involved in the legalization process, many articles of the JVL were a transplantation of foreign investment laws. The laws were made upon the requests of foreign investors, who demanded legal safeguards for their operations, and made in a rushed manner (Jiang 2015). Due to scarce corporate and market operation knowledge of the lawmakers, terms on important operational issues, such as market access, taxation, foreign exchange, land use, labor management, and input sources, were either not mentioned or defined in vague term (ibid). This also gave more leeway to contract negotiations so that specific deals could be fitted their specific circumstances (Fu

[156] The Law on Chinese-Foreign Joint Ventures (中华人民共和国中外合资经营企业法), promulgated on July 08, 1979 , only in Chinese version: http://www.pkulaw.cn/fulltext_form.aspx?Gid=559.

2002: 28). The JLV rather served as a political commitment to MNCs that China "permits foreign companies, enterprises, other economic entities or individuals to incorporate themselves in the territory of China into joint ventures with Chinese companies, enterprises or other economic entities" and "the state shall not nationalize or expropriate foreign investment interest" (Article 2). This provision was later elevated to constitutional status when the National People's Congress amended the Chinese Constitution in 1982 (Article 18).[157] The JVL also stated the tenet of China's IFDI policy that "the technology and equipment contributed by a foreign joint venture as its investment must be advanced technology and equipment that suit China's needs" (Article 5). As some scholars point out, in contrast to some developing nations that set tight control over ownership, the JVL was rather "liberal" in nature (ibid: 28). It had a threshold of at least 25% of foreign equity contributions to a joint venture, but set no ceilings on foreign ownership. A majority foreign ownership up to 99% was thus possible.[158] In the late 1980s, two additional laws were passed – the Wholly Foreign-Owned Enterprise Law in 1986 and the Chinese-Foreign Contractual Joint Venture Law in 1988 and – which along with the JVL Law formed the legal foundation of China's investment regulatory framework.[159] Foreign investment companies in the early reform-era mainly took the form of joint ventures with SOEs to invest in China. As nationalist sentiment was quite strong because of the historical legacy, there would also be high incentive for an MNC to find local partners to reduce the stigma of being entirely foreign (Kennedy 2007: 179). The state also made several preferential policies to attract foreign investment in the 1980s. The so-called "22 Regulations" of 1986 designated two categories of foreign investments as being eligible for additional benefits – export oriented project (projects exporting 50% or more of their production value) and technologically advanced projects (projects that upgrade domestic production capacity through the use of advanced technology).[160] The qualified foreign-

[157] A detailed Implementation Act of the JVL that summarizes the major legal developments concerning income tax and labor management issues of FIEs was published in 1983.
See PRC Constitution 1982, Article 18.

[158] This discriminatory provision remained in effect for more than 10 years until 1990 when the JVL was amended.

[159] Until the 1986 WFOE Law, foreign firms were obligated to form joint ventures with Chinese partners except in the Special Economic Zones and authorized foreign investment zones.

[160] State Council. 2016. The Implementation Codes of the Joint-Venture Law of People's Republic of China.

invested enterprises (FIEs) were to enjoy benefits such as reduced business income tax, credit access and more managerial autonomy (Huang 2003).

Following Deng's instruction, the Shenzhen, Zhuhai and Shantou Special Economic Zones (SEZs) in Guangdong Province and the Xiamen SEZ in Fujian Province were established in 1980. SEZs were not only separated geographically from the traditional core industrial area in the Northeast, but also by different policies. Provincial and local leaders of SEZs first seized this opportunity to attract FDI from Taiwan, Hongkong and Macau that are in the very vicinity of the SEZs.[161] Few WFOEs existed in the early 1980s beyond the geographical confines of the SEZs. It was only after China further opened 14 additional coastal cities and the whole island of Hainan in 1984 and especially after the promulgation of the WFOE Law in 1986 that a substantial amount of FDI began to flow into China. In January 1985, the central government also designated three "delta regions" for foreign investment. Specifically, they were the Yangtze River Delta, (in the East) Fujian Delta and Pearl River Delta (in the South). Geographical expansion of economic opening continued in 1988 to include Liaodong and Shandong peninsulas as "costal economic open areas". By the end of the 1980s, the "special investment areas" in China embraced close to 300 cities along the coast (Fu 2000: 39).

Separate regulatory institutions were only created for the sole purpose of accommodating foreign firms' activities in China (see also McNally 2007: 115). Until the 1988 constitutional amendment that grants a legal status to domestic private economy, private enterprises with more than eight employees were not legally permitted. China's private enterprises until then consisted technically only of "individual household" (getihu) with fewer than eight employees. In reality, although there were many collective enterprises that were registered under a township name but operated by private businessmen, private

[161] Entities from Hongkong, Macau and Taiwan are classified as foreign investors in statistics by Chinese authorities. In fact, quite a few Taiwanese businessmen invested in mainland China via such springboards as Hong Kong, the British Virgin Islands, and the Cayman Islands in order to avoid the multiple restrictions exerted by the incumbent Taiwan authority. Indeed, the actual amount of Taiwan-originated investment in mainland China may be two to three times the amount publicly acknowledged (Long 2005: 31)

enterprises did not enjoy the same legal right and policy privileges in terms of tax breaks and foreign trade as foreign investors (see also Tsai 2006; Huang 2003). In the 1980s, whereas joint ventures were allowed at least in theory to make and implement their own production plans, set their own wage rates and manage employees, domestic firms operated in a command economy. Therefore, the gap between the formal and informal social-economic institutions and the new rules for foreign investors was filled with elite-led initiatives and lacked social support in the early reform-era.

At the macro-level, a bifurcated structure laid down the institutional framework of China's trade and investment policy prior to its WTO accession (Huang 2003). As Bell & Feng note, "under the plan-market system, new market-oriented institutions were only built atop, not in place of the old state institutions" (cf. 2013: 42). The limited "market" in the coastal cities was separated from the state-plan economy elsewhere. The SEZ policy was one of many policies of "disarticulation, in which successive sections of the economy are separated from the planned one, which persists" (Naughton 1995:15).

The basic institutional contour of China's regulatory regime for IFDI was formed at the beginning of the reform. The JVL of 1979 delegated the examination and approval authority of foreign investment projects to "the Committee for Foreign Investment" (CFI) (waizi guanli weiyuanhui). The committee was established on July 30, 1979 by the 10th Plenum of the Standing Committee of the 5th National People's Congress (NPC). It was subordinated to the State Council and served as the same committee for China's Export and Import Regulation (one institution with two duties). On August 23, 1979, the Standing Committee of the CCP and the State Council jointly announced the establishment of CFI with the following six missions: 1) Making policies and regulatory rules on import and export, technology import, foreign investment and foreign economic cooperation with relevant agencies; 2) Making, coordinating and supervising annual and long-term plan on import and export, technology import, foreign economic cooperation, foreign exchange with the State Planning Commission; 3) Coordinating with relevant administrative agencies on the provincial and municipal level to promote export and increase foreign exchange reserve; 4) Ensuring the implementation of regulations for foreign investment based on the JVL, coordinating relevant agencies for approval of foreign investment contracts; 5) Coordinating different agencies and the needs of advanced technologies, supervising the import of advanced technologies to upgrade domestic productivity and technology; 6) Reviewing China's long-term economic agreements with other governments, reporting to the State Council for approval (Section 1).[162]

That the CFI was established by the NPC and chaired by a Vice Premier (Gu Mu) indicates the importance of this agency. It consisted of representatives from then Ministry of Foreign Economic Relations and Trade (MOFERT), the State Planning Commission (SPC), the Central Customs Bureau, the State Economic Commission, Ministry of Finance, Ministry of Construction, Bank of China and so on. The two Vice Secretaries of the committee were Gu Ming and Wang Daohan. Gu Ming was the then Vice Premier and Vice Secretary of the SPC, who was also known for his expertise in economic laws. Wang Daohan was then Vice Minister of MOFERT and an advocate for the SEZ policy. The positions of the two chair persons indicate that the SPC and the MOFERT played the most important role in this committee. The local governments of the SEZs also established their corresponding committees for IFDI. In 1982, CFI along with the MOFERT were merged into the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). The 1986 Wholly Foreign-Owned Enterprise Law and the Chinese-Foreign Contractual Joint Venture Law in 1988 delegated the regulatory authority to the MOFTEC, which was also responsible for the approval of OFDI (Hao 2016).

The MOFTEC inherited the missions of the CFI to coordinate IFDI with China's industrial policies. Joint ventures were subject to the state plan for procurement (including imports) and sales, and served as a supplement to domestic public investment. Thus,

[162] State Council. 1979. Decision of the Central Committee of the CCP and the State Council to Establish the Committee for Export and Import and Committee for Foreign Investment Regulation, http://history.mofcom.gov.cn/?datum=1979 年 8 月 23 日《关于进出口管理委员会、外国投资管理.

proposed contracts of large projects were also submitted to the SPC, which further coordinated with other industrial ministries in deciding the specific needed investments and technology in specific industries. At the micro-level, the IFDI regulatory regime consisted of two major agencies: the State Planning Commission (SPC) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Founded in 1952, the SPC played a central role in the plan economy. It focused primarily on macroeconomic management and on achieving balance between state plan and market supply (Martin 2014). Therefore, the SPC was not only responsible for foreign investment, but also for domestic public investment (such as large infrastructure project) and it bore the responsibility to coordinate both. The SPC also oversaw the creation of China's Five-Year Plan and a wide range of regulatory mandates such as price setting and identifying national pillar industries. It had a cross-sectoral perspective and can be called a "superagency" in the regulatory regime (Yeo 2008; Wang 2019).

On the one side, the SPC and the industrial ministries were defending the national industry. Officials in the industrial ministries and the planning commission were largely made up of technocrats, whose duties were more prone to the development and protection of domestic industries. They set industry-specific policies, product and technology standards, oversee price and inflation in the market and coordinate domestic with foreign investment to meet the capital and technology needs in specific industries. The incorporation of industrial policy into regulatory decisions is a natural consequence of the SPC's (and later NDRC's) institutional role in the regulatory regime. On the other side, the MOFTEC executed the IFDI regulatory policies, attracting, reviewing and approving contracts. It also answered broader mandate to negotiate China's bilateral investment treaties, engage with international organizations such as the WTO and IMF. Various exposure to foreign MNCs and engagement with domestic and international foreign investment laws led to increased knowledge and consciousness of international norms of the MOFTEC officials. In practice, this meant bridging the gap between the international demand for market access and strong domestic reluctance to do so, in addition to answering the demand of the State Council to further liberalize the market. At the meso-level, the SEZs and local governments of other allowed areas for foreign investment enjoyed certain approval authorities. Specifically, the MOFTEC delegated authority for approval of small joint ventures – those with a total investment of $5 million or less – to the relevant ministry branches of the municipal, provincial or autonomous region governments. In the second half of the 1980s, several major municipalities in the eastern were allowed to approve projects up to $30 million in total investment. The approval authority was gradually delegated to more lower-level government agencies and the threshold of the project value for local approval continuously lowered down. The interagency and central-local relationship laid down the foundation of China's IFDI regulatory regime.

Taking the telecommunication sector as an example, IFDI policy in this sector represented the combination of "trading market for technology" and active state intervention. Besides the SPC and the MOFTEC, the key organization for planning and using IFDI in this sector was the Ministry of Posts and Telecommunications (MPT) before its transformation into the Ministry of Information Industry in 1998 and then into the Ministry of Industry and Information Technology in 2008. The Chinese telecom industry was backward when economic opening began in 1978. With assistance of the Soviet Union, a number of equipment manufacturing factories were established in the 1950s in some major cities such as Shanghai, Changchun and Tianjin. Until the 1970s, the telecommunications system in China had been mainly used for semi-military and administrative needs. There were 27 equipment factories under the direct control of the MPT, and 100 other factories regulated by the provincial Post and Telecommunications Administrations (PTAs), while there were no foreign firms in China's TE manufacturing business (Tan 2002: 21). The MPT and the PTAs were both regulator and provider of telecom services. They acquired equipment from domestic suppliers with outdated technologies, which led to a low-efficiency and -quality telecom network and a very low penetration rate in comparison to other developed countries, as well as Hongkong and Macau. Telephone penetration in China was only around 0.4% and communication was manual or semimanual based on switching equipment with analogue technology, while digital electronic switch had already been widely installed in many other countries (Liu & Mei 2019). The poor telecom infrastructure was a major obstacle to foreign investors. For instance, a manual switching from China to Australia had to go through an interstation in Europe, so that a successful connection could take several hours of effort. It happed quiet often that foreign investors who paid business visits to China and wanted to communicate with the headquarters had to go to Hongkong to have a phone call.

In the 1980s, the MPT first followed an import strategy to set up telecom switching equipment in China. Major cities relied almost completely on foreign imports for installation of stored program-controlled switches (SPC switches) (Tan 2002). Much of these equipment was bought with foreign loans under conditionality of buying the equipment from the creditor countries. For a huge potential market, local production was necessary to speed up the business development and the industrialization process, and to avoid a drain on foreign exchange or dependency on external loans. However, at the time, most telecom companies in the world were more interested in exporting their finished products than setting up local factories (Yuan 2009). Against this background, the MPT approached the prestigious telecom companies across the world to explore opportunities for technology transfer through joint venture projects (Shen 1999: 63). In 1983, the China Posts and Telecommunications Industry Corporation (PTIC) established by the MPT formed a joint venture, the Shanghai Bell Telephone Equipment Manufacturing Corporation, with the Belgian Bell Telephone Manufacturing Company (BTMC), which was a subsidiary of the American ITT Corporation. The Chinese side PTIC took 60% of the venture, while BTMC got 33% and the Belgian government 7%. The joint venture was the result of a three-year negotiation between the firms and the Chinese and Belgian governments. PTIC and BTMC had their first negotiation in November 1980. In order to secure the technology transfer, the Chinese government set up a negotiation team with the deputy minister of the MPT as the chief representative and many senior experts in technologies and foreign trade from the SPC and MOFTEC. The major concern was the transfer of the production technology for the custom LSI (large scale integrated) circuit chip, as it was the core technology used for the digital automatic switching system (called the System-12) (Wang & Zhou 2006; Yuan 2009). At the time, the custom LSI chip was listed in the category of the Coordinating Committee for Multilateral Export Control (COCOM) created by the U.S. and its allies in 1949 to restrict the flow of strategic goods and know-how to communist countries.

During the negotiation process, the Chinese side insisted that all the technologies of component production had to be included in the transaction, lest component provision be stopped in the future as a result of changed political relations between the two countries. The Belgian Minister of Foreign Affairs made several diplomatic efforts to convince the U.S. government to lift the restrictions against China. BTMC delegations also travelled frequently to Washington and Paris to pursue this goal. Although the contract for the rest of the technology had been agreed and signed in 1983, it was not until March 1987 that China got the finical approval from the U.S. for the technology transfer of the LSI chip. According to the contract, PTIC was primarily responsible for providing land, buildings and necessary facilities for the plant and for exploring the domestic market for locally produced System-12 exchanges; BTMC provided the technology together with various services; and the Belgian government contributed capital.

The Edinburgh professor Shen Xiaobai conducted a thorough study of the process of BTMC’s technology transfer to China. As she summarized (1999: 68f), the product and manufacturing technology transfer had three phases. The first comprised the assembly of components or parts as well as testing, including incoming inspection, the assembly and test of cables, back-panels, printed boards and racks. According to her investigation, the entire process undertaken was to BTMC standards: It used the most modern production and test facilities; all components or parts and other materials were directly imported from BTMC or from the companies which BTMC specified; every single incoming item and each sub-assembly was inspected. The second phase involved the establishment of a workshop for the production of printed circuit boards and metal and plastic piece-parts. Again, these were all a copy of the BTMC's, ranging from workshop equipment, and functional tests over all sub-assemblies, to waste water treatment. The installation of the equipment was completed by the end of 1986, and the production line was brought into operation in the first quarter of 1987. The final phase was the local manufacture of the LSI chips, which began around the middle of 1991 (see also Zhou & Kerkhofs 1987).

In the almost five-year transfer process, government intervention was necessary. Chinese government policy and its direct support for Shanghai Bell provided the joint venture with privileges, such as low tax, autonomy in management, human and material resource supply, which allowed Shanghai Bell to conduct its business free from the constraints to local private firms. In addition, the central government granted a license for Shanghai Bell to import components at a low tariff rate. It was given the right to purchase components directly from overseas and, moreover, allowed to collect a certain portion of its payments from Chinese customers in foreign currencies. The MPT gave considerable attention to Shanghai Bell's creation, resource allocation and the market for System-12. From the outset, it set up a dedicated bureau in Shanghai to co-ordinate with local government on the building of Shanghai Bell's factory. To ensure its domestic market, the MPT decreed in an internal circular that System-12 was one of the principal switching systems for use in the Chinese telecommunications networks. In terms of human resources, at the end of 1983, the MPT brought together a group of highly skilled staff from MPT's R&D institutes, universities and factories across the country to Shanghai Bell to set up the plant. Among them were many experienced senior engineers, and knowledgeable professors in the telecommunications field. They played a crucial role in building up the company in the early stages. Thereafter, most of them returned to their institutes, and some subsequently used the knowledge they had obtained of System-12 to carry out various R&D projects for Shanghai Bell (Shen 1999). Government approval was needed in particular at that time for Shanghai Bell to be allowed to adopt Western methods of management and to free it from the normal economic and political obligations (e.g. party organizations in the management). Following the Shanghai Bell, many other foreign firms partnered with Chinese SOEs to produce switch equipment. Siemens AG, for instance, formed another major joint venture, the Beijing International Switching Company, with several SOEs in 1988. In the late 1980s, foreign investment in the TE sector developed rapidly in big coastal cities that needed to provide modern communications infrastructure for the booming international business (Hong et al. 2012). According to its former Director Yuan Weiping, Shanghai Bell "triggered the development of the domestic telecommunications equipment sector. Without Bell, there would not be the rise of China's national champions in this sector" (Yuan 2009).

