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„The Effectiveness of Economic Inducements:  
An Analysis of Chinese Economic Inducements Towards  
the Philippines“

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Manuel Steffen Widmann

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## List of Abbreviations

ASEAN	Association of South East Asian Nations
CCCC	China Communication Construction Corporation
CCP	Chinese Communist Party
CEO	Chief Executive Officer
CIDCA	China International Development Cooperation Administration
CMC	Central Military Commission
CNMEG	China National Machinery and Equipment Group
CPPCC	Chinese People's Political Consultative Conference
CRBC	China Road and Bridge Corporation
DV	Dependent Variable
ENR	Engineering News Record
ICT	Information and Communications Technology
IPO	Initial Public Offering
IV	Independent Variable
JMSU	Joint Marine Seismic Undertaking
MFA	Ministry of Foreign Affairs
MofCom	Ministry of Commerce
MoF	Ministry of Finance
MoU	Memorandum of Understanding
NBN	National Broadband Network
NLRC	North Luzon Railway Corporation
NorthRail	North Luzon Commuter Railway
NPC	National People's Congress
ODA	Official Development Assistance
PBSC	Politburo Standing Committee
PRC	People's Republic of China
RMB	Renminbi
RQ	Research Question
SOE	State-owned Enterprise
SASAC	State-owned Assets Supervision and Administration Commission
US	United States

## Chapter 1: Theory

### 1.1 Background and Research Question

In the context of the South China Sea dispute, economic statecraft represents a significant part of the strategic toolkit applied by claimant countries. Among all nations, the People's Republic of China (PRC, hereafter China) was by far “the greatest user of economic actions to advance and protect its territorial claims” (Yung and McNulty 2015, 4). Accordingly, economic statecraft is considered as an “integral part of China's strategy in addressing regional as well as international issues” (Gong 2014, 19).

Within academic literature, however, the attention of scholars has mainly been focused on the analysis of sanctions as part of the economic toolkit to pursue political goals (Cortright 1997). Thus, crucial questions concerning the dynamics and the effectiveness of economic inducements remain unaddressed (Drezner 1999; Nincic 2010). A. Wong (2019b, 5) consequently notes that although “positive inducements are a key component of economic statecraft, there are few theoretical frameworks to understand their success or failure.”

This research therefore aims at contributing additional knowledge to the question as to which circumstances and conditions determine the political effectiveness of economic inducement strategies (Mastanduno 2003, 177). Deriving from this general question, existing literature on the effectiveness of economic inducement strategies is reviewed, analysed and assessed. The theoretical knowledge gained through the literature review eventually serves as the foundation for the selection of a comprehensive analytical framework. Thereafter, the selected framework is applied to a particular case of Chinese economic statecraft. More specifically, this research analyses the Chinese economic inducement strategy towards the Philippines in the mid-2000s, including the dynamics and circumstances related to the controversial Joint Marine Seismic Undertaking (JMSU) signed in September 2004 (Goh 2014).

Accordingly, the research question (RQ) is formulated as follows:

**RQ: What was the level of Chinese state control over commercial actors during the economic inducement efforts towards the Philippines, and can we observe an impact on their effectiveness?**

## 1.2 Case Selection and Relevance of the Research Question

This thesis analyses the Chinese economic inducement strategy towards the Philippines. With its rising economic clout, China was able to expand its set of economic tools and leverage (Reilly 2013, 3). Nevertheless, we are yet to comprehend how China deploys its economic might and how this power effectively translates into political influence (Reilly 2013; Norris 2016; A. Wong 2019b). To overcome this research gap, sound scholarly work in the shape of systematic evaluations of economic inducement strategies is required (Norris 2010; A. Wong 2016; Norris 2016). This thesis is an attempt to contribute to these efforts.

As outlined in the literature review (Section 1.3), the effectiveness of economic inducement strategies is conditional on a wide range of determinants. Accordingly, to explain the effectiveness of the Chinese economic inducements in the present case study, one could examine determinants related to China as the “sender state” of economic inducements, to the Philippines as the “target state” or to the international system, among others (Crumm 1995; A. Wong 2019b). This section therefore discusses the relevance of the particular research approach pursued in this thesis.

First, it is highlighted why, among all possible analytical angles, the shift of the research scope towards China as the “sender state” and its commercial actors is a relevant one. Thereafter, the specific case-selection is explained and justified. Finally, the actual relevance of answering the research question is outlined.

### 1. The Relevance of the Selected Perspective (Sender State)

According to Norris (2010; 2016), academic literature has mainly overlooked the fact that economic inducement strategies are not operationalised at the level of the states but at the micro-economic firm-level. Therefore, the effectiveness of an inducement strategy actually relies on the specific government-business dynamics, precisely on the ability of the sender state to control its commercial actors (Norris 2010, 47). This view is shared by scholars such as Reilly (2013) or G. Smith and D’Arcy (2013), who challenge Beijing’s ability to effectively control investment flows and companies operating abroad. Hence, Beijing struggles to deliver promised rewards, which reduces their effectiveness in achieving the desired policy outcome (Crumm 1995; Reilly 2013).

The justification for the narrow research scope focusing on government-business relationships in the sender state therefore derives from the impact of “state control” on the effectiveness of an economic inducement strategy (Norris 2016).

## 2. The Relevance of the Case Selection (China – Philippines)

To adequately analyse the dynamics of state control and its impact on the effectiveness of economic inducements, it is indispensable to shift the focus on specific cases (Mastanduno 2003; Norris 2016). To this end, the Chinese economic inducement strategy towards the Philippines qualifies as a relevant case study for multiple reasons:

First, since the scope of this research is directed towards government-business relationships in the sender state, the Chinese economy with its transitional and mixed characteristics serves as a fruitful test case (Norris 2010, 305). As outlined in Section 3.2, the Chinese economic inducement strategy vis-à-vis the Philippines consisted of two major official development assistance (ODA) projects, each covering different industries and companies. Accordingly, the cases provide meaningful variations that help “to illustrate the dynamics of the theory” (Norris 2010, 306).

Second, the Philippines, as the target state of the Chinese inducement strategy, are geographically located in the periphery of Beijing’s influence and therefore “face significant economic and political-security tradeoffs” (A. Wong 2019b, 15). Furthermore, Chinese inducements have preferably been targeted towards individual member states of the Association of Southeast Asian Nations (ASEAN). In doing so, China aimed to change their foreign policy preferences, undermine ASEAN’s authority and preserve its own territorial interests in the South China Sea (Le Thu 2019). The Philippines’ status as an ASEAN member and active claimant in the South China Sea therefore indicates the Chinese state’s explicit intention to pursue political goals by mobilising economic means (Yung and McNulty 2015; Norris 2016; A. Wong 2019b). Such cases are particularly fruitful, as they provide solid empirical evidence of the mechanisms by which the Chinese state seeks to control commercial actors and thus exercise economic statecraft (Norris 2010, 12; 2016; A. Wong 2019b).

## 3. The Relevance of Answering the Research Question

Finally, answering the specific research question is relevant in three aspects:

First, this case study presents further empirical evidence on the relationship between the state and its commercial actors, thus providing additional insights into when and under what conditions governments “actually mobilize commercial actors to pursue national strategic interests” (Norris 2010, 44; Blanchard and Ripsman 2008). Examining the empirics of the Chinese economic inducement cases towards the Philippines helps scholars to better understand the role each determinant of state control played in this specific context. The generated knowledge



supports these scholars in their effort of developing the theory of effective state control and economic inducements (Norris 2010, 82). An improved theoretical understanding of state control helps policymakers to craft more effective inducement strategies, which ultimately increases the chances of achieving the desired policy outcome (Crumm 1995; Norris 2016; Reilly 2021).

Second, the Chinese economic inducements provided to the Philippines were accompanied by rather destructive behaviour of the Chinese commercial actors, leading to a major political backlash and anti-China sentiment in the Philippines (A. Wong 2019b, 18). Ultimately, enterprise malfeasance in economic inducement strategies relates with the level of state control over commercial actors (A. Wong 2019a; Reilly 2021). Thus, it is crucial for the Chinese government to thoroughly understand the dynamics of state control and discover potential insufficiencies in its management of commercial actors (Kastner and Pearson 2021, 31–32). Once this is understood, the Chinese government will be able to design its state control in a more informed and effective manner, thus preventing negative behaviour and destructive externalities in future economic inducement strategies (Norris 2010, 316–19). After all, increased state control contributes to a more effective realisation of China's foreign policy objectives (Norris 2016, 14).

Likewise, also the Philippines have an interest in meeting future Chinese engagement, such as the recently announced US \$940 million railway project (Venzon 2021), in a more informed manner. To this end, this case study serves as a valuable benchmark. The findings help policymakers in the Philippines to better understand the dynamics between the Chinese government and the commercial actors responsible for implementing the project (Norris 2010; 2016). Comparing the government-business relationship in the recent railway project with an empirically rich case study related to large-scale Chinese infrastructure projects allows the Philippine government to better assess whether the Chinese state is in control of the commercial actor (Norris 2010; Kastner and Pearson 2021; Reilly 2021). Should the comparative analysis indicate free-wheeling Chinese firms, there exists a considerable risk of enterprise malfeasance that could jeopardise the success of the new railway project (Reilly 2021, 170). Identified in time, the Philippine government can prevent such a scenario either by imposing stricter regulations on the company or by working more closely with the Chinese government in terms of agent oversight (A. Wong 2021; Reilly 2021, 170). By addressing and overcoming Beijing's loss of control, the negative externalities of large-scale projects can be reduced and the infrastructure in the Philippines itself can be improved (Reilly 2021, 170).

The final reason for answering the research question stems from the academic work already conducted by A. Wong (2019b) on this particular inducement case. As outlined in the literature review (Section 1.3.3.2), A. Wong (2019b) focused on the level of public accountability in the Philippines to explain the (in)effectiveness of China's economic inducement strategy. Hence, factors anchored in the sender state, such as state control, remained unaddressed. By approaching the Chinese economic inducement strategy from a different perspective, A. Wong's (2019b) research is complemented by further empirical evidence. At the same time, the results presented by A. Wong (2019b) help to place the findings of this thesis into a wider context and thus form the foundation for a nuanced refinement of the theory of state control and the analytical framework itself (Norris 2010, 314; A. Wong 2019b, 13). As highlighted above, a more precise framework and better theoretical understanding improves the assessment and decisions made by policymakers in both China and the Philippines, thus leading to a higher degree of state control in the implementation of economic inducement strategies. This, in turn, contributes to an improved situation in the target state (e.g., better infrastructure) on the one hand, and to a more effective realisation of the sender state's foreign policy objectives on the other hand (Norris 2016; Reilly 2021; A. Wong 2019b; 2021).

## 1.3 Literature Review

### 1.3.1 Structure of the Literature Review

This literature review is structured as follows: In Section 1.3.2, the terminology used throughout this thesis is reviewed and defined. Thereafter, Section 1.3.3 serves to gain a comprehensive understanding of the literature dealing with the various determinants of effective economic inducements. In accordance with the research question, particular attention is paid to the aspects anchored in the domestic landscape of the sender states. Finally, based on the selected literature, the analytical framework applied in this thesis is elaborated.