Technology transfer through IFDI in the 1980s was not particularly successful in most sectors. Localized foreign equipment was rather confined to some new machinery and product lines than the actual learning of technology (Pearson 1991: 177-182). Production lines only involved directly introduced and applied designs that were already developed in parent companies (Chen 2018: 52). The majority of FIEs in the 1980s were rather small and medium-sized enterprises in labor-intensive light manufacturing located in rural area in the vicinity of Hongkong and Macau (Huang 2003:2; Pearson 1991:209). For smaller FIEs, local subcontracting was also an attractive business option, which encouraged the growth of private enterprises in light manufacturing that did not need much initial capital and advanced skills to catch up and satisfy the subcontracting needs. This undermined some power disparity in local production, but the local firms were far from the position to break the hierarchical segregation between themselves and global firms. As Japanese firms were aggressively taking over well-established American firms in the 1980s, most Chinese manufacturing firms were still processing firms located at the very lower end of the value chain. As the revaluation of the yen pushed up the price of Japanese exports, Japanese manufacturers increasingly began to explore China as a location for lower cost manufacturing. Thus, IFDI inflows in the 1980s contributed to China's export growth to some extent, but little to its industrial upgrading (Huang 2003). At the time, FIEs also imported more than exported (see table 10).

IFDI inflows in the 1980s were not only minimal, but also lacked a "foreign" nature. Most investments came from ethnic Chinese from Hongkong, Macau, Taiwan, and business ties were built on personal relations and geographical proximity. Due to unstable and restrictive legal environment and banking policy, foreign investors had to rely on personal relations with local cooperation partners to manage administrative and legal matter. While state banks granted overwhelming proportion of credits to SOEs, private firms and especially those in light manufacturing could hardly get credit access (Huang 2003: 181f). Private entrepreneurs in the coastal regions therefore relied on the capital of their guanxi networks to access finance and overcome policy restrictions. Ethnic Chinese investors with their family ties provided the business convenience and opportunities of informal financing (see Wang 2000). Culturally close investors also provided the Chinese government with a familiar regional and thus more controllable "testing" ground for opening domestic capital markets (Töpfer 2018). To some extent, the trade and investment relations with Taiwan improved the cross-strait relations. However, economic and political gains through IFDI in the 1980s were limited. Seeing in such a light, if the government wanted to change China's position in the global division of labor and yield more technological benefits brought by MNCs, it had to search for other ways to reverse its subordinate position. Relative gains-seeking from IFDI by transferring new technology to China was an apparent strategy of the central government, yet its effects on China's economic position in the world economy was limited.

Table 10. FDI in number and value, and its contribution to exports

	1978-1985	1986	1987	1988	1989	1990	Total
FIE Number	6128	1498	2233	5945	5779	7273	22,202
FDI value	6.07	1.42	1.96	2.24	2.31	34.9	3.19
Share of Imports	-	5.6%	7.8%	10.6%	14.9%	23.1%	Av. 86-90: 12.5%
Share of Exports	-	1.9%	3.1%	5.2%	9.4%	12.6	Av. 86-90: 6.4%

Source: MOFCOM 2019, edited by the author (in 100 millions of USD)

3.2 Critical juncture 1989 - 1992

As Chinese economists describe, earlier phase of the economic reform was one of "pareto-improvement," meaning economic efficiency or proto-marketization was achieved by allowing new interests to emerge without treading upon the old ones (Lin et al. 2002: 266). However, while the pro-market reformers were skirting round the political minefield, groups that belonged to the "system-within (*tizhinei*)" did not want to lie dormant and see their future discounting away. Throughout the 1980s, conservative leaders launched several ideological attacks on the SEZs and foreign investment. Chen Yun was well known for his skeptical view about international capital. He repeatedly stressed that foreign capitalists were not just looking for normal profits but "surplus profits", and therefore it was impossible for China to gain from foreign investment. The Tiananmen Incident in June 1989 granted Deng's opponents an opportunity to blame the social turmoil on the malign influence of "bourgeois liberalization" unleashed by the economic opening. It was said that "one percent more increase in foreign investment meant one percent more increase in capitalism and bourgeoisie for China" (Lin 2008: 64). A wave of political debate on "opening" or "selling the country" emerged in the late 1980s. Many opponents to foreign investments referred to a large investment project of a Hongkong firm, which obtained a rent area of 30 square kilometers for 70 years on the Yangpu Island of Hainan Province. The grant of such a long-term and large rent area attracted much media coverage and public discussions (Yin 2006: 86). A group of representatives of the People's Consultative Conference led by the President of the Shenzhen University, Zhangwei, petitioned the State Council to stop this project in Yangpu. The Liberation Daily launched a media attack on the "Yangpu model", pushing the discussion towards the direction of "defending national dignity." Even during the Student Movement in the summer of 1989, many students used the slogan of "don't' sell my country", "taking back Yangpu" against the central government (ibid). Against this background, the reformists welcome-policy towards foreign investment encountered a severe challenge during the political turmoil in the late 1980s. As the reformist leader Zhao Ziyang lamented, "In hindsight, it was not easy for China to carry out the reform policy. Whenever there were issues involving relationships with foreigners, people were afraid of being exploited, having our sovereignty undermined, or suffering an insult to our nation" (cf. Tang 2014: 216).

However, the reform policy itself also had created its own constituency. As the foreign sector became more entrenched and amassed its own resources (including capital, foreign exchange, technology), government cadres, technicians, and managers involved in carrying out the policy had a greater interest in seeing the foreign sector remain strong. China's military leaders were also Deng's supporters since foreign technology transfer served China's military modernization. Already in the Sino-Vietnam War in 1979, the PLA suffered enormous casualties against the much smaller force of Vietnam and realized the army's outdated military skills (see Shambaugh 2002; Zhang 2015). The defense sector was in steady decline as a result of the military-civilian conversion initiative in the late 1970s. The initiative was a part of Deng's reform program and aimed to tackle the burdens of excessive militarization and modernize the military. By 1988, the number of military personnel had been slashed almost in half compared to that of 1975. The continuously diminishing military budget forced the PLA to engage in commercial activities in the second half of the 1980s. After 1985, joint ventures were allowed in a number of the previously restricted sectors, including aviation and transportation (see Pearson 1991: 117). By appointing pro-reform generals to key positions, Deng gradually created a leadership core of his loyalists (Yang Shangkun, Yang Baibing), which was to play a decisive role in Deng's political feat in salvaging the faltering reform program in 1992. In Zhuhai, he called a meeting on military planning and military top brasses such as Yang Shangkun, Yang Baibing, and Liu Huaqing all agreed with Deng at the meeting over the need to speed up reform (see Tang 2014:224f). Deng could also count on an important constituency – the provinces in his campaign to solidify support (Zhao 1993). Indeed, the provincial and municipal officials who constituted the largest bloc in the Central Committee consistently objected to the post-1989 recentralization policies in the central work conferences preceding both the Fifth Plenum of the Thirteen Central Committee in November 1989 and the Seventh Plenum in December 1990 (Shirk 1993: 80). After a series of ideological campaign between 1989 and 1991, Deng's proposition for a "socialist market economy" was endorsed as the ultimate goal of China's reform path in the Fourteenth Party Congress in September 1992. The Central Committee passed a resolution on establishing the system of socialist market economy at the Third Plenum in 1993. The decision unleashed the high tide of SOE reform, rapid expansion of stock markets and privatization of the economy as a result of ideological liberalization. Eventually, the critical juncture from 1989 to 1992 transformed the pivot of China's foreign economic policy from security concerns to economics benefits.

3.3 Accelerated liberalization 1992-2001

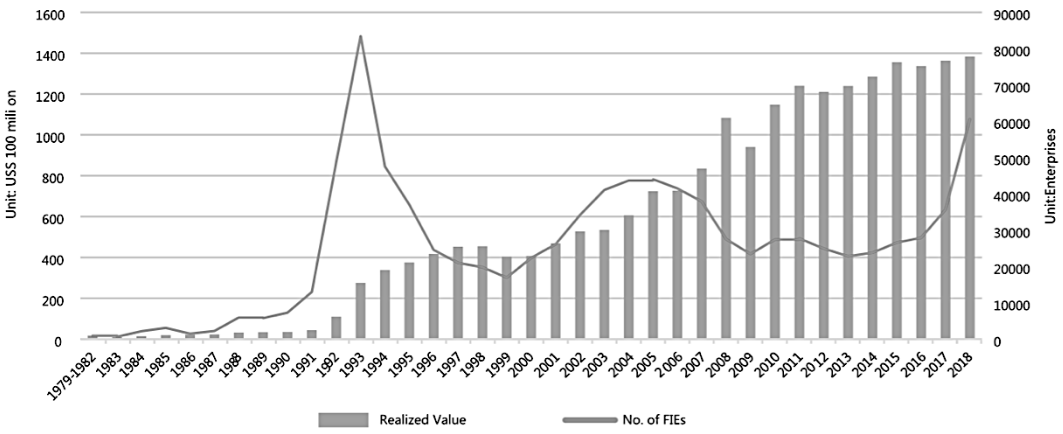
The second era of China's IFDI policy was characterized with accelerated liberalization of China's capital market. Upon the reformists' win to further open China's door to foreign MNCs, a National Leading Group of Foreign Investment was established in 1994. As mentioned above, the Committee for Foreign Investment (CFI) was merged into the MOFTEC in 1982. The Leading Group again re-established an almost identical committee to the CFI, involving representatives from the same agencies. This time, the office of the leading group was located directly under the MOFTEC instead of the State Council, which indicates that the IFDI issue became institutionalized within MOFTEC than just governed by an ad-hoc committee. At the same time, the establishment of this extra leading group shows the importance of the IFDI policy in the early 1990s. Both the CFI and the leading group had the nature of a separate professional decision-making agency as CFIUS. They offered a centralized high-level platform for consultation and policy-making, facilitated the decisions to attract and approve major foreign investments. They also acted as the corresponding agency in the communication with foreign governments, when there was state-sponsored investment cooperation (Hao 2016).

At the meso-level, the IFDI regulatory system was further decentralized in the 1990s. The central government authorized 21 additional cities to receive foreign capital flows. To attract foreign investors, local officials promised tax breaks and created industrial zones without approval of the central government. Some provinces and municipalities that are especially attractive to foreign investments such as Shanghai and Guangdong also established their leading groups for foreign investment. Usually, they are chaired by the provincial or municipal Party Secretaries, organizationally located in the house of local commerce bureaus, yet enjoy higher authorities of the commerce bureaus due to the constituent higher-level decision-making officials. Under such an agency, major foreign investments were thus reviewed and approved not by lower-level administrative persons, but by the leading officials of the local governments (ibid: 36). In 1996, the State Council amended regulations on investment oversight by lifting the ceiling on projects that did not need central government approval from $10 million to $30 million, with approval rights granted to provincial-level affiliated institutions of the ministries (Fu 2000:39). The SEZs were given independent approval authority for light industrial projects up to $30 million and heavy industrial projects up to about $50 million. In practice, it is often the local government that has the real hands-on approval power and control over projects (Zhang 2000: 49). Using measures such as tax cuts, government funding, and bank credits, local officials went out of their way and competed to bring in foreign investors as a way both to promote local growth and to establish political achievements under the cadre evaluation system. They can also initiative preferable policy towards foreign investors much more easily than the central government. During the 1990s, local commerce bureaus arose in most of the city governments and gained more autonomy in FDI regulations (see also Chen 2018: 25). By China's WTO accession in 2001, its IFDI regulatory regime had become very fragmented, with multiple agencies at the national and local level in charge of project review and approval. As the center's agents, the local governments' missions were to implement the regulatory guidelines they received from the central government. However, the irony is that the greater the expansion of state intervention, and the greater the sprawl of its administrative apparatus, the more difficult the center have to impose a unified course or vision, for a centrifugal tendency can develop within such a system (see also Wang 1991: 9).

The 1990s also witnessed China's efforts at the international level to promote foreign trade and investment relations. It had signed BITs with 27 countries by 1992. The most significant international agreements were those with the U.S. In 1992, both governments signed a Memorandum of Understanding on a range of issues ranging from market access to intellectual property rights protection. China's WTO substantial negotiations also began in 1992 after it reached an Memorandum of Understanding with the U.S. on the market access and the restoration of China's membership in GATT. Chinese officials have also acknowledged the role played by the IMF in mid-1996 in the decision to allow FIEs complete access to the interbank foreign exchange market – a key intermediate step toward achieving current account convertibility (Bell & Stephan 2013: 234). While the state's regulatory capacity gradually decreased with market liberalization and the decentralization process, globalization's constraining effects increased.

IFDIs began to play a vital role in the Chinese economy in the 1990s. A substantive amount of foreign capital entered China upon Deng Xiaoping's Southern Tour in 1992, which marks the begin of the second era of China's IFDI liberalization (MOFCOM 2018; Chen 2018; Hsueh 2011; Wilson 2009; Huang 2003). Aggregated FDI inflows in China more than doubled from $4,7 billion in 1991 to $11,3 billion in 1992. In comparison to the total amount of $25.1 billion FDI from 1978 to 1991, an inflow of $11,3 billion in the single year of 1992 is a remarkably high number (PRC NBS 2008) (see figure 6). In 1992, the first foreign acquisition was conducted by the Hongkong Zhongce Group to take over a state-owned rubber company of Shanxi Province. China became the largest recipient of FDI among developing countries and the second largest next to the U.S. in the world in 1993 (UNCTAD 1995). At the same time, the U.S. GDP was ten times larger than of China. In this sense, the Chinese economy was more dependent on IFDI even though IFDI flows into the U.S. were larger. Country origins of foreign investors were also diversified in this period. While investors from Hongkong and Taiwan continued to play an important role, Japanese, American and European firms also increased their investments. FDI from the U.S. and Europe tended to be market pursuing and clustered in high-tech and high-value-added sectors (Hseuh 2011: 12). In the mid-1990s, roughly three quarters of the investment were joint ventures with Chinese partners. By the mid-2000s, three quarters were wholly foreign-owned subsidiaries of MNCs (NBS PRC 2005: 643).

Figure 6. China's annual inward FDI and FIEs 1979-2018



Source: MOFCOM 2020. Statistical Bulletin of FDI in China, Figure 1. Online available: http://images.mofcom.gov.cn/wzs/201912/20191226103003602.pdf

The gains of IFDI expanded further when the reformist leadership in the Jiang Zemin and Zhu Rongji administration decided to push forward SOE reforms by allowing FDI participation in the late 1990s. The new SOE reform policy of "Grasping the large and releasing the small" (zhuada fangxiao) in 1995 signaled the government's willingness to allow many small and medium-size SOEs to change ownership. Between 1998 and 2003, the industrial ministries decoupled most of their enterprise units, which provided further incentives for FDI to form joint ventures with SOEs (Liang 2013: 90). The quick alignment between FIEs and SOEs is not hard to explain, because SOEs not only possessed privileges in allocating tangible resources, but also intangible ones such as political network in China (see Zou & Simpson 2008: 507). IFDI policy in the 1990s marked a major push in favor of privatization which allowed the state to shed of some of its worst assets, and some of its social obligations (Huang 2008: 169).

At the macro-level, a major consequence of economic opening was the rise of the private economy in China in the 1990s. In sectors where government policy was more open to different forms of ownership, competition promoted the creation of domestic firms and increase in their capabilities. Foreign firms also needed to localize more activities and transfer more technology to Chinese partners in order to be cost-competitive (Tsai & Naughton 2015: 7). From 1992 to 2001, the proportion of non-state economy in China's GDP grew from 53,60% to 62,32%. Its contribution to China's national tax income increased from 33,00% to 64,42% in the same period. Moreover, the share of urban workforce in non-state economy grew from 39,03% in 1992 to 68,09% in 2001 (PRC NBS 2003). In the fast-growing coastal provinces, local government officials were quick to strike various forms of partnership with domestic private entrepreneurs. This corporatism fostered the rise of what is called "collective firms", or "red capitalists" – township and village enterprises that are registered collectively with a public patronage but not run by the government in practice (Haggard & Huang 2008: 342). The liberalization of the regulatory regime for IFDI thus not only benefited the SOEs in the 1980s and 1990s but also indirectly fueled the growth of China's private economy. However, at the same time, the state's intention to promote industrial upgrading was being complicated by the problems of coordinating SOE-foreign-domestic private firm relationship. This relationship did not necessarily matter national security in the interstate relationship, but it could influence domestic social stability and bring political demands to protect national firms. Against this background, important changes in the state-market relationship also emerged by the turn of the 2000s. The government began to support virtually all technologically advanced enterprises, including small private start-ups.

Again, taking the telecom equipment sector as an example, the 1990s saw China's telecom sector experiencing the fastest growth rate in the whole economy and attracting considerable interest from Western economies as well as domestic players (Shen & Naughton 2013). In 1989, the State Council promulgated Directive 56 which limited foreign participation in switching equipment manufacture to three companies: France's Alcatel, Germany's Siemens and Japan's NEC. This limitation on the number of foreign firms was lifted after the 1989 political event. Motorola soon became the fourth foreign manufacturer and the only wholly-foreign owned enterprise at the time that localized production, when it received "tremendous good will" from the government for returning to China six months after the Tiananmen crackdown (cf. Hseuh 2011:79).[163] In 1992, the company registered a $120 million investment capital in the Tianjin Economic Development Area, which was approved by the State Council, to set up factories for semiconductor and pager production. For a country that had just experienced political turmoil in 1989, the open-door policy towards foreign telecom equipment vendors indicates that the desire of technology upgrade and economic development were prioritized than national security concerns. By the late 1990s, major foreign telecom equipment makers, including Nokia, Ericsson and Philips had built production lines in joint ventures with SOEs decoupled from the industrial ministries in the late 1990s. The first 1995 and the 1997 revised Catalogue of Industries for Guiding Foreign Investment encouraged investments in digital wireless systems, optical SDH transmission systems, digital microwave systems, asynchronous transfer mode (ATM) switching systems – the subsectors of the telecom industry where China lagged behind the global market.

The large-scale installation of imported stored program-controlled switches in China's telecom networks and the presence of many JVs in China fostered the diffusion of technology know-hows across the country. Many engineers of China's current leading telecom equipment makers such as Huawei and Xiaomi worked at Motorola in the 1990s. Domestic researchers and engineers, teamed with private entrepreneurs quickly grasped the opportunity to develop competitive local products (Shen 1999; Tan 2002; Harwit 2008). China's current national champion of telecom equipment, Huawei, came of age in this investment and regulatory climate. The spread of switch products facilitated their domestication. Huawei was founded by Ren Zhengfei in 1988 in Shenzhen, China, with a registration assets of only 21,000 RMB. In its first few years of operations, Huawei focused on reselling switches and fire alarms imported from Hongkong (Ahrens 2013). Another Chinese telecom champion, Zhongxing Telecommunication Equipment Corporation (ZTE) was established in 1985 and initially produced watches, electronic keyboards and telephones. It followed a similar strategy of Huawei by importing and

163 Motorola already had product sale on the Chinese market and there had been governmental efforts of Tianjin Economic Development Area to court investments of Motorola in the late 1980s.

reselling telecom equipment in the 1980s and started to develop its own switch products and diversify into different subsectors in the 1990s. At the time of the two companies' establishment, major international telecom companies (Alcatel, Ericsson, Motorola and Nokia) already had a presence in the country. Huawei's early strategy was to establish joint ventures or other forms of cooperation with local Post and Telecommunications Administrations (PTAs) to encourage the purchase of Huawei's equipment that were much cheaper than the MNCs' products. As mentioned above, the preferential policy of SEZs created a bifurcated urban and rural market structure. This structure provided Huawei and ZET and other Chinese domestic TE suppliers with a vast rural market that, nevertheless, only offered slim profit margins. In adopting to subnational demands, domestic suppliers also developed their service-oriented business model and learning capabilities. By absorbing and digesting imported technology, local manufacturers developed switches that were modified and possibly improved than the Western models. This kind of technology modification requires less time, financial and human capital than the technology transfer or licensing, but can also reap benefits from property rights. Starting from a 10% market share in 1992, the four domestic manufacturers – Great Dragon, DaTang, ZTE and Huawei already held 43% of China's switch market in 2001 (Harwit 2008). To facilitate the domestic production of switches, the government started to impose an import tariff on TE in 1996. Meanwhile, its product began to serve more developing countries. Local manufacturers started to integrate into the global market by exporting their products and accumulated more capital for research and development. In the late 1990s, Huawei and ZTE already tapped into global R&D resources, investing in global innovation centers of telecom technology and software development, such as Silicon Valley.

3.4 Selective reregulation in the 1990s

As expanding segments of the economy were increasingly transferred to control by market mechanisms and left with much diminished oversight by government planning bodies, the state also showed renewed interest in regulation, particularly of strategic industries. In 1995, the State Planning Commission (SPC), the State Economic and Trade

Commission (SETC) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) promulgated the 1995 Catalogue of Industries for Guiding Foreign Investment."[164] It presented to foreign investors for the first time a detailed sectoral road map, including whether WFOEs or JVs were preferred or required, under four categories of projects: encouraged, restricted, prohibited and permitted (see also Fu 2000: 60; Breslin 2006). The Catalogue divided the industrial sectors for foreign investment into four categories: "encouraged", "permitted"[165], "restricted," or "prohibited". It was stipulated specifically in the first Catalogue of 1995 that investment "harming state safety or impairing the public interest", or "harming the safety and usage of military facilities" should be prohibited. By introducing the Catalogue, entry barriers were erected to protect incumbent state firms in critical sectors, such as power grid, petroleum and gas extraction, where the state's monopoly is absolute. The Catalogue also prohibited FDI in sectors where its domestic enterprises have an absolute advantage such as traditional handicraft industry. It should be noted that the categorization was not inflexible and may change under certain conditions. For instance, foreign investment projects classified as "restricted" might be treated as "permitted" if their product export sales amount to more than 70% of their total product sales (see Huang 2009: 198). Projects classified as "permitted" or even "restricted" can enjoy the same treatment as "encouraged" projects if they are considered to be particularly conducive to economic development in western and central China (ibid). If a FDI fell within the "encouraged" category, it is subject to relatively lenient approval requirements. The primary concern of the government when it introduced the Catalogue system in 1995 was to guide the orientation of foreign investment, to keep them in line with the national industrial policy and to shield certain critical sectors from foreign influence. The Catalogue has be updated every few years (from 1996 to 2015 six times in total) and what to be added and deleted is a decision of the NDRC.

Most importantly, local authority in IFDI regulation was thus countermanded by this

[164] MOFCOM. 1995. Catalogue of Industries for Guiding Foreign Investment, http://www.mofcom.gov.cn/aarticle/b/f/200207/20020700031063.html

[165] The category "permitted" was merged into "encouraged" since the 2002 Catalogue. Industrial sectors that are not listed can be regarded as "permitted" since 2002.

industry-specific rule that insists on central government approval for investment in restricted industries identified in The Catalogue. According to the interviewees working at provincial development and reform committee, “local approvals of foreign investments strictly comply with the Catalogue system of the NDRC and no local officials would circumvent it in the approval process.”[166] They expressed the view that conflict may emerge between local interests and the central regulations, but the NDRC has the veto right. Due to the broad definition of some sectors in the Catalogue, there might have been some cases that the local governments approved within their approval authority (under $10,000 million), that the NDRC and MOFCOM were not notified and could have decided differently if they did. “Yet these cases were rather unintentional and also inevitable in the administrative process”.[167]

3.5 Critical juncture 1997-2001

Since most of the capital inflows to China were long-term direct investment and little of the inflows was short-term borrowing, China was not severely influenced by the Asian Financial Crisis (AFC). Portfolio inflows and outflows were under tight policy control by the late 1990s (Lardy 1992; Breslin 2006: 17). Although stock markets in Shanghai and Shenzhen began operations in 1993, shares in the markets were categorized as A and B and foreign companies were only allowed to buy B-stakes on the stock market.[168] Restrictions denied free entrance to the Chinese capital market but also shielded China from the volatility of global capital flows in the financial crisis. Despite a reduction in portfolio investment in 1998 when investors withdrew from East Asian economies in general, the very low level of such investments in China minimized the impact on the economy in general. However, the disastrous consequences of the Asian financial crisis in 1997 triggered a domestic debate about the implications of globalization and a sense

166 Interviews with officials working at the local DRC and Commerce Bureau of two Eastern provinces who have been in charge of IFDI affairs of the provinces for over five years. Telephone interview on February 10 and 15, 2020, Frankfurt am Main. Due to the requests of one interviewee, the provincial name and the identities of the interviewees are quoted here anonymously.

167 Ibid;

168 See SAFE. 2004. Notice of the State Administration of Foreign Exchange on the Relevant Issues Concerning the Improvement of Foreign Exchange Administration of Direct Investment by Foreign Investors, February 06, http://www.fdi.gov.cn/1800000121_39_199_0_7.html.

of urgency regarding economic and financial security in an emerging era of ever-deepening interdependence (Wang 2004; Kim 2009). Analysts also note that the AFC was seen to have obvious security implications, diminishing state autonomy and threatening domestic stability in some developing countries. Strong states with a centralized banking system appeared to be capable of handling the crisis, while weaker states suffered from authority and efficacy loss (see also Zhu & Pearson 2013).

However, despite the debate about the globalization impacts on national security, it seems that China had been locked-in Deng's path of liberalization on its way to the WTO accession. In 1998, then Premier Minister Zhu Rongji initiated a comprehensive program of bureaucratic restructuring. The administrative reform abolished a number of bureaucracies or downgraded them to the rank of bureau. During this reform, the National Leading Group of Foreign Investment was abolished and its duties was transferred to the MOFTEC (see State Council 2009). In total, the State Council compressed over eighty ministries into fewer than thirty. It dismantled almost all industrial ministries such as ministries for petrochemical, electricity, textiles. This reform was particularly significant for IFDI regulation given that the previous structure provided each industrial sector an guardian ministry that owned informal veto power to some industry-related investments. However, to facilitate its goal of relinquishing control in less strategic areas while retaining control in the most strategic sectors, the State Council created bureau-level government offices under the State Economic and Trade Commission (SETC) to replace these sector-specific ministries. The SETC was merged by the State Economic Commission revamped in 1993 and the Ministry of Domestic Trade. The SETC was another planning agency in charge of making yearly plans for national-level production output and their implementation. Its slight difference from the SPC was that the latter was in charge of mid-to-long-term plan, investment decisions of large-scale infrastructure projects. The SETC was responsible for the implementation and supervision of these development plans. Most importantly, it had a direct constituency that the SPC did not have – the state-owned enterprises. The subordination of the industrial ministries under the SETC also brought their affiliated SOEs under the supervision of the SETC. In comparison to the SPC, the SETC had both the policy tools to materialize the plan objectives and constituencies on which their policy could land effectively. The "industrial bureaus" under then SETC then strengthened its capabilities in setting and coordinating industrial policy, which, in turn, also led to its overlapping and conflictive role with the SPC (see Yang 2004; Wang 2019). At the same time of cutting off major industrial ministries, the State Council also created the Ministry of Information Industry (MII) to spearhead China's entry into the digital economy. It was a merge of the Ministry of Post and Telecommunications and the Ministry of Electronic Industry. Therefore, while the state was reorganizing SOEs, it also began to reorganize the government apparatus. The implications for China's IFDI policy was that another two superagencies (the SETC and MII) were added to the regulatory regime and functioned besides the SPC as major coordinators between China's industrial policies and IFDI.

The national security and sovereignty narrative was quite silent in China's market liberalization process in the 1990s. As David Shambaugh (2002: 2) notes, "the Gulf War [of 1991] stimulated deep introspection and analysis in the PLA about the nature of contemporary warfare and the reforms necessary to ready Chinese armed forces to wage it. In the wake of the Gulf War, PLA strategy was revised to focus on 'limited wars under high-technology conditions.'" Technology transfer and spillovers through IFDI, especially in the telecommunications sector, promoted the modernization process of China's military. However, approaching the last step of China's WTO accession, a major event happened in 1999. On May 8, during the NATO bombing of Yugoslavia, five U.S. Joint Direct Attack Munitions hit China's embassy in Belgrade, killing three Chinese journalists and outraging the Chinese public. The conjunction of the NATO bombing and a negotiation deadlock between Beijing and Washington over the terms of China's accession to the WTO in November 1999 prompted a debate over China's national security, its relations with the U.S. and the way of China's reform. Premier Zhu Rongji bore the brunt of criticism from two fronts: the senior-level Party leaders and organs headed by Li Peng, then chairman of the NPC, and the ministries (especially the SPC and MII) (see Tang 2014: 241). Li Peng took a strong position on the WTO issue by declaring that "China need not join the WTO by making concession or under attached conditions. As some Chinese scholars have observed, in every major coordination conference held in the State Council, each bureaucratic agency in charge of the "infant sectors", insufficient heavy-industry sectors and the agriculture" seemed to become the staunchest defender of the most fundamental interests of the Chinese nation-state […] criticizing the front-line negotiators as lacking knowledge of national conditions, as "too naive and too idealistic" (see Zhong & Wang 2007). However, the liberal constituent, including the Ministry of Foreign Affairs, MOFTEC, the coastal provinces the emerging urban middle class and may influential intellectuals, was obviously broader than the opponents. In 2000, Jiang brought up the "Three Represents" Theory during his visit in Guangdong, which reflects an alliance between the CCP and China's new socioeconomic elites – "the most advanced productive elements of Chinese society" – strongly in favor of internationalization. The CCP membership criteria was broadened to admit "workers, peasants, soldiers, intellectuals and the advanced elements of other social classes" at the Sixteenth Party Congress in 2002. Despite the harsh rhetoric, the Jiang administration eventually did not resort to confrontation with the U.S. on the embassy booming and the foiled WTO negotiation. Only months after the bombing, China supported the UN intervention in East Timor despite the domestic debate over state sovereignty. Although several security- and sovereignty-related debates in the late 1990s opened windows for a step back from the opening process, China's accession to the WTO in 2001 signified the continuity of the liberalization path.

3.6 Institutional continuity and change

The Chinese bureaucracy inherited from the plan economy system enjoyed enormous authority and capability in economic management. Socialist planning mechanisms such as industrial ministries, finance bureaus and party bureaucracies were able to regulate and oversee foreign-backed operations (Pearson 1991: 15). However, through the reform process in the 1980s and 1990s, the regulatory capacity was weakened in many aspects. First, considering the monitoring capacity, the laws established in the 1980s required strict approval procedures before a joint venture could be established. A foreign investor had to contract with a Chinese partner to run the enterprise. Because most Chinese partners at the time were SOEs, the state had the opportunity to directly foster its own ends and to control the role of foreign capital in China's development. China's foreign currency bureaucracy also developed a foreign exchange certificates alike a separate currency (waihui quan) to be used by foreign investors, which enjoyed limited convertibility into hard currencies and limited FIEs' access to domestic market. By 1990, there did not exist a financial market and foreign investment could not be conducted solely through financial investment. In the 1990s, the investor countries, invested sectors and cooperate forms were getting more and more diversified. The local governments were taking more responsibility in the registration process and only file their approvals to the MOFTEC (beian guanli). As a result of limited manpower, staff members of the central agencies cannot possibly conduct independent and thorough reviews of all investment projects under their jurisdiction. They had to rely on detailed reports from the local governments and the SOEs. Analysts also found that the SPC was known to subcontract private firms to monitor public-invested projects (see Lin 2007: 326).

Considering the strategic agency and bureaucratic coherence, the institutional mission of the SPC in the regulatory regime was to coordinate with the industrial ministries in setting sectoral policies and approve major investment projects. There were not only one but several strategic agencies in the review process in the 1980s. However, throughout the 1990s, new bureaucratic interest have arisen and gained influence during market reform, most notably the financial agencies and new regulatory bodies such as the MOFTEC. The National People's Congress was also acquiring increased assertiveness beyond its former rubber-stamping role and interest in participating in policy process previously transpired behind closed doors of the State Council and the Politburo (Lin 2007: 328). At the same time, decentralization of approval let the local government stand at the forefront of establishing interactions with foreign private firms and undertaking direct developmental interventions. Foreign capital were channeled to find local projects favored by local government officials and through their control of local branches of the state banks, and the central government was forced to invest in basic industries directly and rely on money creation to finance domestic investments. It became possible, where local and central interests conflicted, for a project to be approved at the local level when it might have been rejected by the center. If authorities from a central ministry opposed a venture because the ministry was involved in a similar venture elsewhere, through various accounting and financing schemes, the venture's sponsors kept the amount of total investment low enough so that local authorities, who favored the project, would be authorized to approve it (see Liang 2013: 85). The situation was made worse by the fact that central government tax revenues as a percentage of GDP had deteriorated markedly as the traditional tax base – the retained profits of SOEs – had dwindled due to partial price liberalization as well as from competition with the emerging private sector. A major performance measure applied to localities was the gross quantity of foreign capital they absorbed. Localities thus felt performance pressure to court and approve foreign projects even at the expense of other approval criteria (Pearson 1991: 110). Therefore, the monitoring capacity of the central state and bureaucratic coherence largely decreased through the accelerated IFDI liberalization process in the 1990s.