### 1.3.2 Terminology and Definitions

#### *1.3.2.1 Economic Statecraft*

This section discusses the definition of economic statecraft. In the context of economic statecraft, this thesis refers to "sender states" and "target states", with the former being the actors that exercise economic statecraft and the latter being the recipients (A. Wong 2019b).

In the sense of Baldwin (1985, 30), economic statecraft is defined as "governmental influence attempts relying primarily on resources that have a reasonable semblance of a market price in terms of money." Mastanduno (2012, 204) further describes economic statecraft as "the use of

economic tools and relationships to achieve foreign policy objectives.” These tools and relationships can be either negative (economic sanctions and coercion) or positive (economic inducements) (Drezner 1999a; Mastanduno 2012).<sup>1</sup>

However, the definitions provided by Baldwin (1985) and Mastanduno (2012), albeit useful, remain focused on the macro-level of economic statecraft, with states being considered as the key actors (Okano-Heijmans 2011). Consequently, these definitions do not provide a sufficient foundation for a thorough examination of the mechanisms by which states actually mobilise economic resources in pursuit of strategic objectives (Norris 2016, 16).

In an effort to account for this theoretical shortcoming, Norris (2016, 14) defines economic statecraft as “the intentional attempt of the state to deliberately incentivize commercial actors” to achieve its foreign policy objectives. As this thesis focuses on the Chinese state and its ability to mobilise and control commercial actors in pursuit of foreign policy objectives, the definition provided by Norris (2010; 2016) is adopted.<sup>2</sup>

#### *1.3.2.2 Economic Inducements*

Although this thesis focuses on economic inducements and therefore “positive” economic statecraft, it is imperative to establish a clear understanding of the “negative” tools of economic statecraft as well (e.g., economic sanctions and coercion) (Drezner 1999a; Mastanduno 2012).

In the case of negative economic statecraft, the sender state’s foreign policy objectives are pursued through the application of economic means involving “the threat or the use of sanctions or other forms of economic coercion and punishments” (Mastanduno 2012, 204). When referring to economic sanctions and economic coercion, this thesis follows Drezner’s (2003, 643) approach, who used both terms interchangeably and defined them as “the threat or act by a sender government or governments to disrupt economic exchange with the target state, unless the target acquiesces to an articulated demand.”

In contrast to Drezner’s (2003) definition of economic sanctions, Baldwin (1971, 23) defines economic inducements as “actual or promised rewards” towards a targeted country. Likewise, Haggard and Noland (2017, 4) refer to economic inducements as the “promise or extension of

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<sup>1</sup> The negative and positive manifestations of economic statecraft are further discussed in Section 1.3.2.2.

<sup>2</sup> There is as vivid discussion in academia when it comes to the definition of “foreign policy objectives.” Pape (1997), for instance, advocates a rather narrow definition, which is exclusively restricted to political, non-economic goals. Baldwin, instead, argues that “any influence attempt is a political act and that the goals of influence attempts are therefore ‘political’ no matter what form they might take” (Baldwin and Pape 1998, 191). When referring to “foreign policy objectives”, this thesis follows Baldwin’s definition.

economic exchanges as an instrument of foreign policy.” According to Norris (2010; 2016), those economic exchanges are not taking place on the level of the states, but on the micro-economic firm level and may include the trade of commodities, investments or construction activities, among others.

However, throughout the years, the concepts have been further refined and specified. While Drezner (1999b) analysed the effectiveness of well-defined quid-pro-quo inducements, Papayouan and Kastner (1999) focused on long-term Chinese economic inducements. Eventually, it was Mastanduno (1999) who coined the terms “tactical linkage” and “structural linkage.” Tactical linkages are understood as the quid-pro-quo exchange of economic inducements for specific political concessions (conditional), whereas structural linkages aim to alter the target state’s general policy preferences on the long run (unconditional) (Mastanduno 1999, 303–4). It is crucial to understand that in practical terms, specific tactical linkages “can be embedded in long-term [structural] engagement strategies” (Mastanduno 1999, 303–4). For the further course of this thesis, the distinction of inducement strategies into tactical (short-term) and structural (long-term) elements provided by Mastanduno (1999) is adopted.<sup>3</sup>

### *1.3.2.3 State Control and Commercial Actors in Economic Inducements*

The definition of economic inducements that underpins this thesis assigns a central role to commercial actors and the state’s ability to control them (Norris 2016). Accordingly, this section serves to develop a clear understanding of the terms “commercial actor” and “state control.”

Norris (2016, 11) defines commercial actors as “those entities that actually carry out international economic transactions”, including trade, investments or construction work. Generally, this rather broad definition can include Chinese state-owned enterprises (SOEs), Chinese private enterprises as well as non-Chinese entities (Norris 2016, 2).

He further argues that through engaging in economic interaction, the activities of commercial actors generate certain political effects and externalities. The sender state of economic inducements is therefore interested in ensuring that the behaviour of its commercial actors leads to externalities that are conducive for reaching its overarching foreign policy objectives (Norris 2016, 26). Leveraging the principal-agent theory and earlier work by Gill and Reilly (2007), Norris (2016, 26) defines “state control” as the ability of the sender state to direct the behaviour of commercial actors in a way that creates externalities consistent with its policy objectives.

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<sup>3</sup> In academic literature, scholars frequently refer to economic inducements as “positive sanctions” (Mastanduno 1999; Newnham 2002) or “economic engagement” (Haggard and Noland 2017, 4).

To explain how states manage to control commercial actors and thus exercise economic statecraft, Norris (2010; 2016) introduced an analytical framework that can be leveraged to make a dichotomous assessment of whether or not the state was in control of the commercial actor in a given empirical context.

#### *1.3.2.4 The Effectiveness of Economic Inducements*

When can economic inducements considered to be effective? This question has been thoroughly discussed in academic literature. Within this section, the core criteria for evaluating the effectiveness of an economic inducement strategy are outlined.