Yet at the same time, the Catalogue regularly updated by the SPC specifies the operational range and procedure of the central state and serves as an institution to direct the sectoral choices of foreign investors. The central state was able to enforce policy priorities and local governments took care of day-to-day business of local development. The common goal of holding them together is the promotion of IFDI to serve development. In the 1980s, there was lack of a formal channel for laggard domestic private firms to articulate their interests. While the privatization trend of SOEs concerted well with foreign investment, China's private sector did not receive the same policy as foreign investors. Throughout the 1980s, private entrepreneurs experienced not only a social stigma but also political persecutions for being profit-oriented. There was considerable political uncertainty about the trajectory of economic reform, and private entrepreneurs were publicly criticized during the national campaigns against "spiritual pollution" in 1983-1984, and against "bourgeois liberalization" in 1987. Although the 1993 Company is supposed to be a unified legislation governing firms of all ownership types, it rather stipulated the continuation of the separate legal regime for FIEs that "entry regulations applicable to FIEs are separately defined by the State Council" (Section 11).

It is very difficult to give an assessment of the institutional linkage between private firms and the state. On the one hand, in a political system where business entrepreneurs were yet not a formally acknowledged member group within the Party until the late 1990s, local state officials were the direct agents who conducted economic policies and the location where domestic private enterprises could align with (see Tsai 2006). Economic decentralization provided an incentive for local governments to promote township and village enterprise. The amendments of the Constitution in 1993, 1997 promoted the legitimate position of the market economy. After Jiang's Three Represents theory legitimized admission of private businessmen into the Party, the 1999 amendment of the Constitution acknowledged private sector to be an integral part of the Chinese economy. In this aspect, formal channels for private firms to articulate their interests increased. On the other hand, as many China scholars have pointed out, the identities and interests of domestic private entrepreneurs are very diverse (see Tsai 2005). It would be difficult to view them as a coherent group. Moreover, social interest representation diffused by different nodes of network interactions among central agencies (Lin 2007: 321). Although business associations did get formed in the 1990s, whether they could represent their members is "frequently unclear", since the level of government intervention is high. "The consequence of such intervention is not to eliminate industry's voice but to fragment it" (cf. Kennedy 2011: 118; see also Zhu 2017: 11). Therefore, even there had been increased institutional linkages with private business, it is hard to assess their real political impacts.

4. Promoting and policing IFDI after the WTO accession

4.1 WTO commitments and reinforcing the state

Beginning from 1978, marketization has never been the sole goal of the economic reform. As the first part of Zhu's SOE reform policy "Grasping the Large" suggests, the reform to SOEs also included reserving and building China's indigenous, internationally competitive large corporations. During the SOE reform in the late 1990s, all but the largest SOEs were restructured, merged or shut down, but large-scale SOEs in sectors labeled the "commanding height" or "top tier" in Pearson's word (2015) of the economy were still managed by the central government. They were reorganized into state-controlled business groups – large SOEs that own several enterprise units and positioned in critical industries such as energy, petroleum, aviation, construction, banking and insurance.[169] These industrial sectors are directly related to national security and fall under investment entry protection. Large SOEs in these critical industries are "too big to fail" not only because of their industrial importance, but also because of its large employment effect.[170] State ownership had only become much less prominent in important but less strategic sectors – the middle tier sector – such as machinery and autos, chemicals and pharmaceuticals, in which Chinese firms are exposed to global competition (see also Tsai & Naughton 2015: 5). Small and medium-sized SOEs in the middle tier are owned by subnational levels of government, such as provinces and municipalities.

Parallel to the liberalization process, the state also reinforced itself in the early 2000s. In the 2003 administrative reform, the primary functions of the SETC were split into three institutions designed to oversee macroeconomic policy, state-owned enterprises and international trade. Authority over industrial regulation of the SETC merged with the SPC into the National Development and Reform Commission (NDRC), which consolidated authority for industrial regulation and became the primary central government institution responsible for macroeconomic management. The bureau-level offices for industrial policy and the management of some SOEs under the SETC came also under the supervision of the NDRC. NDRC also retains the function of the SPC of coordinating domestic and foreign investment, as well as setting industrial policy. Authority over foreign trade issues was centralized in the Ministry of Commerce (MOFCOM), ending

[169] For instance, the core assets of the State Bureau of Civil Aviation Administration were consolidated into five business groups, including three large airlines and two aviation service providers; the core assets of the Ministry of Electricity Industry were consolidated into seven large business groups, including two grid operators and five power generators. These large enterprises that were carved out from their ministries also absorbed the backbone assets of the old industrial ministry system and many managerial positions were taken by former government officials (ibid).
[170] For instance, the China National Petroleum Corporation and China State Railway Group have over one million of employees.

overlapping ministerial competencies that had previously co-existed. The duty of supervising SOEs of the SETC came under a new agency – the State Asset Supervision and Administrative Commission (SASAC) established in 2003. SASAC also absorbed the mission of the Central Large Enterprise Work Commission (CLEWC) established in 1998 to implement the decoupling between the large-scale SOEs and their parent industrial ministries and manage the resultant carved-out enterprises (Li C. 2016:938). Therefore, the newly found SASAC consolidated the function of supervising large SOEs. In the year of its establishment, SASAC owned 196 SOEs in perceived seven critical industries including: defense (e.g. CNNC and CNECC), mining, aerospace and aviation (e.g. Air China, China Southern), shipping, oil and petrochemicals (e.g. CNPC, SIONPEC, CNOOC); electricity (e.g. State Grid, Datang, Huadian); telecommunication (e.g. China Mobile, China Unicom and China Telecom). It is the institution through which the state manages the capital of the large-scale SOEs in critical and strategic sectors, except their operational autonomy, but including the sales and purchases of their businesses and business units. It makes investment decisions in the way similar to how a private equity company might treat its holdings or what a Wall Street investment bank would do (Naughton 2015: 48). [171] Oversight over such a large portion of economy is thus not scattered across the relevant ministries, but concentrated in the hands of a single government agency.[172] From 2003 to 2018, the number of central-administered SOEs (yangqi）SASAC oversees reduced from 196 to 96 SOEs, meaning that 100 of them were consolidated into even larger SOEs. If foreign investors want to take part in those SOEs, it must go through SASAC for approval. This also applies to local offices of SASAC of provinces and municipalities that oversee critical SOEs in their regions. Clearly, there will be few foreign enterprises that are capable to make a bid to SASAC to take part in its large constituencies. The founding head of SASAC from 2003 to 2010, Li Rongrong, once stated a major institutional mission of SASAC: “China must nurture its own

[171] SASAC. 2019. List of centrally administrated SOEs, http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html.

[172] Maybe Chinese SOEs are not so well-known as the American leading MNCs. To understand SASAC’s tremendous assets, just imagine if one U.S. government agency would control General Electric, General Motors, Ford, Boeing, DuPont, AT&T, Honeywell, etc. And this agency could hire and fire their CEOs, deploy and transfer resources across holding companies, and generate synergies across its holdings.

multinationals to challenge the dominance of foreign corporations" and that SASAC was to "vigorously pursue a strategy of creating major corporate conglomerates" in targeted strategic industries. Bearing a mission of promoting national champions by pushing merger and acquisition of large SOEs in critical sectors, SASAC is less interested in breaking up the monopoly in the market as long as firms are globally competitive (Yeo 2008).

So far, the regulatory regime for IFDI was strengthened with the consolidation of two super agencies. A major dysfunction arising from the presence of supra-regulatory authorities in the IFDI regulatory process is that their management authority over large SOEs has posed major challenges to the regulatory independence of MOFCOM. After 2003, the NDRC stepped into the regulatory regime with respect to foreign investment by unilaterally promulgating a regulation of its own entitled "Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects."[173] Under this rule, the NDRC not only regulate all forms of IFDI, including greenfield and M&A activities, but also obtained a grip on the pre-existing FIEs that had been approved previously by the MOFCOM. If a company tried to expand the size of its same project after 2004, it had to go additionally to NDRC after 2004. In this way, the NDRC retroactively invaded the turf that had traditionally been dominated by the MOFCOM. On the one hand, the lowering of the project amount for approval at the regional level reinforced the autonomy of local governments; On the other, top-level approvals from the NDRC to large-scale projects also forced international investors to align with this planning agency when they want to initiate or join state-approved giant projects.

4.2 Soaring foreign takeovers in the early 2000s

Relaxed investment rules not only helped the state to implement the restructure plan of inefficient SOEs, they also induced MNC's restructuring strategy and contributed to the acceleration of foreign M&As in China. In 1990s, practically all of the plants utilized

[173] NDRC PRC. 2004. Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects, effective on October 9, 2004, https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/200506/t20050601_960642.html.

core technologies produced elsewhere, and China operated at the lower end of hierarchical global production networks. For earlier foreign investors, production transfer alone to emerging market aligned well with the experimental nature of having a small local presence in China (Huang 2009: 197). They were highly dependent on local partners for sales and distribution (Shaw & Meier 1993). The main challenge for MNCs in China had been to find local partners to negotiate and establish joint ventures. Relocating home production facilities in China was the priority for most early foreign investors. For other activities that would generate more values in the global value chain such as procurement, R&D, branding, sales and training, MNCs had either relied on their parent or corporate members in other countries (ibid). However, entering the 2000s, MNCs who now had larger-scale operations and sales in the Chinese market were in urgent need to promote corporate strategies and integrate different units in China. Partnering with Chinese firms then became very ineffective, because many joint venture partners failed to deliver value chain contributions or fulfill their internal corporate strategies (Luo 2007: 21). “The gap between MNC’s need for a national cost-effective distribution system and the more locally oriented goals of their partners created serious tensions”(cf. ibid).

As a remedy and against the background of relaxed investment rules, strategic MNCs began to transfer or build their own teams to improve distribution control. In addition to using China as the “world factory” for manufacturing, MNCs began to takeover leading Chinese players in their fields to acquire more market share. They also set up R&D centers to satisfy local consumers’ increased need for innovation and learning. For instance, Motorola as the first MNC which established a R&D center in Beijing in 1993, had continuously expanded its investment in research and training in China. By 2002, it had set up 18 R&D centers in various cities (Chen 2002); Cisco had set up 20 branches of its global networking academy program in Chinese universities offering training and certification (Luo 2007: 22). With continuous volume growth in a specific sector, MNCs could further expand via reinvestment and diversification of business segments. Based on their connections with global suppliers, MNCs also promoted a “group-offshoring strategy”, attracting other foreign suppliers to the same region (Chen 2018). Foreign capital switched from consumer products such as textile to various sectors of manufacturing such as equipment production and raw material, as well as services (Brandt 2007: 302f; Xia 2017). Improvement of the MNC's value chain increased their profit margins and long-term returns. Many MNCs also collaborated with various levels of Chinese government institutions in improving economic infrastructure, industry competitiveness and economic performance. They were increasingly perceived as players or even leaders in the domestic market, and long-term contributors to regional and national economies. MNCs worked together with local regulators to collectively maximize corporate gains by sharing complementary resources while also improving their own performances (Chen 2018; Luo 2007: 18-20).

Table 11. Proportion of foreign acquisitions out of FDI in China

Year	Cross-border M&As in China	FDI Inflows in China	Percentage
1990	8	3487	0.22%
1991	125	4366	0.86%
1992	221	11008	2.01%
1993	561	27515	2.04%
1994	715	33767	2.12%
1995	403	37521	1.07%
1996	1906	41726	4.57%
1997	1855	45257	4.1%
1998	798	45463	1.57%
1999	2395	40319	5.94%
2000	2247	40715	5.52%
2001	2325	46878	4.96%
2002	2072	52743	3.93%
2003	3820	53505	7.14%
2004	6768	60630	11.6%
2005	8253	72410	11.%

Source: MOMFCOM 2018 & Zou & Simpson 2008: 493 (in millions of USD).

Despite the gains and benefits, there were also increased fears that FDI, especially M&As would result in foreign monopolies, loss of state-owned assets and unemployment of Chinese workers (Li & Bian 2016: 154; Bu 2012: 348f; Zhao 2012). Increased foreign investment also led to perceptions among many Chinese government officials, economists and businessmen that the country had been excessively dependent on foreign technology, which threatens national security and undermines the gains Chinese industry would otherwise be able to realize from participation in the global economy (Suttmeier 2005:36). A report conducted by the Development Research Center under the State Council in 2006 showed that foreign investors controlled the top five businesses in all the industrial sectors that were open to foreign investments, and they also possessed majority assets control in 21 out of the 28 leading industrial sectors in China.[174] This is certainly an unusual situation for a country where state ownership used to dominate the industrial sectors, yet the previous regulatory regime did not provide legal basis for the government to screen out undesirable FDI transaction when they fall within the "encouraged" and "permitted" industrial areas (Huang 2007: 808). Another impact on the Chinese economy was that local governmental support of the global firms sometimes squeezed and segregated local firms into the bottom of the production chain and formed them to compete for cheap labor and limited production opportunities. For domestic entrepreneurs, foreign enterprises were being given too many advantages in the emerging market and gaining capacity and market share in China without adequate oversight by the central government. The tensions between private entrepreneurs and the alliances of SOEs and MNCs finally arrived a breaking point in 2003.

4.3 An unintended consequence and another critical juncture? The Xugong-Carlyle bid and bounded state intervention

In sectors in which the Chinese government had relinquished control, the lack of rules and lackluster enforcement of regulations first posed challenges to state. In the spring of 2003, the municipal government of Xuzhou, Jiangsu Province announced its plan to restructure its government-owned Xugong Construction Machinery Group through a procurement tender which was also open to foreign companies. Xugong was a leading enterprise in China's machinery and construction sector and a SOE wholly owned by the

[174] Chen, Hongwei. 2007. Top-Ten News of 2006 on Foreign Investment in China, China Economic Times, January 07, http://www.china.com.cn/economic/txt/2007-01/07/content_7618793.htm.

Xuzhou local government. The company designed and manufactured a wide range of engineering machinery, including cranes, road rollers, earth scrapers, concrete machines and their basic parts and components. In the past years, Xugong had consecutively run deficits and was faced with a debt and pension problem. Upon the sale announcement, more than 30 domestic and foreign enterprises and funds came into bid, including industry competitors and champion investors such as the Chinese Sany Group, the American Caterpillar Group, and JP Morgen Chase (Wang 2006). Among the bidders, Carlyle Group, a private equity firm headquartered in Washington D.C., offered to buy 85% stock of Xugong Construction Machinery Group at the price of $375 million. The Carlye Group possessed much investment in construction machinery in its portfolio. In June 2004, after the first round of tender, all Chinese bidders ran out the race. In October 2005, Carlyle's bid was accepted by Xugong. According to Xugong's president, Wang Min, investment from Carlyle would "bring in new technology, capital for development, and help Xugong's internationalization" (ibid). The deal was ratified by Xuzhou municipal government, then submitted to MOFCOM for approval (Ning 2018).

None of the parties had expected that the case would trigger a fierce public debate in China and a three-year review of MOFCOM. The president of Sany Group, Xiang Wenbo, first launched a blog campaign to attack the deal, publishing more than 30 blogs in June 2006. He criticized the government for allowing foreign ownership in a vital part of the Chinese construction industry. He also argued that the acquisition deal was not a fight between Xugong and Sany Group, but a fight for "national interests", since Xugong was a leader in a national strategic industry, and it was "sold too cheap" to Carlyle.[175] Moreover, he pledged that the state should support Chinese domestic private firms (minying qiye, such as Sany Group) and be cautious of the subordination of foreign firms' interests to their home governments.[176] Xiang's blog campaign triggered wider public discussion on the haunting issue of selling state assets to foreign investors in the last years.

[175] Xiang, Wenbo. 2006. Xugong's Reform Did Not Give Sany A Chance (徐工改制没有给三一机会), last update on July 06, http://xiangwenbo.blog.sohu.com/6046566.html.
[176] Ibid. 2006 Discriminating Chinese Private Firms Is A Strategic Failure (歧视民企是战略错误), last update on July 08, http://xiangwenbo.blog.sohu.com/6202024.html.

Interestingly, the Sany Group which operates outside the SOE budget system appealed for the protection of a SOE. In the media debate, rather than using the neutral term "domestic industry" to refer to Xugong, many writers chose the term "national industry" (minzu gongye) in arguing the importance of blocking the deal.

Upon growing public sentiment, MOFCOM commenced an unprecedented close-door hearing with the Xugong Group, Xuzhou government officials, the Carlyle Group and several other state agencies in July 2006 (Ning 2018; Xiao 2006). At the same time, State Secretary Colin Powell and Deputy Secretary of U.S. Commerce Department were also in Peking. Insiders suggested that the Xugong bid was the main topic during Powell's meeting with then Commerce Minister Bo Xilai. Subsequently, MOFCOM also conducted an investigation with other bidders in the acquisition tender to ask for their opinions. Two month later, Carlyle made concessions and revised its offer twice, which ultimately resulted in a substantial reduction of Carlyle's proposed stake in Xugong to a minority of 45% with a bid price of $180 million, while the remaining 55% interest would be reserved for Xugong Group itself. The new deal was submitted again to local and national agencies for approval (see Wang 2006). However, this gesture obviously did not answer the concerns which MOFCOM and other relevant ministries of the State Council raised in their unprecedented gathering, which suggested to break the deadlock by adjusting the deal. Although many held a positive view of the new plan, the whole deal fell through as Xugong declared in July 2008 that the proposed deal of Carlyle expired (Xiao 2006).

MOFCOM's hands were tied to block the Carlyle case due to the lack of a legal ground. Neither a national security review regime, nor an Anti-monopoly law had officially been established in 2008. It is also hard to know the extent to which national security concerns actually weighed on the failed acquisition (Li X. 2016: 265). By the time of the Caryle-Xugong transaction, only three machinery industries fell within the "restricted" category of the 2002 Catalogue, including container, axel bearings and truck cranes. Xugong's portfolio also covered them. However, construction machinery in general did not fall within the "prohibited" category of the 2002 Catalogue, nor had it been regarded as a sensitive sector in China (ibid; see also Zou & Simpson 2008: 494). During MOFCOM's review process, however, the machinery industry lobbied for and received specific protection that foreign investors in the equipment manufacturing industry must inform related national agencies and ask for their approvals when acquiring Chinese firms.[177] Many scholars have noted that the Xugong-Carlyle case was the most notable case in which national security review concerns were raised in foreign mergers and acquisitions (Mu & Xiao 2009: 59; Jensen 2010; Li X. 2016).

The national security problem of M&As was further realized when Chinese companies went overseas to conduct takeovers and found that many countries, both developed and developing ones, took measures to resist Chinese investments in their firms in the name of national security. By the early 2000s, many developed countries had adopted certain form of a national security review (NSR) process for foreign M&As. The U.S. further strengthened CFIUS's reviewing spectrum and investigation power after 9/11 (see Part IV, fourth section). While national security review had become an internationally accepted practice, China was locked into a liberalization path towards deregulations. Several publicized Chinese outbound investment projects around the mid-2000s were blocked by the NSR regimes in the U.S, Australia and UK (Li & Bian 2016: 154f; Bu 2012). The failure of Chinese oil giant China National Offshore Oil Corporation (CNOOC)'s bid to acquire the California-based oil company Unocal in 2005 triggered a wide discussion in China on the "unfair treatment" of Chinese companies in the U.S.

In 2006, the last year before full WTO compliance, MOFCOM delayed a number of pending transactions of M&As due to national security review, such as the Luxembourger company Arcelor Mittal's acquisition bid of Laiwu Steel (see Schneider 2007: 270f).[178]

[177] See State Council PRC. 2006. Several Opinions on Further Accelerating the Development of the Construction of Equipment Manufacturing, http://www.gov.cn/gongbao/content/2006/content_352166.htm
[178] Arcelor Mittal. 2007. Arcelor Mittal and Laiwu Steel Announce Termination of Share Purchase Contract, December 14, https://corporate.arcelormittal.com/news-and-media/press-

After one-and-half year's review, the deal did not receive approval. The French home appliance company SEB's acquisition of Zhejiang Supor Cookware's 61% share in August 2006 triggered another wave of public debate on selling state-owned assets to foreign entities at low price. Yet none of investment bid was in the "restricted or prohibited sectors". Song Heping, then Deputy Director of the Industrial Damage Investigation Department of MOFCOM, commented on this event that "foreign acquisitions of leading Chinese companies were a new problem China had to face, while advancing economic reform and opening-up." "The ministry is trying to balance protection of indigenous industries with the investment enthusiasm of foreign companies." [179] Previously in the year, during the "Two Conferences", China's Association of Industry and Commerce had handed in a proposal to the National People's Congress on regulating foreign M&A of SOEs. Under such political pressure, MOFCOM must be cautious in making approvals to sell Chinese SOEs (Xiao 2006). According to my interviewees, the concerns about foreign takeovers of Chinese national champions have also been shared at the local level. They gave me examples that foreign firms often took over competitive Chinese enterprises in their industry just to "lay them down." For instance, once after the Japanese Hitachi had paid an expensive deal and taken over a Chinese competitor, it stopped the local factory's operation without immediately firing the workers. "At the beginning, the local officials who approved the deal did not understand why. After the factory was abandoned two years, they realized that Hitachi only took over the factory to stop its production of competing products on the market." The case of Xugong-Carlyle signified that MOFCOM had to deal with the decentralized regulatory structure of foreign investment, in which local governments sometimes make local-oriented decisions that unintendedly run contrary to national interests.

A more delicate issue is that a deep entrenchment of foreign capital into almost every aspect of its economy gave rise to the criticism that excessive foreign capital had put

releases/archive/2007/dec/14-12-2007.

[179] Wu, Qi. 2006: China Regulates Foreign Mergers for More Investment, PRC Embassy in the U.S., http://www.china-embassy.org/eng/gyzg/.

China's national security in jeopardy and endangered its domestic enterprises (see Li X. 2016: 269; Schneider 2007: 272). Domestic enterprises in the Xugong-Carlyle case were demanding a balance between protection for their own business interests and incentives for introduction of more foreign capital. The alignment between foreign investors and SOEs since the late 1990s had squeezed out many domestic private firms. As mentioned above, policy treatment of foreign firms was substantially more favorable than that of domestic private firms in the 1990s. One hypothesis is that Chinese leadership might have viewed FDI as a substitute for the domestic private sector (Huang 2003; Haggard & Huang 2008: 368). In the 2000s, this role of foreign investment has continuously declined in a vibrant domestic economy. The private sector boomed with China's overall economic liberalization and its WTO accession. Moreover, China had accumulated $8189 billion foreign exchange reserves by 2005 with an annual growth rate of 30% on average since 2000.[180] Its thirst for foreign capital – an important drive behind its economic opening in the late 1970s – was gradually becoming an obsolete argument in favor of more foreign capital (Wang 2004). Instead, China began to show it capital strength in the world as its OFDI began to increase significantly from the mid-2000s.

4.4 Accelerated reforms 2006 - 2011

In August 2006, MOFCOM and five other ministerial-level authorities jointly promulgated the Provisions of the Takeover of Domestic Enterprises by Foreign Investors.[181] For the first time, Article 12 of the 2006 Provisions specifically stipulates that foreign investors are obliged to seek approval from MOFCOM if proposed takeovers may have an impact on "national economic security." The most relevant provision for NSR is Article 12, which requires the parties concerned to apply for approval from MOFCOM, when an acquisition of a domestic enterprise by a foreign investor results in actual control and involves key industries or transfer of domestic enterprises that hold

[180] SAFE, PRC. 2011. Annual Report of State Administration of Foreign Exchange, see http://www.safe.gov.cn/en/file/file/20170726/5a2810b9daf44219a791cfed50c19109.pdf?n=Annual%20Report%20of%20the%20State%20Administration%20of%20Foreign%20Exchange(2011), p.120

[181] The 2006 Provision was jointly promulgated by MOFCOM, SASAC, the State Administration for Industry and Commerce, the State Administration of Taxation, China Securities Regulatory Commission and the State Administration of Foreign Exchange.

famous trademarks, Chinese time-honored brands or any other important industries. Otherwise, MOFCOM and other relevant authorities would terminate the transaction or divest the relevant equity or assets (see also Brandt 2007: 3-5). However, article 12 does not provide procedural safeguards and define which transactions are subject to national security review (NSR). A foreign entity's "right to control" was not defined. Given the vast number of ways in which an investor can gain even some miniscule degree of control over business entities, the phrase "control" is extremely ambiguous (Huang 2009: 809f). The procedural vagueness gives wide discretion to officials charged with approving foreign acquisitions.

On November 10, 2006, the NDRC issued the 11th Five-Year Plan on Foreign Capital Utilization. This document prioritizes quality over quantity of foreign investment, emphasizing advanced technologies, management experience and high-quality talent,[182] which marks a significant reorientation of China's policy towards foreign investment: It began to differentiate between "foreign investment" and "good foreign investment". In August 2007, nearly 30 years after the economic reform, China adopted its first Anti-Monopoly Law. Article 31 of the AML provides that "where a foreign investor participates in the concentration of business operators by merging or acquiring a domestic enterprise or by any other means and national security is involved, besides the examination of the concentration of business operators, the examination of national security shall also be conducted according to relevant provisions." As law scholars point out, the provision may be "misplaced" in an AML, since the two reviews should carry different policy considerations (Li X. 2016: 264).[183] However, this article reaffirmed that NSR would become part of the approval process and for the first time in a national law promulgated by the National People's Congress, the highest legislative body in China (Li

[182] Public Information Service. 2006. The 11th Five-year Plan on Foreign Capital Utilization, http://www.fdi.gov.cn/1800000121_39_3819_0_7.html.

[183] Three government agencies were primarily responsible for implementing the Anti-Monopoly Law: the NDRC, the State Administration of Industry and Commerce, and MOFCOM. Specifically, MOFCOM was primarily responsible for merger control, a pre-emptive form of antitrust intervention, while the other two agencies were responsible for ex post antitrust enforcement. In the most recent administrative reform in March 2018, all the anti-monopoly duties merged into the State Administration for Market Regulation.

& Bian 2016: 158).

It should be noted that reviewing “state economic security” both in AML and the 2006 Provisions rather refers to “economic or industry security” than “defense security.” In 2009, MOFCOM revised the 2006 Provisions but retained the article that requires foreign investors to submit a petition of approval voluntarily to MOCFOM when national economic security is at stake. In the Revision, “state economic security” was not replaced with a broader wording of “national security”. Despite the grand declaration, no further details were crafted out for how to carry out such a review (Liu 2013: 62). As Wang Zhile, director of MOFCOM’s MNC Research Center, noted in a series of papers on FDI in 2006 and 2007, “the factor that decides whether a country’s economy is secure is its economic competitiveness” (Wang 2006a&b, 2007). Clearly, the conception of “state economic security” is less related to defense and physical security, but national competitiveness (see also Bath 2012: 22). Far away from a national security review regime, Article 31 of AML is merely a conceptualization, which leaves MOFCOM little regulatory capability in practice (Li & Bian 2016: 160). However, as time changed – free market entry by foreign investors had become the trend – Chinese policymakers seem to have an updated view toward national security review: it went beyond flat prohibitions in defense-related sector to a delicate balance between national interests and economic benefits from international cooperation.

In 2010, the establishment of a NSR regime was put onto the government’s agenda in State Council’s Several Opinions on Further Utilizing Foreign Capital.[184] On February 12, 2011, the General Office of the State Council promulgated the “Circular on the Establishment of National Security Review System Regarding Mergers and Acquisitions of Domestic Chinese Companies by Foreign Investors”, which established an interagency committee to conduct national security review on certain foreign investment.[185] On

[184] State Council. 2010. Several Opinions of the State council on Further Improving the Utilization of Foreign Investment (国务院关于进一步做好利用外资工作的若干意见), http://www.gov.cn/zwgk/2010-04/13/content_1579732.htm.
[185] General Office of the State Council. 2011. Circular of the General Office of the State Council on the

August 25, 2011, MOFCOM promulgated the "Provisions on the Implementation of National Security Review Regime Pertaining to the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" of 2011.[186] With these two announcements, China's NSR system was finally launched (ibid).

At the helm, NRDC and MOCFOM serve as the leadership for the review process. Article 1 of the Circular first defines the scope of security review as:

the M&A by foreign investors of domestic military-industrial and military related enterprises, neighboring enterprises of key and sensitive military facilities and other units concerning national security; and such domestic enterprises as major farm products, energy and resources, infrastructures, transportation services, key technologies and major equipment manufacturing involving in the national security and whose actual control right may be gained by foreign investors.

It includes both defense-related enterprises and strategic sectors for the national economy. Article 2 of the Circular further provides four criteria for evaluation during a national security review: 1) the effect of merger and acquisition on the national security, including the productive capacity of domestic products for the national defense, domestic service providing capacity and related equipment and facilities; 2) the effect of merger and acquisition on the national steady economic growth; 3) the effect of merger and acquisition on the basic social living order and 4) the effect of merger and acquisition on the R&D capacity of key technologies involving the national security. It should be noted that the defined sensible sectors for NSR are similar but not identical with the restricted sectors in the Catalogue (and the Negative List) which is amended every several years by NDRC.

Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprise by Foreign Investors, http://www.fdi.gov.cn/1800000121_39_57_0_7.html , Chinese Version: http://www.gov.cn/zwgk/2011-02/12/content_1802467.htm.

[186] MOFCOM. 2011. Announcement No.53 of 2011 of the Ministry of Commerce of the People's Republic of China Concerning the Provisions of the Ministry of Commerce for the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, http://english.mofcom.gov.cn/article/policyrelease/aaa/201112/20111207869355.shtml, Chinese version: http://www.mofcom.gov.cn/aarticle/b/c/201108/20110807713530.html.

While the regulatory authority of IFDI has been continuously decentralized, the central state has now found out a new reason – national security – to re-strengthen itself. Based on institutional mission of NDRC in the NSR regime, the security impact would not be judged separately without an industrial perspective. While the local administration, as well as the MOFCOM, have continuously evolved to a "public service agency" for foreign investors, the NDRC has become the policeman enforcing detailed market rules.

The WTO accession locked China into a path of further reform and global integration (Zweig 2002: 29). As Wade (2003) argues, the surge in international regulation – seen in the WTO in particular – has shrunk the "development space" within which states can operate and limited the policy autonomy of the state, especially in developing countries. However, the particularity in the case of China is that it had a huge domestic market which the state can use to coerce foreign actors to cooperate. The year-to-year policy change from 2006 to 2011 was a marked contrast to the deregulating process that foreign investors had enjoyed since China's WTO accession agreement. Accelerated policy changes and the establishment of a new NSR regime were obviously reactive changes caused by the globalization process and the "holes" in transforming the state and the economy. Seeing the continuous decentralization of IFDI regulation power, it would be tempting to lead to the conclusion that the remaining elements of planning and industrial policy are mere vestiges of the old way. In contrast, the state has found a new reason to maintain an important role for itself in parts of the economy: to enhance economic security (see also Pearson 2015). Moreover, the establishment of the super agencies such as SASAC in 2003, MIIT in 2008 and the rapid reregulation on foreign takeovers between 2006 and 2001, as well as the protests of domestic entrepreneurs against a long-preferential policy towards foreign investors all mirrored a coalitional change within the society and the Party since the mid-2000s. As Tang (2014: 53) notes, a "populist coalition" resonated with the so-called New Left critique of China's course of internationalization based on a belief that strengthening the state power can redress the injustices created by free markets, privatization and globalization." In Barry Naughton's account (2011), the supporting bases of a "performance coalition" that formed the backbone of the internationalist coalition has shrunk while the constituency for "a welfare coalition" has grown in convergence with those of the "control cartel." The political logic of globalization manifested in social protection demands enabled the state to set up new institutions to police globalization. Therefore, the main goal of China IFDI policy since the 2000s has been not only the one of promoting foreign investments, but also of reregulating it. This is only one aspect of the enabling effects which was driven by domestic demands. The other aspect driven by international competition, pressures for innovation and relative gains is even becoming more salient, as the mini-case in the telecom sector will show.

4.5 Building alliances with MNCs to set Chinese standards in the wireless sector

In the telecom sector, after the phase of government-led technology transfer in the 1980s, accelerated market liberalization in the 1990s, the state again developed its strategy, putting more efforts in standard setting after the WTO accession. In the administrative reforms of China in the 1990s and 2000s, while almost all old industrial ministries were abolished, the Ministry of Post and Telecommunications only reshuffled, merged with Ministry of Electronic Industry to form the Ministry of Information Industry in 1998 and then transformed into the Ministry of Industry and Information Technology in 2008. These transformations removed inter-ministry tensions in regulating the telecom sector and ensured the firm control of the state (see Pearson 2005; Yeo 2008).

The WTO agreements for China included a timeline for the further liberalization of China's telecom sector, including telecom services to foreign firms. Negotiation agreements with the U.S. specifically include agreements for the entry of American firms into the public switching equipment market and the use of U.S. mobile standards. All these international commitments enlarged the opportunity window for foreign MNCs to enter the large Chinese market. In 2002, the U.S. government granted the Permanent Normal Trade Relations (PNTR) status to China, which removed the threat of U.S. import tariff increases on Chinse goods before. By eliminating this political risk, PNTR generated greater incentives to U.S. producers to invest in Chinese suppliers and move production from the U.S. to China to increase corporate competitiveness (Pierce & Schott 2018). In late 2000, China surpassed Japan with more than 80 million subscribers as the second-largest mobile phone market in the world after the U.S. (Zheng 2004: 7). In July 2001, China replaced the U.S. and has been since then the largest mobile phone market. However, for a country with a more than 1,2 billion population, 80 million subscriber suggests a still very low penetration rate, which, in turn, means that the market potential at the time was enormous. China's great market size also gave its policy makers a leverage to use its market as a bargaining tool to establish the perceived lock-in effects associated with technological standards ownership and the long-term gains it confers. Since tariffs are hardly available tools after the WTO accession, the state was making use of its rapidly growing market and domestic regulatory regime to reduce its reliance on foreign technology and payments of license fees. It was within this period the indigenous technology standard was explored. The primary emphasis of this policy program was the creation and commercialization of proprietary ideas, standards and technologies created by Chinese companies.