Hufbauer, Schott and Elliott (1990) argue that – from the perspective of the sender state – the effectiveness depends on the extent to which its foreign policy objectives were achieved and what impact the chosen policy instrument (e.g., inducements) has actually made. Pape (1997, 97) further adds that the use of economic inducements can only be considered effective if it can be ruled out that there is a “more-credible explanation” for reaching the sender’s foreign policy objectives.

To control for the attainment of foreign policy goals, A. Wong (2019b) suggests leveraging observable evidence, such as a drastic policy shift in favour of the sender state. It must be emphasised, however, that even if changes in the behaviour of the target state can be observed, the assessment of whether these changes are sufficient to classify the sender’s goals as achieved remains rather subjective (Hufbauer, Schott and Elliott 1990, 41). This can lead to scenarios where different scholars examine the same cases of economic statecraft and subsequently come to different conclusions regarding their actual effectiveness. One prominent example has been the discussion on the effectiveness of economic sanctions between Hufbauer, Schott and Elliott (1990) on the one hand and Pape (1997) on the other hand.

To reduce the subjective bias when assessing the effectiveness of the Chinese economic inducement strategy towards the Philippines, this thesis draws on the conclusions of other scholars who have already studied the same case, such as Baviera (2016) or A. Wong (2019b).

Moreover, the evaluation of the effectiveness of the Chinese economic inducements is approached in a more nuanced manner. In line with Mastanduno (1999), who argues that an economic inducement strategy can comprise a combination of tactical and structural elements, the Chinese economic inducement strategy towards the Philippines is examined for its short- and long-term effectiveness.

### 1.3.3 The Impacts on the Effectiveness of Economic Inducements

#### *1.3.3.1 Introduction and Structure*

Economic inducement does not necessarily translate into the desired policy outcome (Dorussen 2001, 251). This section therefore identifies the conditions that have an impact on the effectiveness of economic inducements in reaching the sender state's foreign policy objectives. In view of the research question, the scope of the literature review focuses primarily on the characteristics of the sender state and its level of state control.

This section is structured as follows: First, some of the most fundamental contributions on the effectiveness of economic statecraft are discussed. Consequently, the first part also includes literature addressing determinants that go beyond the domestic circumstances of the sender state. Thereafter, the focus shifts to the characteristics of the sender state and their impact on the effectiveness of economic inducements (Section 1.3.3.3). As some of the selected sources share important interdependencies, they are arranged according to their substance rather than to their publication date. Ultimately, this section is followed by a critical evaluation of the discussed literature, serving as the foundation for the analytical framework applied in this thesis.

#### *1.3.3.2 Fundamental Contributions Relevant to this Thesis*

In 1945, Albert O. Hirschman was among the first to elaborate on foreign trade as a tool of economic statecraft (Baldwin 1981). According to Hirschman (1980), the only pre-condition for trade to be used as an instrument of economic statecraft is a nation's ability to control its own imports and exports. In the sense of Hirschman (1980), control is defined as the ability to stop or start trade relations rather than to influence their flow. Additionally, he introduced the theory of "asymmetric dependence", according to which the influential effect of trade relies on the subjective value the target state ("B") assigns to its trade relations with the sender state ("A").

This subjective value arises from various aspects, such as A's market power, B's wealth, B's trade dependence on A as well as B's ability to substitute goods or trading partners. Accordingly, a poor nation B with a high trade dependence on a monopolistic sender A is fairly likely to make political concessions to A (Hirschman 1980, 15-26). With regard to obtaining political concessions, great importance is attached to the role of commercial actors in the target state. It is argued that by safeguarding their own interests, these commercial actors would pressure their own government to maintain a friendly relationship with the sender state, thus increasing the effectiveness of an asymmetric trade dependence (Hirschman 1980, 29).

Although Hirschman (1980) primarily focused on trade as a tool of economic coercion, his implications were nevertheless useful for developing the theory on the effectiveness of economic inducements (Abdelal and Kirshner 1999).

Mastanduno (1992), for instance, applied Hirschman’s (1980) theory of asymmetric dependence to the usage of positive and negative linkage strategies. Building on Hirschman (1980), who noted that a sender state must be able to open and close the door of economic cooperation, Mastanduno (1992) argues that especially democratic governments with decentralised economies face difficulties in this regard. Therefore, effective economic statecraft requires a highly concentrated decision-making authority in the sender state, as the trade has to be altered according to changes in the target state’s behaviour. Likewise, it is necessary for the sender state to maintain sufficient control over non-governmental actors for both “the mobilization of private economic interests and their long-term subordination to political considerations” (Mastanduno 1992, 54).

Further research on the determinants of effective economic inducements was presented by Crumm (1995). Similar to Hirschman (1980), she argues that the effectiveness of economic inducements relies on the perceived inducement value by the target state. Accordingly, her case study of Indo-Soviet relations was dedicated to the development of “systematic and predictable ways in which variations in an incentive event [...] can alter the value that a target actor [...] assigns to an incentive” (Crumm 1995, 313). By considering multiple perspectives, the framework introduced by Crumm (1995) is considered one of the first attempts to analyse the impacts on the effectiveness of economic inducements in a comprehensive way (see Figure 1):

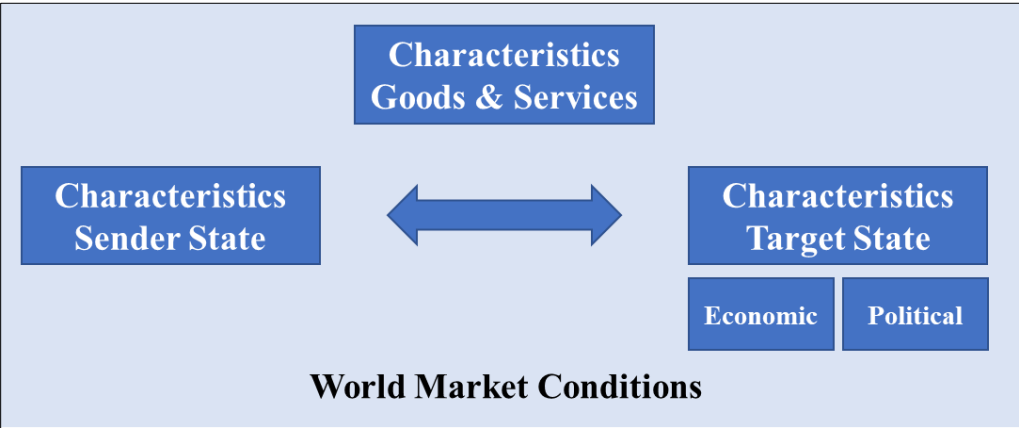


Figure 1: The Perceived Value of Economic Inducements  
 Source: Crumm (1995). Author’s design.

Overall, Crumm (1995, 314) argues that the perceived inducement value and therefore the effectiveness of economic inducements relies on a variety of factors, some of which are anchored

in the target state itself. Furthermore, she identifies the world market conditions – composed of the availability of substitutes and the target’s ability to substitute trading partners – as relevant drivers for the inducement value, thus sharing another analytical aspect with Hirschman (1980). Crumm’s (1995) model is complemented by aspects concerning the offered incentive type as well as the characteristics of the sender state.<sup>4</sup>

As highlighted previously, this thesis focuses on the characteristics of China as the sender state of economic inducements and in particular on the extent of its “state control” over commercial actors. Therefore, the comprehensive framework provided by Crumm (1995) is not further discussed in detail. Nevertheless, the model remains highly relevant to this case study, as it illustrates the variety of aspects that can have an impact on the effectiveness of economic inducements. Accordingly, when assessing the impact of China’s state control on the effectiveness of its economic inducement strategy towards the Philippines, it is important to bear in mind that state control is not the only relevant explanatory variable.

A. Wong (2019b), for instance, sought to explain the outcome of the Chinese economic inducements towards the Philippines by analysing the characteristics of the Philippines itself. She argues that “the effectiveness of economic statecraft is conditional on the level of public accountability in the target country” (A. Wong 2019b, 1). In this context, “public accountability” is defined as “transparency” (freedom and access to information) plus “oversight” (accountability of political leaders) (A. Wong 2019b, 9). To test the theory, A. Wong (2019b) analysed cases of Chinese-led economic inducements towards three countries, with each case representing a different level of public accountability (see Table 1):

	Low Accountability	High Accountability
Subversive Carrots	Effective <i>Case: Cambodia</i>	Ineffective <i>Case: the Philippines</i>
	<i>Case: Myanmar →</i>	

Table 1: Theoretical Predictions of the Effectiveness of Chinese Economic Statecraft  
Source: A. Wong (2019b).

<sup>4</sup> For further details on the type of incentives, which are not subject to this study and thus not further elaborated on, can be obtained from Crumm (1995).



Eventually, the empirical evidence reaffirms A. Wong's (2019b, 41) initial predictions, suggesting that economic inducement is more effective in translating into political concessions in countries with a low degree of public accountability.

### *1.3.3.3 Characteristics of the Sender State and State Control*

After reviewing some of the most fundamental contributions to the theory on effective economic inducements, this section discusses the relevant literature dealing with the characteristics of the sender state. To this end, particular attention is paid to cases in which China acted as the sender state of economic inducements. This literature review serves to gain a comprehensive understanding of the domestic characteristics of the sender state and their influence on the effectiveness of economic inducements. Ultimately, this knowledge is used to develop a sound analytical framework that allows for a systematic analysis of the degree of Chinese state control during the economic inducement strategy towards the Philippines.

#### **General Literature on the Sender State and State Control**

Mastanduno (1992) was among the first to intensify research on the domestic circumstances of states exercising economic statecraft. Overall, he challenged the ability of democracies with decentralised economies to effectively control their trade flow when engaging in economic statecraft. Such inability eventually decreases the effectiveness of economic statecraft.

This view is shared by Crumm (1995), who considers state control to be a crucial determinant for the value of the offered economic inducement. If the sender state is not able to fully control its economy, the target state might be sceptical concerning the actual delivery of the promised reward, thus decreasing its perceived value. Moreover, the credibility of the sender state is further reduced by domestic economic and political instability. Inducements from economically weak sender states tend to have a lower value for the target state, as the sender's ability to provide the necessary funds remains questionable. Likewise, economic inducements presented by politically unstable sender states are at risk of not surviving domestic political struggles and are therefore discounted by the target states (Crumm 1995, 320–27). In line with Mastanduno (1992), Crumm (1995, 314–17) argues that authoritarian regimes with a single-party system tend to have a higher level of control than capitalistic democracies, in which the economy is mainly determined by the private sector.

This argument has later been supported by a study presented by Kahler and Kastner (2006), who found that conditional inducement strategies containing clear quid-pro-quo arrangements are less effective if the sender state is a democracy. The scholars argue that in order to

effectively execute conditional economic inducement strategies, the sender state is required to exercise sufficient control over its firms. The challenge here is to maintain a balance between motivating companies to operationalise promised inducements and preventing them from merely pursuing their own profit-maximising interests (Kahler and Kastner 2006, 523–25).

The sender's domestic dynamics were also subject to a study presented by Long (1996). The scholar, corresponding with Crumm (1995), emphasises the need for the government's institutional capability to effectively implement promised incentives. Therefore, strong domestic political and economic allies, which are willing to mobilise resources, are required (Long 1996, 101–102).