Most of these large, complex network equipment did not emerge de novo, instead they are strongly path-dependent, built on the foundations of previous investments. Achieving "interoperability" and "interconnectivity" is not simply a technological issue. It rather involves the constitution of a diversity of existing and emerging systems, standards, and uses, with a multiplicity of social and political interests inscribed in them. Technologies are protected by IP rights, by which the owners of the technologies packaged in the standard are guaranteed to have monopoly in the market over other technologies. Standardization processes have always been a fierce battle between large multinational players and/or different business alliances. (see Krasner 1991). Especially in recent years, the emergence of competing regional consortia around incompatible standards leading to what some have described as "standards wars" (Mattli & Büthe 2003). Because of intensive competition in the telecommunications equipment (TE) sector, license and royalty fees eat substantially into the already thin profit margin of the producers. Once the relative gains from patent rights are guaranteed, dominant actors have a great incentive to design integration solutions that define and solidify trading relationships and reinforce their dominant role, which will then generate huge profitability. At the same time, the resulting fragmentation and duplication of development effort and inter-connection problems may motivate collaboration.

As a whole, building large infrastructural technology systems is a constant configuration process, in which previously discrete and separate technologies may become integrated. For example, the early fixed-line telecommunications networks have been integrated with other networks over time, e.g. mobile networks and internet services and further broadcasting services and e-services. In the industrialized countries, particularly North America and Europe, a major shift in the ownership of telecommunication infrastructure, from being mainly in the public sector 30 years ago, to today in private hands or a mixture of public and private players was driven by policy deregulations and other socio-economic factors. Their dominant position was compounded by the IP regimes. For latecomers, there are enormous barriers to enter the field. To adopt existing technology systems, nations which expect technology development to deliver an infrastructure for social development are likely to find themselves facing a wall of technological dependency with a substantial bill paying for components, as well as licensing and/or royalty fees. The key challenges are not only technical and but also (and perhaps primarily) social and institutional. Attempts to overcome these problems/barriers are not readily within the remedy of individual companies, however high their technological capabilities may be.

General wireless technology standards are set by the International Telecommunications Union (ITU) based in Geneva. The ITU organizes study groups to produce draft recommendations on international specifications for each generation of mobile wireless technology (from 1G to 4G) and these broad standards are then approved, modified or rejected by world telecommunications standardization conferences that include representatives from member states, industry associations and telecom firms. Since interoperability is needed to allow equipment such as mobile phone handsets and wireless infrastructure (tower, base stations and network switching equipment) to interact, the strongest players who possess a complete ecosystem of the wireless technology introduce their own solutions for specific interconnect standards and submit these to the ITU for approval. In each generation, the specific standards were first defined by the companies that have supplied effective technical solutions and incorporated their patent-protected technology in a specific standard. The patent owners have been a few established players primarily because of high capital investment, in particular in R&D which is critical for anticipating technology changes and maintaining its market position. Despite the shift of manufacturing to Asia, the TE market structure was still determined by the historically monopolistic network operators. The wireless communication technology standard Global Standard for Mobile (GSM) was developed by the European Telecommunications Standards Institute and its member companies, within a framework set by the European Community. Participant companies in this process – such as Alcatel, Ericsson, Nokia and Siemens – were able to develop the required technological capabilities before the standard was released and thereby had a huge first-mover advantage (Pawlicki 2017).

Entering the 2000s, wireless technology became the core subsector which developed rapidly in the TE industry. China's first large-scale deployment of mobile communications came in the 1990s in the 2G-era. The 2G network in China was preset by two standards – GSM deployed in the EU and CDMA in the US – and four foreign vendors (Motorola, Ericsson, Nokia and Siemens) controlled more than 90% of the market in the 1990s, of which 30% was sourced from joint ventures and 62% was imported from foreign firms (Thun & Sturgeon 2019). For all these technologies and standards which were developed by foreign companies, their applications in China involved license/royalty fees. Although China already became the largest mobile handset producer in the early 2000s, the more devices they have produced, the more license/royalty fees they have to pay to the technology owners (Shen & Naughton 2013: 203). If Chinese firms want to move upwards in the global value chain and yield higher profits in the marketplace, they have to let their technologies become international or at least national standards. Over the past twenty years, China earned its position in the global division of labor on the basis of cheap labor and specialized in low-end assembly operations in the consumer goods sectors. The highly competitive nature of the Chinese consumer market drove down the profit margin of technology products. Most Chinese enterprises found themselves in relentless price competition with little control of upper-stream technology. As mentioned above, Huawei's growth in the 1990s relied on its price advantages for the domestic rural market and other developing countries. While MNCs used China as their low-cost manufacturing base, they controlled the core technology and thus the pricing power of the more sophisticated upstream components. Both gave them a strong market advantage over Chinese enterprises. MNCs also became increasingly aggressive in cracking down on intellectual property right violations, by threatening lawsuits, and charging patent royalties after the industry had matured into mass production with slim profits. Speaking about the situation of Chinese firms, one of China's prominent economists, Zhang Weiying, suggested an analogy that "it is as if Chinese business people were walking naked in the dark, and all of the sudden, someone flips on the light." The light came from globalization, especially the aggressive marketing and intellectual rights strategies of MNCs. Suddenly exposed, the primitive nature of the operations of Chinese firms became painfully obvious and difficult to sustain (Zhang 2004; see also Zhou 2006: 55).

National security was a major explanation for the government' strategies on setting China's own 3G and 4G standards and develop indigenous technologies. The government had long been worried about the dependence on foreign technology, especially from the U.S. After many years' dominance of MNCs as technology providers and market leaders in the Chinese telecom sector, telecom service providers had been using the European standard (GSM) and the American Standard (CDMA) for their 2G networks. It is then a natural consequence that they would adopt next generation of wireless technology based on these standards and equipment. However, in the late 1990s, the government supported the SOE Datang Telecom Technology and Industry Group to develop China's own 3G standard called the TD-SCDMA. Since the recognition of its national technology as a global standard needs strong support from the incumbent service operators and relevant equipment manufacturers, foreign participation in the domestic telecom market is necessary. In traditional sectoral systems a basic principle with patents is that when one company can obtain a monopoly – it can stop others from using its patented solution. However, in the wireless technology sector the need for convergence and interoperability in standardization has resulted in the development of a system whereby the partnering companies must sign a waiver from the beginning, by which they waive their rights to a monopoly and promise to license all of the involved patents on Fair and Reasonable Terms.

In setting China's own standards, the government actively endorsed technical assistance from global, publicly listed companies to build joint ventures and alliances with local Chinese partners. China's home-grown 3G standard TD-SCDMA is made by Datang Mobile in conjunction with the Chinese Academy of Telecommunications Technology under the MPT. They established a collaboration with Siemens who possessed world-leading switching technology. The R&D fund came from MPT (which became the Ministry of Information Industry in 1998) and from the State Science and Technology Commission (which later became the Ministry of Science and Technology, MOST). In June 1999, Datang Group summitted its TD-SCDMA mobile system for approval by the ITU. In May 2000, ITU approved the Chinese standard as one of the three global 3G standards besides the US-centered CDMA-2000 and the WCDMA standard deployed in Europe. As analysts commented, technically, the Chinese 3G was far from being an entirely "indigenous" Chinese technology. Only a minor part of the technology were Chinese patents. TD-SCDMA includes historical CDMA patents, which are owned by Qualcomm and Ericsson (see Shen & Naughton 2013: 205f). However, the development of this standard is an "entry point for gaining a membership in this prestigious club of global mobile innovators" (cf. ibid: 204). To confront other well-established competing standards, the government invited foreign MNCs to join the development process. After issuing the 3G-licenses in 2009,[187] a series of public tenders were organized for the

[187] When ITU approved the Chinese 3G-standard, it was still an immature technology, a newcomer which needed to make its way to the market in competition with American and European standards. The latter

supply of integrated equipment such as network equipment, terminals, mobile systems, which attracted major domestic players and foreign companies and joint ventures such as Alcatel-Shanghai Bell, Ericsson, Nokia, Siemens.

The strategy of alliance building was reemployed in the development of China's 4G standard. In 2007, the State Council announced a large-scale research plan for a 4G standard with a time frame of approximately 15 years. An initial investment of $70 billion yuan in R&D was given by the Ministry of Finance for basic research. As reported, "the central financial administration will mainly invest in the early stages of basic research, while product development and industrialization will mostly come from the market" (Wang 2008). As of September 2011, 24 international carriers – double than domestic ones – joining the state's Chinese 4G (TD-LTE) initiative, which facilitated the coordination between firms and mutual knowledge transfer (see table 12). In January 2012, the Chinese standard was officially approved by the ITU as one of the two 4G global standards.

Table 12. List of key participants in 4G alliances in China

Operators	Group	Alliance members	Total number
China Mobile (TD-LTE)	Chinese firms	Agilent Technologies, Datang, Datang Microelectronics Technology, HiSilicon Technologies, Huawei, Innofidei, Leadcore Technology, Potevio, ZTE	9
	Foreign firm	Alcatel-Lucent, Apple, Asus, Ericsson, Google, HTC, Motorola, NSN, Samsung, Sony Ericsson, Spreadcom, St-Ericsson	12
China Unicom (FDD LTE)	Chinese firms	Huawei, ZTE	2
	Foreign Firms	Ericsson, HP, HTC, LG, Motorola, Samsung, Sony	7

were both mature products already operating in their respective markets, building upon an installed base of 1-2G systems. China's 1-2G mobile system was based upon the European standard. In the absence of a domestic 3G mobile infrastructure at home, many Chinese firms were producing products used for CDMA (US standard) and WCDMA (European standard) ranging from handsets to large network equipment for the global market. All these factors meant that no firm would commit significant investments in the Chinese prototype (Shen 2018: 7). Therefore, although the ITU approved the Chinese 3G standard in 2000, it was not until 2009 – after years of governmental and enterprise efforts to adjust the integrated technologies and services – that the Chinese 3G was introduced into the domestic market. For more on this, see Shen & Naughton 2013.

		Ericsson	
China Telecom (FDD LTE)	Chinese firms	None	0
	Foreign firms	Apple, HTC, LG, Motorola, Samsung	5

Source: cf. Kwak et al. 2012: 971.

The mini-case study of China's 3G and 4G standardization shows that the government has shifted form the techno-nationalism approach to what some scholars have termed as "techno-globalism" (see Suttmeier 2005). While the former (as in the Mao-era) stresses technology autonomy, the latter "expanded state commitment to technological development and at the same time active public-private partnership." As Suttmeier & Yao observed, after China's WTO accession, "a more welcoming openness towards foreigners in national technology programs, and greater commitment to international rule-making and policy coordination" are sought (2004: 17). Although national security is certainly on the mind of Chinese leaders, policymakers did not appear to be paranoid about importing western technology. The link between who controls the technology and national security seems to be "malleable", subject to negotiation and bargaining (Zhou 2006: 53). The effort of setting the national standards is rather a part and parcel of China's effort to master the essentials of core technology in its industrialization process. The motivation has much less to do with nationalist security than searching for alternatives to the monopoly of western corporations. The importance placed on foreign investment signals that Chinese forays into the field of high-technology policy should not be seen as simple techno-nationalism (Bach et al. 2007:501). "The goals could be much greater and more ambitious than autonomy. Rather, armed with new regulatory capabilities, China is developing a sophisticated strategy to manage the rules of global market to its advantage, a strategy that takes full advantage of both the opportunities afforded by globalization and the potential power China gains from its huge domestic market" (ibid). The dominance of European and North American equipment suppliers was successfully broken by Huawei and ZTE in the 2000s, who came to take the leading or at least one of the top-five positions in various products for wireless and wireline technologies in this period. By 2013, Huawei already took up 39% of the worldwide LTE contracts. Leading European TE companies together finalized 57% of LTE contracts, and the rest belonged to Samsung (2%) and ZTE (2%) (cf. Pawlicki 2017: 24).

In understanding China's industrial policy in the telecom industry, it is insufficient to only focus on its IFDI policy. As many other countries also do, the state has employed a range of policies such as governmental subsidies, reorganization of SOEs, as well as domestic procurement policies to promote the development of the industry. For instance, a "buy-local policy" was promoted in the wireless sector. In 2006, China Mobile and China Unicom, the biggest domestic network operators and both SOEs, unified their purchasing policies with regards to GSM equipment. While provincial operators were still able to choose their supplier independently, they had to follow central set prices, which openly favored domestic suppliers (Hong et al. 2012: 919). In 2007, Huawei and ZTE had a 13% share in the Chinese GSM market, while Ericson had 42%. In 2008, the two Chinese companies were able to take 37% of the Chinese GSM market (ibid). Under the "buy-local policy" foreign firms that wanted to sustain their market in public procurement had to transfer its R&D platforms via co–development and joint patent registration with Chinese firms.

4.6 The new foreign investment law and the unsuccessful birth of a statutory NSR regime

With the rise of the private sector, the state has shifted its focus from a FDI-centered development approach to the competitiveness of indigenous firms. FIEs now comprise less than 3% of China's total number of firms in 2017 (Xinhua Net 2018a). Between 2011 and 2015, the annual growth rate of IFDI dipped to 3% from 13.3% over the previous five-year period (MOFCOM 2019). In 2016, when China's OFDI exceeded IFDI for the first time, the latter's growth faltered further, dropping from 5,5% in the previous year to -0.2%. FIEs' contributions to China's tax revenues and industrial output has steadily declined since 2012. On the ground, foreign investors were pulling out of the Chinese market. Especially since 2015, a number of large MNCs such as Microsoft, Panasonic, Philips, Sony, Oracle, Best Buy and L'Oreal have either downsized their operations or shuttered them in China (Li 2019: 206). According to the 2017 annual Chinese Business Climate Survey Report issued by American Chamber of Commerce in China, nearly a quarter of respondents expressed the view that they had recently moved or plan to move operations out of China. Nearly half of the surveyed firms feel they are not treated fairly when operating in China, with the highest level of concern (59%) in R&D intensive industries (Areddy 2018). In the face of a strong state-economy, vibrant domestic private-own business and most importantly, the rising labor costs in China, many MNCs are actively divesting underperforming assets or exiting China entirely. The labor-intensive manufacturing works have been increasingly transferred to other developing countries such as India, Vietnam and Bangladesh.

Besides the assertiveness of deepening economic system reform, the continuing rise of the private sector also helped set the stage for a conservative reaction in the form of increasing support for SOEs and revitalized statism in the Xi Jinping and Li Keqiang administration. The SOEs have been given a central role in a raft of ambitious new industrial policies that aim to build world leading national champions in key sectors. This is particularly evident in policies such as Made in China 2025 – a ten-year industrial development plan for new and high-tech manufacturing issued in 2015 (as mentioned in Part IV). As Lardy (2019:20) notes, "in a stark reversal of the earlier trend, beginning in 2012, banks direct a larger share of credit to state firms, essentially crowding out the private sector". In 2011, 54% of all new corporate loans within the formal credit system went to private enterprises compared with 28% to the SOEs. In 2016, the trend largely reversed that SOEs took over 83% of new credit compared with just 11% going to the private sector (ibid: 105). The SOEs have also been given a central role in a raft of ambitious new industrial policies that aim to try and turn many SOEs into world leading national champions in key sectors. This is particularly so in policies such as Made in China 2025, as mentioned above in Part IV.

In the Xi-Li-administration, while there has been renewed support for the SOEs and the state sector, the central government has also rolled out a series of regulatory changes aimed at simplifying the administrative procedures and improving business environment for foreign investors. When comparing the 2011 Catalogue with the 2015 version, the number of restricted industries reduced from 79 items to 38 items. Major revisions to the regulations were implemented in September 2016, including the NPC's revision of the three foreign investment-related laws promulgated in the late 1970s and 1980s, as well as the establishment of the long-anticipated Negative List for Foreign Investment. The Negative List replaced the Catalogue and only set "restricted" and "prohibited sectors." Theoretically, for sectors not on the list, foreign investors shall be treated equally to their domestic counterparts. The number of restricted items and sectors on the Negative List have been continuously reduced since 2016. At the same, NDRC also promulgated a Catalogue of Industries for Encouraged Investment" which specifies "encouraged" sectors for the central and western provinces of China. Preferential policies such as customs duty exemption on the imported equipment and lower price of land renting are given for investments in these sectors. In July 2017, Premier Li Keqiang hosted a State Council Executive Meeting, which led to the "Notice on Several Measures of Promoting Foreign Investment Growth".[188] The Notice urged the government to build a legal, international, and convenient environment for foreign businesses by introducing new measures to enhance market access for FIEs in the services, manufacturing, mining, and infrastructure sectors. During the Boao Forum for Asia on April 11, 2018, less than a month after the constitutional amendment that removed the presidential term limit, President Xi Jinping announced that China's doors would only open "wider and wider" to foreign investment, promising to remove foreign equity stake caps for banks, securities firms, and insurance by the end of 2018. Xi further assured foreign investors that China would prioritize protecting intellectual property rights and tweak its domestic regulations to comply with international economic and trade rules (Xinhua Net 2018b). All the efforts suggest that China has continued needs of foreign investment.