Likewise, Bernauer and Ruloff (1999, 37) argue that the sender state's ability to mobilise the necessary resources may be compromised by "unrelated vagaries of domestic politics", such as election campaigns or changes of government. Ultimately, events like these decrease the effectiveness of economic inducements (Bernauer and Ruloff 1999).

Building on Mastanduno's (1992) emphasis on private actors for operationalising economic inducement strategies, P. A. Davis (1999) asks not only how states might mobilise the required resources in general, but also how these resources can be directed to achieve the desired policy outcome. Her findings suggest that one crucial aspect for persuading commercial actors to move in the desired direction is the sender state's ability to coherently align business interests with governmental interests (P. A. Davis 1999, 26).

After studying the inducement strategies of the United States (US) and West Germany towards Poland, P. A. Davis (1999) concludes that the goal alignment between the government and commercial actors has been more effective in cases where the sender assembled the characteristics of a "trading state." Such trading states feature a high degree of bureaucratic coordination, functional autonomy and continuity on the one hand, and institutionalised relations with commercial actors on the other hand (P. A. Davis 1999, 26). In the case of West Germany, the capacity of the state to effectively channel commercial activities in the desired direction was further facilitated through the formation of special committees involving business and governmental representatives, trade fairs or governmental credits (P. A. Davis 1999).

In a similar study dealing with West German economic inducements, Newnham (2002, 109) concludes that the commercial actors involved did not seek to influence the interactions for their own economic advantage, but prioritised political goals instead. These findings therefore reaffirm earlier observations by P. A. Davis (1999) and underline the importance of coherent

coordination between state institutions and resource mobilising actors for the effectiveness of economic inducements (Newnham 2002).

Leveraging Hirschman's (1980) theoretical foundations of trade dependence, Mastanduno (2003) further elaborated on the determinants of effective economic inducement efforts. With regard to the sender state, he argues that successful economic inducement strategies require a gradual inward flow of incentives into the target state. With free movement of capital, however, the controllability of this flow is not guaranteed, thus bearing the possibility of compromising the foreign policy objectives of the sender state (Mastanduno 2003, 183). The core of Mastanduno's (2003) argument therefore draws on the earlier considerations of Crumm (1995), Long (1996), Bernauer and Ruloff (1999) or P. A. Davis (1999): the sender state needs to maintain a necessary level of control over its own commercial actors.

Turning to the political landscape of the sender state, Mastanduno (2003, 183) emphasises that "economic inducement is a long-term strategy that requires consistency, patience and perseverance." Similar to Long (1996), he therefore argues that a strong national unity in the sender state has a positive effect on the success of an economic inducement strategy, whereas a decentralised and fragmented political systems with a difficult decision making process reduces its effectiveness (Mastanduno 2003, 184).

Similar considerations were also raised by Kahler and Kastner (2006). As long-term inducement strategies may be accompanied by occasional setbacks, the scholars emphasise the need for a coherent political consensus in the sender state – even in the case of changes in government (Kahler and Kastner 2006, 527).

### **Literature on Cases with China as the Sender State**

Building on the understanding that economic statecraft is ultimately carried out by commercial actors rather than the government itself, Gill and Reilly (2007) scrutinised the relationship between the Chinese state and its enterprises operating in Africa. In this context, the scholars discover "an increasing set of tensions and contradictions between the interest and aims of government principals – the bureaucracies based in Beijing tasked with advancing China's overall national interests – and the aim and interests of ostensible agents – the companies and businesspersons operating on the ground in Africa" (Gill and Reilly 2007, 38–39). Deriving from the principal-agent theory, Gill and Reilly (2007) formulate three conditions that hamper effective governmental control over commercial activities in Africa. First, the coordination mechanism of Chinese enterprises is highly complex, involving a multitude of bureaucratic institutions at

different levels of government with different reporting lines and responsibilities. Second, the geographical distance contributes to an increasingly asymmetric distribution of information, thus impeding effective coordination. Lastly, the complex coordination may result in conflicting interests between different bureaucratic agencies and actors affiliated with Chinese economic statecraft (Gill and Reilly 2007, 44).

The obstacles of principal-agent relationships were also subject to the work conducted by Norris (2010; 2016), who therefore added an important piece to the research on the sender state's conditions. He criticises that the vast majority of literature is yet to systematically analyse the role of commercial actors in operationalising economic inducement strategies. It is argued that the effectiveness of such economic inducement strategies primarily relies on the micro-economic behaviour at the firm level (Norris 2010, 45–46). Norris (2016, 25) therefore, similar to P. A. Davis (1999), emphasises the need to thoroughly comprehend “business-government dynamics; specifically, the factors that enable a state to effectively control or direct the behavior of commercial actors such that their activities generate security externalities that are conducive to national strategic objectives.”

Accordingly, Norris (2016) introduces the concept of “state control” as the dependent variable (DV) of his model. State control can also be paraphrased as the ability of the state to “manipulate, control, direct or otherwise use commercial actors in the state's pursuit of its strategic goals” (Norris 2016, 23). The analytical framework is completed by five independent variables (IVs), each having a direct causal linkage to the DV “state control” and therefore the effectiveness of economic inducements (Norris 2010; 2016) (see Figure 2):