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[188] State Council. 2017. Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment (国务院关于促进外资增长若干措施的通知), http://www.lawinfochina.com/display.aspx?id=1113aba1f2edb7efbdfb&lib=law.

In early 2015, MOFCOM released a draft of a new Foreign Investment Law (the 2015 Draft) for public comments. Over the next month, a total of 62 comments were submitted to the online portal hosted at MOFCOM. This number appears small, yet understandable considering that an investment law is very technical and ordinary citizens do not have either the expertise or the stakes to offer feedback on the draft. As analysts noticed, the comments came from a wide range of government and social groups. The largest number of comments (29%) were coming from various government bureaucracies at the local level, including provincial government, provincial and city bureaus of commerce, finance, foreign trade and economic cooperation, industry, and taxation. The second largest group of comments were from firms (24%), including state owned enterprises, domestic private firms and FIEs. The rest commentators included law firms (9%), industrial and trade associations (8%), followed by equal shares (4%) of accounting firms, tax firms, and university scholars. More than half (56%) of the online comments involved very detailed suggestions on how to revise various articles in the draft law. The MOFCOM also encouraged comments through email, phone, and letter (Li 2020). Foreign businesses, for example, have been found to use their connection to lobby and pressure the national and local governments to advance their own interests through in the promulgated regulations (Hui & Chan 2016). The US-China Business Council, for example, posted its comments on the draft FIL and presumably also relayed the same document to the MOFCOM through its own channel. According to Li Fei, Deputy Secretary of the NPC Standing Committee, the FIL went through a long legislation process. “There have been continuous preparations since the 15th National Congress of the CPC (in 1997) for a unified national foreign investment law and the law was repetitively brought up on the legislation agenda.” After the law draft was submitted to the 2nd Session of the 13th NPC in March 2019, the NPC has gathered 2232 revision suggestions from 1152 representatives, of which over 30 revisions have been made (Zhu 2019).

One of the major goals of the proposed new FIL is to simplify and streamline the process for foreign investors through the “limited licensing plus comprehensive reporting system”.

The adoption of such as a system would effectively remove the pre-approval requirements via licenses from a wide range of governmental authorities (Li 2020:10). Foreign investors outside the Negative List would enjoy national treatment principle and will no longer be subject to a different regulatory regime than for domestic Chinese investors.[189] Similar to FINSA's effect on CFIUS, the new national security review legislation would also ground the Chinese NSR regime with a statutory authority. On September 7, 2018, the NPC released the FIL for a second round of public comments. The Law was adopted by the National People's Congress on March 15, 2019.

However, despite the 2015 and 2018 grand declaration of establishing a NSR regime and the high publicity of the new FIL, there is only a two-sentence article in the new FIL stating that "the state establishes a security review system for foreign investment and conducts security review of foreign investment that affects or may affect national security. Security review decisions made in accordance with law are final decisions." The law did not codify a NSR, nor any details of conducting national security reviews on foreign investments. Experts explained in my interview that the failure to codify it was due to "the remaining controversies in details." "In order to get the law passed, legislators had to skip over these controversies."[190] The new FIL of 2019 was considered by many to be more "about slogans" than substance (Birminghan et al. 2019). Compared to the 2015 Draft, the new version is substantially watered down with only six chapters and 42 articles, a third of which contain only one sentence. Not only the chapters on national security review, but also on information reporting, coordination and complaint handling, and supervision and inspection in the 2015 draft were dropped in the final version. It does appear that the removal of these hotly debated issues have it possible for the legislators to quickly pass the law. In the face of the declining inflows of IFDI affected by the Sino-U.S. trade war and other economic and political factors, it would be an counter-effort to

[189] The "Negative List" only lists two categories of industrial sectors – "prohibited" and "restricted" – that fall under restrictive review process. See MOFCOM. 2015. Annual Year Review of 2015: Accelerating the Construction of New Institutions for an Open Economy, http://www.mofcom.gov.cn/article/ae/ai/201512/20151201220159.shtml.
[190] Telephone interview with Prof. Dr. Li Xingxing, University of Jinan, December 12, 2019, Beijing.

add barriers to foreign investment. Yet the new law responded to some of the key concerns raised by the U.S. such as market entry, forced technology transfer and intellectual property protection (see also Li 2020). As Bell & Feng (2007) observed elsewhere, international pressures propelled top party elites into the arena to exercise "management by exception". Over the last decades, foreign investment, technology inflows and the growing export markets (especially the U.S. market), as well as increased engagement with international regimes has radically altered China's structural location within the world economy and increased its dependence on foreign investment. "Foreign business have generated direct industrial pressure and lobbied their governments for diplomatic pressure on Beijing's policymaking" (ibid). External pressure is even more potent in relation to the party leaders after Mao and Deng, who lack the legitimacy of revolutionary experience enjoyed by the elder generation party leaders. Therefore the handling of diplomatic affairs provides an important source of domestic credibility, power and clout.

5. Analysis

Given the historical legacies of a strong state prior to the economic opening, and of an informal institution of economic nationalism and even anti-foreignism in its extreme form, a viable catch-up strategy had to scrap these renascent old institutions at first. China's economic opening in 1978 was based on a reconciliation between the reformist and conservative line. Departing from this initial compromise, the path has been featured with market liberalization and regulatory decentralization, but also repetitive political struggles at critical junctures and parallel efforts of state-making. China's integration to the world capital market has not created a single Chinese economy that is open to all foreign investors and that can be analyzed as a monolithic whole (Pearson 2015: 32). In the policy area of IFDI, a bifurcated system of state regulation *and* market mechanisms laid down the institutional groundwork in the late 1970s, showing path dependency.

Many of the five aspects to assess state capacity in this study have changed since 1978. Due to the decentralization of the regulatory regime, the monitoring capacity of the central state and the coherence between the central and local state has been weakened. The SPC and later the NDRC worked as the lead strategic agency in the regulatory regime. At the micro-level, the superagencies may manage to balance the “normal” regulatory agencies such as MOFCOM. But it is more difficult to overcome the centrifugal forces of local governments (provincial and below). Local governments generally gained more freedom and become more adaptive to local conditions. As the Xugong-Carlyle case shows, local decisions may be (unintendedly) conflictive with national interests. Considering the institutional linkage with domestic non-SOEs, there are many formal and informal channels for domestic firms to articulate their interests, as shown in the legislative process of the FIL. Besides these aspects in which the state’s regulatory capacity was weakened to some extent, the aspect of the operation range and procedure presents a distinctive effort to remake the state in the decentralization process. The Catalogue system divided strategic and nonstrategic sectors, encouraged and restricted sectors, and made differentiated regulations. Through the Catalogue system and the approval authority of the national agencies for large-scale investment projects, the central government still enjoys “a priority enforcement capacity” (see also Zhu 2017).

Globalization has not only showed its constraining effects on the reform process of China’s IFDI regulatory regime, but also its enabling effect on the state. On the one side, foreign MNCs enjoyed preferential tax policies, managerial autonomies, loose trade restrictions in the 1980s and 1990s in comparison to domestic private firms. Three investment-related laws are created in the 1980s to accommodate MNCs. On the other, while reorganizing the SOEs, the central state was also reorganizing the government apparatus. The establishment of SASAC re-strengthened the regulatory regime by reinforcing the state control of SOEs. Besides the path dependency in formal institutions, the informal institution of “economic nationalism” also appears stable. “Economic security”– is increasingly invoked as a rationale for public ownership and governmental control, especially in strategic sectors (see Hseuh 2011; Suttmeier et al. 2004, 2006). State firms can also draw on some reservoir of good will among the Chinese population because of a tendency to see them as part of a national response to crisis over the past century.

"Unlike in the United States, where there is an instinctive antipathy to government firms, SOEs in China are widely seen as having a legitimate place in the Chinese economy" (cf. Tsai & Naughton 2015: 10).

The mini-case study of the IFDI policy in the telecom sector shows that the government sought to increase relative gains from the international market through interventions in technology transfer in the 1980s, deregulations in the 1990s and support of research and capital alliances between domestic and foreign firms in the 2000s. "Although benefiting in absolute terms from participation in international production networks, Chinese firms often feel that they are not getting a fair return because of excessive royalties on licensed technologies" (cf. Suttmeier et al. 2006: 60). Because the intellectual property that is incorporated into technical standards lies in the hand of foreign companies, license fees are thought to cut into the profits of Chinese firms. Hence the strong emphasis was placed upon developing products with Chinese intellectual property and Chinese standards. The domestic telecom market started with reliance on direct import in the early 1980s. Enhanced liberalization towards IFDI in the 1980s and 1990s led to the emergence and dominance of JVs in China. Built on the diffusion of technology know-how through FDIs, local R&D efforts, and supportive government policy, domestic manufacturers began to rise in the Chinese market in the late 1990s. Meanwhile, they also got integrated into the global market by exporting their products to developing countries and seeking R&D resources in developed markets. The advocation of joint cooperation between domestic and foreign firms in the standard setting process since the 2000s is similar to the policy of "trading market access for technology" in the 1980s and 1990s. It should be noted that the question of whether there have been significant high-technology transfer by foreign firms and what contributions they have made to China's industrial transformation is still controversial in academic researches. Some analysts rather assessed China's "trading market for technology" policy as failed (see Sun & Grimes 2017: 75-80). For instance, Moran (2011: 3) suggests that in the case of exports, the production of increasingly sophisticated goods destined for international markets from China has been remarkably well constrained and contained within the plants owned and controlled by foreign MNCs.

Domestic firms have remained a low value-added assembler of more sophisticated inputs imported from abroad – a “workbench” economy largely bereft of the magnified benefits and externalities from FDI (ibid). In the case of the TE sector, Huawei and ZTE did not form joint ventures with MNCs in their early development stages. They rather grew from the side-effects of China’s IFDI policy in the 1990s and expanded themselves not only through government support but also their own clever corporate strategies. The case study of the telecom sector also indicates that “national security” is “malleable”. If foreign technology and international support is needed, the emphasis on “national security” attenuates. The strategic IFDI policy to enhance domestic telecoms innovation and modernize infrastructure is unfolding right now with the development of 5G networks. Thus, the attempts to set national standard do not represent a turning-back from globalization, but rather an effort to have China’s voice heard in influencing the terms of globalization. Again, the informal institution of self-strengthening (or economic nationalism) and the faith of building “national industry” underline the catch-up strategy.

VI. Conclusion

This dissertation posed two research questions. First, how have the American and Chinese states dealt with the security implications of economic globalization and how has the nexus influenced and altered the state in turn? To answer this question, I studied the state and its institutional change in the U.S. and China in the policy area of regulating IFDI. They offered two examples of how the states from two poles of the spectrum of political systems have struggled for regulation and deregulation in an evolving international market. The second research question was about an empirical puzzle in recent foreign economic policies of the U.S. and China: Is there a policy reversal between the U.S. and China that the former is shifting to a protectionist stance, while the latter is becoming the defender of a neoliberal economic order? If true, what are the underlying reasons? In this concluding chapter, I revisit these questions in light of this dissertation's findings, discuss the theoretical contribution of HI to the scholarship of IR, and identify promising avenues for further research. I have summarized many of the specific findings in the last sections of Part IV and V. Here, I focus on the broader conclusions and comparisons.

Globalization and the changing state in comparison

As discussed in the theoretical part, globalization has both constraining and enabling effects. "Tightly constrained by exposure to global capital markets, the exit power of multinationals, participation in the multilateral trade regime, the transformed state appears to be 'straitjacketed'" (Weiss 2005: 345). However, "using two eyes rather than one", some constraints "become less important when set against the existence of ample room for action in key policy areas" (ibid). The pursuit of relative gains driven by the political logic – the insecurity and competition problem – of globalization also enables the state to transform domestic institutions and seek new policy instruments. I argued in the theoretical part that multilateral or bilateral interstate negotiation and ratification only stand for the content and possibility of an economic cooperation agreement, it is the step of implementation by social economic actors that effectively touches the reality of cooperation and its inherent distributional problem. The theoretical discussion about relative gains in IR in the 1980s and early 1990s only concentrated on the negotiation phase of cooperation, but neglected the more efficient way of pursuing relative gains – by regulating multinational corporations and changing domestic regulatory institutions.

In the policy field of regulating IFDI, there was ample room for policy actions in both countries in the 1970s. The necessities of institution building in the U.S. were triggered by contingent external factors – a surge of IFDI after consecutive dollar devaluations and the Oil Crisis in the early 1970s, while in China it was generated by the elite-led economic reform. I found in both cases that globalization and the security concerns embodied in IFDI generated significant impacts on the preferred rules, practices and institutional arrangements. In the U.S., security concerns were more about the access of foreign firms to cutting-edge and dual-use technologies. The state's main goal was to police IFDI and the trend has been increased state capacity to regulate foreign investors. In China, security concerns included a historically constituted sovereignty threat, dependence on foreign capital, and sustainable economic development that serves the basis of military capabilities. Institutional change is featured with a liberalization and decentralization process, which, however, happened parallel to a state-building process in the broader domestic economy. The political logic of globalization – insecurity and competition – enabled both states to rebuild themselves in balancing the security implications and economic benefits of IFDI.

Institutional changes in both cases are characterized with an incremental process, while the Chinese case also showed periods of "compressed" or accelerated changes. Since its establishment in 1975, CFIUS has had its powers elevated and procedures reformed through legislations passed in 1988, 1992, and 2007 and 2018. At the micro-level, the role of the Treasury has changed from the decisive agency in the U.S.'s IFDI policy and the CFIUS process to only one of the decision-making members. At the meso-level, Congress has largely extended its role in this policy area. My historical institutionalist approach first put the analysis in the broader historical context. Due to the historically institutionalized dominant role of the Treasury in managing foreign assets, the Executive first shielded the IFDI policy from politicized sites in Congress. CFIUS was originally designed as a weak organization to gather information on foreign investments. Despite a second round of structural change, congressional oppositions, interagency conflicts as well as the demands of domestic protectionist business groups in the 1980s, the Treasury managed to tailor CFIUS' practice with the neoliberal approach of the U.S. foreign economic policy at the international level. Yet the Exon-Florio Amendment set the stage for the Treasury's more hawkish partners such as the DoD to align with members in the Congress to add on new rules. Contingent historical events in the 2000s, such as the terrorist attack on September 11, and the support offered by a security network led by the DoD led to a major reform breakthrough in 2007 that vastly increased CFIUS's powers and responsibilities. Today's policy instruments are outcomes of long-term exposure to the changing international markets. The U.S. had encountered three "rivals" – Germany, OPEC, Japan – that had "helped" to build up the regulatory regime for IFDI before it encountered China. Important political developments in the policy filed of regulating foreign capital only happened gradually over the 1970s and 1980s, yet they were profoundly important for shaping and reshaping the terrain on which immediate shifts occur, after Chinese investors hustled into the American market. The President has now a range of policy tools to prevent Chinese firms from gaining relatively in the global market by taking over or learning from advanced technologies in the U.S. Since the First World War, history has evolved into a heavy hand on the Trump administration. The war-time law – the Trading with the Enemy Act of 1917 – just celebrated its 100th anniversary in 2017. An information-gathering agency established in 1975 has fledged into an efficient regulatory agency. As mentioned at the beginning, experts estimated that unresolved national security concerns of CFIUS led Chinese investors abandon deals worth more than $2.5 billion in the U.S. in 2018 (Rhodium Group 2019). This figure equals more than the half of China's total IFDI ($4.8 billion) in the U.S. in the same year and there were probably much more Chinese investment deals deterred by CFIUS.