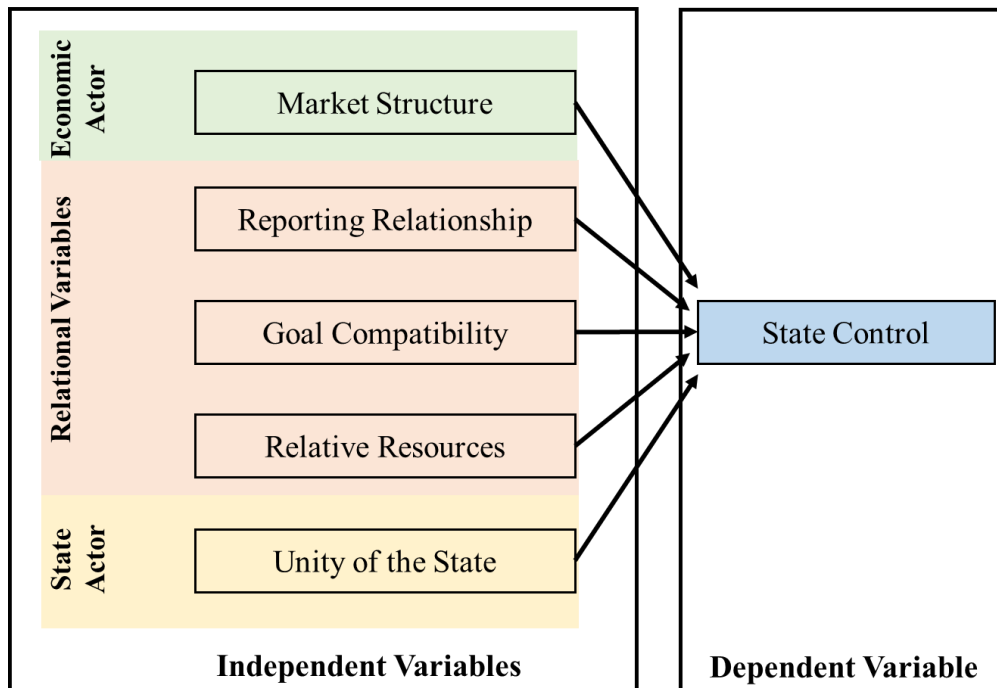


Figure 2: Overview of the IVs and DV  
 Source: Norris (2010; 2016). Author's design.

The IVs are further distinguished into three categories, namely state, relational and economic actor variables. Starting with the latter, Norris (2016) argues that the degree of state control relies on the characteristics of the market structure the commercial actor is operating in. Here, possible findings range from monopolistic to fragmented, with an oligopolistic market structure being most favourable to state control. Turning to the state, the need for governmental cohesion is highlighted, with a higher unity of the state leading to a higher degree of state control (Norris 2016, 27–31). Lastly, relational aspects between principal and agent matter. In this regard, Norris (2016, 28) argues that a greater goal convergence of principal and agent as well as actors, which are “directly owned, financed, or managed by the government”, are expected to increase the level of state control. A final aspect to consider is the relative distribution of resources, with higher state resources having a positive impact on state control (Norris 2016, 28).

While the framework presented by Norris (2010; 2016) provides a comprehensive toolbox for analysing the different IVs that ultimately determine whether a state is in control of a commercial actor, Reilly (2021) introduced a method for conducting an ex-post assessment of the effectiveness of state control. He therefore suggests applying a three-stage test based on observable empirical evidence, with each stage representing a different level of state control:

1. The first stage of the test examines whether the state managed to direct the commercial actor to “engage in economic activities in the direction that Beijing desired” (Reilly 2021, 14).

This test is considered passed when commercial actors engage in a particular country to execute a government-funded project or when they expand their trade and investment ties into a certain region at the request of the state.

2. In a second step, it is to be examined how coherently Chinese economic inducements have been implemented. In other words, this test reflects the degree to which the commercial actors “acted in ways likely to advance (or undermine) the state’s foreign policy objectives” (Reilly 2021, 14).

Such behaviour is evidenced by commercial actors changing the central policy objective (“policy stretching”), acting in a fiscally irresponsible manner or engaging in enterprise malfeasance (Reilly 2021, 14–15). A. Wong (2019a) adds that enterprise malfeasance may be visible through “poor quality, corruption, environmental degradation, forced resettlement, and an influx of Chinese labor.”

3. In a final step, it is to be examined whether or not the state was capable of detecting incidences of policy stretching or irresponsible corporate behaviour and subsequently managed to redirect the course of the commercial actors (Reilly 2021, 16).

Overall, Reilly’s (2021) test serves as an easily applicable tool to retrospectively assess the extent and effectiveness of Chinese state control in a given empirical context.

When assessing the extent of Chinese state control over commercial actors, however, it is important to recognise that the Chinese economy is not to be considered monolithic (Pearson 2015, 32). Pearson (2015), for instance, distinguishes the Chinese economy into different “tiers” (top, middle and bottom tier), with each tier representing certain industries, sectors and enterprises. Overall, the state’s regulatory oversight can be expected to decrease from top- to bottom-tier. This subdivision allows analysts to gain a nuanced understanding of “how tightly the party-state leaders wish to hold onto – exercise control over – different sectors” (Pearson 2015, 32). The model also provides insights into the relationship between state and commercial actors, thus complementing the relational dimension of Norris’s (2016) framework for state control (Pearson 2015; Kastner and Pearson 2021).

In an effort to assess the behaviour of Chinese commercial actors in implementing state-led inducement strategies and the impact of this behaviour on their effectiveness, G. Smith and D’Arcy (2013) made use of Zhou’s (2010) logic of “bureaucratic collusion.” According to the theory, the implementation of top-down policies from China’s centralised government (principal) leads to collusion on lower bureaucratic levels (supervisor), which in turn results in ineffectiveness or goal displacement on the level of the commercial actors (agents) (Zhou 2010, 63). This three-tiered relationship is referred to as the “principal-supervisor-agent framework”, in which the outcome of central policies is ultimately determined by the agents (Zhou 2010, 56).