In China, a bifurcated structure of the regulatory regime on IFDI has remained stable since 1978, despite constant micro-level policy adjustments. After the country was forced to integrate into the European international system in the mid-19th century, the motive of survival dominated the political practices of Chinese elites and this is especially the case after 1949 when an autonomous state was finally created. The Cold War structure and conditions of late development stimulated the Chinese state to centralize its power and engage in industrialization through a central planning system. This system, in turn, created an unique form of government-business relations. When China reopened its door to the international market in 1978, the party-state had been well consolidated with a set of plan agencies, industrial ministries, state-owned enterprises and a strong socialist ideology that suppressed the development of market economy. These historical and structural features allowed the state to start to absorb investment from a highly controlled position in which it could choose, at least initially, the precise areas for the liberalization of control and the pace of such liberalization. However, in 1978, an international economic order was well embedded in numerous international institutions and rules led by the GATT, IMF and World Bank. MNCs had much more experience in bargaining with host governments than China had with them in the late 1970s. Latecomers that want to join the international market have to first adopt pre-existing standards and rules of the current international market. Therefore, in the Chinese case, a bifurcated system was formed in the early reform era. On the one hand, there were many preferential policies for foreign investors in comparison to the restrictive environment for the domestic private sector. By gradually but continuously loosening the restrictions, by targeting reform areas individually, and by benefiting local communities with decentralization experiments, the power balance between the reformists and conservative coalitions was gradually modified. The reform coalition was established and became stronger in the 1980s. Together with the constraints of international rules, this change locked the Chinese IFDI policy onto a liberalization process; However, on the other hand, the central state has also found prioritized areas for interventions. It regulated strategic sectors, larger investment projects and added superagencies into the regulatory regime that have strategic goals rather than the "normal" regulatory agencies such as MOFCOM. After China's WTO accession, the state encountered similar problems as in the U.S. – IFDI did not only bring in economic benefits but also endangered the domestic economy by taking over leading domestic firms in their industries. The central government made accelerated reforms from 2006 to 2011 to combat the threat from foreign takeovers to national economic security. Yet the institution-building process was constrained by external events. After years of discussions and legislative efforts, the National Security Review regime eventually had its unsuccessful birth in 2019. It has not been codified in the new Foreign Investment Law amid the trade war. When efforts at the elite level were directed at pacifying conflicts with its largest trade and investment partner – the U.S. – China could not add another barrier at this time to foreign investors. If foreign investments continue to decrease in the aftermath of the corona crisis, the state would continue to hold a NSR regime at bay.

I also argue in this conclusion part that using the general label like "weak" to describe the U.S. state and "strong" to describe the Chinese state is rather misleading. As Part IV and Part V showed, the state power and capacity vis-à-vis the society were constantly changing, so were the relationships between the state agencies at the micro- and meso-level. Throughout the history, there were gaps between the social coalitions and institutional arrangements in both countries. In the U.S., even though capital transfer had hit its domestic production capabilities and U.S. companies' economic positions in strategic sectors in the 1970s and 1980s, the Treasury Department steered the institutional change of CFIUS and shielded it from the more politicized – yet also more democratic – site of decision-making in Congress. In China, institutional change and policy liberalization have also been mainly characterized with an elite-led process, which countered the demand of the greater conservative social coalition in the 1980s and impeded the legalization of a NSR for IFDIs amid the trade war.

In the U.S. case, CFIUS now does possess real power over markets whereby the actual or perceived threat of state intervention can determine the course of investments and ownership (Baltz 2017a: 107). CFIUS' power to overturn its approval at any time if a company "materially fails to comply with the terms" seems like a performance requirement employed in the Chinese IFDI policy. The decentralization process in China and the case study of the Xugong-Carlyle bid indicate that the central government is losing its regulatory power to some extent. In general, a comparison of the two cases shows that the state capacity to regulate IFDI for strategic goals was increased in the U.S., while decreased somewhat in China. Consequently, it would be tempting to give a conclusion that the two states are becoming more similar to each other, or approaching each other from two poles of the spectrum of political systems in the policy area of IFDI. However, the more accurate way to describe and compare the power of the Chinese and U.S. state in the policy issue of IFDI is to refer to Michael Mann's famous distinction between "despotic" and "infrastructural power" (1984: 115). "Despotic power" refers to the ability to enforce policy priorities, while "infrastructural power" means the ability to control market and civil society. CFIUS' power is essentially "despotic" in the sense that it exercises real power *over* markets when national security is at stake (see also Baltz 2017a: 107). It does not (yet) possess the ability to exercise power *through* markets and to coordinate foreign investment into certain sectors in the interests of achieving strategic industrial goals such as in the case of China. However, with undefined "national security", expanding operation areas, increased bureaucratic coherence against Chinese investments, CFIUS reform is showing an increase in its infrastructural power. In comparison, the power of the Chinese state is undoubtedly much more stronger than the American state. Institutions such as a NSR regime that took decades to build in the U.S. were done in China within a few years. However, the joint force of globalization, the international institutions and current reform process is weakening its infrastructural power. The Chinese state is rather showing a strong despotic power to enforce policy priorities and deal with emerging problems in the policy field of IFDI regulation.

IFDI policy of the U.S. and China

In the introduction part, I observed an empirical puzzle that there were not only rhetorical differences between the two countries' leaders but also signs of a policy reversal. While the U.S. seemed to have shifted away from a neoliberal foreign economic policy to a protectionist one, China appeared to be more committed to globalization. This is true to some extent. In the policy issue of foreign investment, the U.S. policy change has largely to do with the increased role of Congress in the policy-making process. The policy-making authority has not only shifted away from the policy-center monopolized by state organizations (especially the President and the Treasury) to the more politicalized site of decision-making – the Congress, but also to the more security-oriented agencies such as the DoD. Therefore, conventional analyses of the current protectionist policy in the Trump administration that concentrate on the preference of the President put the cart before the horse. Protectionism is not the cause of the politicized enforcement but rather its outcome. The protectionist IFDI policy in the U.S. is the result of a protracted process with intense congressional involvement and different security agencies. In China, the entry barriers to foreign firms have been reduced. However, its shift to a more liberal policy is not only driven by continuous needs of foreign investments, but also based on a strong state sector that dominates the critical sectors and backed by emerging national champions that are capable to compete with foreign MNCs domestically and internationally. The door can be continuously opened to foreign investors, as along as important industries remain firmly in the grasp of an elite empire of SOEs.

As documented in extant research (e.g. Krugman & Obstfeld 1994; Chang 2003; Peng et al. 2017), the U.S., many EU-member states, as well as Japan, have a long history of interventionist policies supporting the activities of their MNCs and infant (strategic) industries through preferential access to markets, tariffs, and the cross-subsidization of R&D activities, thereby distorting the competitive landscape in favor of their own domestic "champions". As some scholars suggested, developed countries are now "kicking away the ladder" that they themselves used in order to climb up to their current status and are only now exhibiting preferences for less intervention (Chang 2003). As intellectual property rights are gaining currency in China and its national champions are vibrantly moving upwards in global value chains, the ladder can also be replaced with a fine-looking liberal façade.

IFDI policy was used by both countries to pursue strategic goals such as seeking or protecting relative gains from the global market. From the dyestuffs during WWI to the semiconductor chips in the 1980s and to the present day, the U.S. state has repeatedly intervened in foreign investments in strategic sectors to pursue and retain technology competitiveness. The development of China's telecom sector is a textbook example of strategic investment policy. The state intervened in technology transfer in the 1980s, offered preferential policies to foreign investors in the 1990s and supported alliances between domestic and foreign firms to develop China's own wireless technologies and standards in the 2000s. The means and ways of regulating IFDI were different, yet the same ultimate goal was to speed up national industrial development and move upward in the global value chain. National security was "malleable" and used to cover protectionist policies of both countries.

Reflections about historical institutionalism in IR

This dissertation began with the story of the "poster-boy" of realist political economy – relative gains seeking in international relations – and unraveled it in the lens of domestic institutional change with a historical institutionalist approach. The HI approach is at odds with realism, since what I showed in the Part IV and V is *not* the timeless law of power balancing. At one level, this study presented a story about how the geopolitics of threat perception has generated a vast state apparatus in the U.S. and China geared to protect or pursue technology superiority. At another level, this study is a story about the domestic challenges and political obstacles that have impeded state-building and reshaped the state and its relationship with foreign investors in the U.S. and China when merging public and private resources in distinctive ways. States structures are thus not only the products of competition in the international system (as neorealism contends) but also of history. The HI approach is highly sensitive to timing and initial environmental conditions. The historical institutionalist argument about power balancing should be the one that once the power structure is settled, it would be very difficult to alter. Weaker latecomers adopt pre-existing standards and rules of the current international market and of the pre-existing dominant actors. International institutions are hard to change because their establishment usually demands great efforts and costs. They should be particularly "sticky" (Keohane 2017). Therefore, once the contours of cooperation, competition and the distributional structure of gains are established through international institutions, they are politically sustained through the institutions. The case of China shows that the state first adapted some of its domestic institutions to international rules. IFDIs in the 1980s concentrated on the labor-intensive industries and generated limited technology spillovers. Although IP regimes were established for good reasons, they safeguarded the architecture of global value chains and first-mover advantages. In the U.S. case, HI also shows its explanatory strengths that domestic institutions could not be easily altered for a strategy of internal balancing.

However, as Drezner (2007: 227) observed: laggard states not only reinforce the previous international rules but can also resist to or repel them. Domestic capacities (market size *plus* domestic regulations) give advantage to one great power over another. Since a large market always attracts international firms, once the business links are built, the laggard state can also leverage its large market and coerce firms to comply with its own rules, which is the resistance strategy. Power, in the understanding of historical institutionalism, is not only decided by market size, but also by a jurisdiction's ability to leverage access to its domestic market in pursuit of its preferred international outcome (cf. Bach 2010: 570; see also Drezner 2007: 44). "Domestic regulatory institutions are the source of both power and preferences on the global stage" (Drezner 2010: 794). Latecomers can also repel extant international institutions and develop a viable alternative (see Posner 2010). In the case of resistance and repellence, the distributional effect of pre-existing international institutions becomes less significant and the relative benefits of current winners will no more accumulate. What the Chinese case has shown since the 2000s is the resistance and repellence strategy. After the Chinese market became an integrated part of the large MNCs' corporate strategies, it began to reregulate MNCs and set international standards. These are typical signs of realism's power balancing through internal means and "clever strategies." However, it is important to point out that IR scholars who have paid increased attention to the interaction between domestic and international institutions and conflictive national regulations usually took the largest and most important economies such as the U.S., the EU and China as the starting point (Drezner 2007; Farrell & Newman 2010; Mosley 2010; see also Li W. 2017). A strong state with a small market can hardly resist to or repel existing international institutions. In such case, the hierarchical structure in the world economy will be reinforced and hegemony does not lead to balance of latecomers. Therefore, HI and neorealism can complement each other in explaining change and continuity in world politics.

While influential contributions of historical institutionalism have emerged in the various subdisciplines of Political Science, with a few exceptions,[191] HI has remained at the "sidelines" in IR (cf. Fioretos 2011: 68). As international institutions reach more deeply into domestic politics with the globalization process, HI holds much promise for explaining the origins and effects of the institutions that link international and domestic politics (Fioretos et al. 2016: 20; Rixen & Viola 2016). The rise of HI in IR is particularly boosted by the *Oxford Handbook of Historical Institutionalism* which has a strong section about IR (Zürn 2016: 200). In 2016 and 2017, two consecutively published volumes *Historical Institutionalism in International Relations* and *International Politics and Institutions in Time* furthered the development of HI in IR. The new trend has brought Comparative Politics to International Relations and bridged studies of domestic and international politics – an approach that IR scholars have ever desired for (Rosecrance & Stein 1993; Jacobsen 1996; Li & Wang 2006). Thanks to its substantive profile characterized with its attention to "change" and "stability" of rules and order – a topic that again became extremely popular with China's rise in the world politics – historical institutionalism has burgeoned in IR studies.[192] However, scholarly interests have so far concentrated on the "stickiness" and change of *international institutions* (see Zürn 2016; Keohane 2017). As globalization is shifting the locus of interstate conflict away from multilateral interstate negotiations toward regulating networks of private actors (Farrell

[191] See Ikenberry, G John. 2001. *After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order after Major Wars.* Princeton, NJ: Princeton University Press.; Rawi, Abdelal. 2007. *Capital Rules: The Construction of Global Finance.* Cambridge, MA: Harvard University Press; Barton, John H., Judith L. Goldstein, Timothy E. Josling & Richard H. Steinberg. 2006. *The Evolution of the Trade Regime: Politics, Law, and Economics of the GATT and the WTO.* Princeton, NJ: Princeton University Press.; Abraham, Newman, N. 2008. *Protectors of Privacy: Regulating Personal Data in the Global Economy*. Ithaca, NY: Cornell University Press.; Raustiala, Kal. 2009. *Does the Constitution Follow the Flag? The Evolution of Territoriality in American Law.* New York: Oxford University Press.

[192] See Ikenberry, G John, Wang, Jisi & Zhu, Feng (eds.). 2015. *America, China, and the Struggle for World Order: Ideas, Traditions, Historical Legacies and Global Visions*. New York: Palgrave Macmillan.

& Newman 2019), domestic institutional change – the “second image reversed” – deserves more attention.

Most of the literature on institutional change developed arguments based on cases of democratic, advanced capitalist countries (see Thelen 2004; Mahoney & Thelen 2010). Even in studying non-democratic countries, scholars have largely relied on the theories that are employed and tested almost only on Western advanced capitalist countries. In democracies, policymakers are subject to pressure from domestic political constituencies through periodic elections, protests, and lobbying. They also face constitutional rules that weigh against rapid institutional change; One-party states, in contrast, do not face the periodic electoral competition that checks officials’ actions and that provides feedback on the legitimacy of state institutions. “Such states generally lack constitutional balance of power that creates ‘veto points’ against institutional change” (cf. Wilson 2009: 42). Chinese state officials are mostly perceived in the institutional literature to be highly autonomous from society and from constitutional constraints. This makes them more selective in how they respond to civil society pressures and more able to enact significant reforms at the national level. The dominant view in the literature on China’s foreign economic policy is that the eternal vehicle behind China’s policy change is an domestic one (see Lardy 1992; Howell 1993; Zweig 2002; Wu 2016). As Thomas Moore observed (2002: 35), “if there is a single dominant theme within this literature[…] it is that domestic politics have been the primary source of policy changes in China’s reform and opening.” This is not saying that the elites-led policy and institutional change are not influenced by external factors such as globalization. Elites prepared for globalization and adjusted the domestic institutions. However, as the Chinese case study shows, there were also unintended consequences and external factors causing institutional change. With China’s evolvement with globalization, the state cannot be immune to external factors (see Bell & Feng 2007). In the literature on Chinese Politics, scholars also recognized a distinctive policymaking style – policy experimentalism – to explain policy and institutional change in China (Heilmann 2008; Heilmann & Perry 2011; Bell & Feng 2013; Töpfer 2017). In this process, central policy-makers encourage local officials to try out new ways of problem-solving and then feed the local experiences back to higher administrative levels (Heilmann 2008: 2). If judged to be conducive to current problems for higher-level government leaders, local initial experiences are disseminated through extensive media coverage, high-profile conferences, and appeals for emulation to more implementation in wider regions. This "learning-by-doing style," as Heilmann (2008a) points out, has constituted a crucial mechanism for institutional and policy innovation in China. Although IFDI policy is not a typical bottom-up policy issue, the case study shows that the distinctive policymaking style – local experimentalism – does well capture some dynamics of China's institutional change in regulating IFDI. Administrative agencies at the local level with a significant degree of policy autonomy can mobilize bottom-up resources to shape strategic policy decisions (Moore 2002). While their primary function in the Chinese political system is to implement policies, this does not mean that their role is confined to acting as administrative outsiders. Citing from Chen Ling, "the influence of globalization on policy outcomes was made possible only through local bureaucratic agents (2018: 26)." The case of China also reveals that existing critical juncture theory has a limited, temporally specific account of agency, but overlooks the potential important of changes on either side of critical juncture. Incremental change before critical junctures played an important role in China's institutional evolution (see Bell & Feng 2019). The constant piecemeal modification of review threshold between the central and local government indicates that the regulation power has continuously shifted to the local level. Based on such antecedent conditions, institutional change is then no more abrupt at the critical juncture. Therefore, for future HI studies, my study also suggests that researchers should not carry the "bias" in the literature that underestimated the structing impact of the international political economy on Post-Mao China. Rules leave the actors leeway to reconsider their interests. Many effects were not expected at the time of the initial designing. So it is perhaps the unintended consequences of institutions that are not only the most powerful for institutional change but also the most interesting for future research.

Looking forward

The question surrounding the governance of markets in China and the U.S. is not whether the government will remain involved, but rather which form the new regulatory state will take. The subject is important because the institutions and norms now taking root in both countries will constitute the foundation for the state's role in the economy for the foreseeable future. Historical institutionalism has few predictive functions to offer. Its arguments through temporality and sequencing (including historical accidents) suggest that the future is, by nature, unpredictable. What HI can offer, however, is a history book that mirrors many incidents in the present. It shows us that the paths we stepped down are recurring and the subsequent future we may encounter as history says. Perhaps some unprecedented similarities could be drawn between China nowadays and the U.S. in 1900: a relatively open market, broad foreign engagement in national economy, alignment between domestic and foreign firms, an increasing political consensus and a widening social foundation of neoliberalism, and most importantly, their second or third-place in the ranking of high-technology dominance. WWI helped the U.S. to skip the technology gap with Germany. In the absence of legitimized state coercions as in wartimes, the final frog leap to number one for China may need a very strong state to support its indigenous firms.

Historical institutionalists are open-minded and optimistic in the way that same history never happens. In one way, the hidden investment wars made state interventions and new regulatory apparatus. In the other, efforts have been made at the international level to promote substantially higher flows of FDI for sustainable development in developing and least developed countries. The objectives have gone beyond the protection of foreign investors to include performance improvement, the protection of labor rights and the environment. Perhaps states are more willing to regulate capital in a good way and the poster-boy of relative gains seeking only hangs at the dark corner of great power politics. We will see.

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