Deriving from acknowledging that China is represented by an increasingly complex range of actors with diverging goals and interest, G. Smith and D’Arcy (2013, 218–24) applied Zhou’s (2010) framework to the theory of economic inducements. The scholars conclude that the inability of the Chinese central government to control supervisors and agents at a national level is exacerbated by the greater distance between the entities in a transnational context.<sup>5</sup> Empirical evidence also shows that commercial actors – in pursuit of self-interest – tend to play different levels of bureaucratic institutions against each other, thus undermining the effectiveness of Chinese economic inducements (G. Smith and D’Arcy 2013, 226–28).

Similar considerations were also subject to the work of F. Wu and De Wei (2014), as they examined China’s success in translating its economic means into political gains. The scholars argue that the effectiveness of Chinese economic inducements eventually relies on the behaviour of its domestic “power sources”, namely state-owned enterprises, state-owned banks as well as China’s sovereign wealth funds (F. Wu and De Wei 2014, 784). Yet, in the case of all three key actors, F. Wu and De Wei (2014, 748) expect the Chinese government to be able to exercise a sufficient level of state control. This view thus puts them in stark contrast to scholars such as P. A. Davis (1999), Gill and Reilly (2007), G. Smith and D’Arcy (2013) and Norris (2010; 2016), all of whom challenge Beijing’s ability to control such power sources.

However, by examining cases in which China attempted to persuade target countries in South America and Africa to adopt the “One-China Policy”, the scholars also sought to identify when and how Chinese economic inducements effectively translate into the desired policy outcome (F. Wu and De Wei 2014, 796). The evidence of successful cases shows that the policy decisions of target countries were predominantly influenced by economic aspects, with political

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<sup>5</sup> A similar argument on the distance between principal and agent was raised by Gill and Reilly (2007).

concessions being awarded to China as the highest bidder. In some cases, even the prospect of future gains from a prospering relationship with China was sufficient to turn diplomatic recognition away from Taiwan (F. Wu and De Wei 2014, 796–98). These findings were subsequently echoed by Blackwill and Harris (2016), who not only suggested to further elaborate on the relationship between China and its domestic power sources, but also emphasised the importance of China’s (perceived) economic power for the success of its economic inducement efforts.

Referring to China’s economic power, Reilly (2013) argues that successful Chinese inducement ought to be more frequently observed than it actually is. He therefore concludes that when it comes to operationalising economic inducements, China’s control over its commercial actors remains limited (Reilly 2013, 11).<sup>6</sup> Not only is it difficult to convince companies to go against their commercial interests, but the “dispersal of power [...] across the multiplicity of actors involved in the state sector results in incoherent and often contradictory approaches to economic statecraft” (Reilly 2013, 14). Subsequently, Reilly (2021) dedicated further research to the challenge of directing commercial actors in a way that is conducive to the government’s foreign policy objectives. Building on the findings of several case studies, Reilly (2021) describes the Chinese approach to economic statecraft as an act of “orchestration.” Such orchestration entails not only appropriate incentives for companies and bureaucratic agencies, but also a policy design that is aligned with the interests of the executing actors in the first place (Reilly 2021, 58). However, if orchestration fails to provide effective state control over commercial actors, negative repercussions arising from the externalities of the engagement, such as enterprise malfeasance, may be the result (Reilly 2021).

Similar to Reilly (2021), also Song Guoyou highlights the need to reconcile the goals of commercial actors with the strategic objectives of the state (A. Wong 2016). Accordingly, the scholar suggests developing mutually beneficial engagement strategies to avoid a conflict of interest between the state and commercially oriented companies (G. Song 2014). With regard to the role of commercial actors, G. Song (2014) identifies state-owned banks and state-owned enterprises, especially those managed by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), as the most important carriers for economic statecraft.<sup>7</sup>

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<sup>6</sup> This finding is consistent with the notions of other scholars, such as Gill and Reilly (2007), G. Smith and D’Arcy (2013) or Norris (2010; 2016).

<sup>7</sup> However, also private enterprises become increasingly important for the operationalisation of Chinese economic inducements (A. Wong 2016).



Further knowledge on the role of commercial actors was added by X. Zhu (2015), who particularly focused on Chinese SOEs in state-led foreign assistance programmes. The scholar, similar to P. A. Davis (1999) and G. Smith and D'Arcy (2013), challenges the assumption that Chinese SOEs simply act according to governmental directives (X. Zhu 2015, 2). To illuminate the dynamics between sender state, SOEs and target state, X. Zhu (2015) collected empirical evidence on Chinese assistance towards Sri Lanka. The scholar eventually concludes that “it is no longer productive or accurate to view the state as monolithic. Its command over economic diplomacy and foreign assistance is increasingly shaped by the power of Chinese SOEs – now behaving like market actors – and businesses” (X. Zhu 2015, 15). Therefore, exercising coherent inducement strategies through SOEs becomes increasingly challenging for the Chinese government (X. Zhu 2015, 2).

A similar argument was made by B. Wu (2008), who notes that in terms of policy formation, the Chinese state should not be considered as unitary. Instead, a broad variety of actors, including powerful governmental departments, the media, the congress, the public opinion as well as commercial agents are involved. The managers of large enterprises, for instance, do not only provide policy and investment advice to the state, but also have the privilege to accompany high governmental representatives on state visits. Furthermore, major business people have fostered their influence over the policy-making process through seats in the National People's Congress (NPC) or other bureaucratic entities, thus increasing the complexity among all actors involved (B. Wu 2008, 16–19).

Further evidence challenging the theory of a monolithic Chinese state apparatus was added by A. Wong (2018). Drawing on developments concerning the South China Sea dispute and Beijing's “One Belt – One Road” initiative, the scholar examined the influence of different actors on China's national foreign policy-making process. A. Wong (2018, 753) concludes that “the directions, coherence and success of China's foreign policy” is ultimately shaped by provincial and commercial actors rather than a unitary state.

The role of commercial actors was also scrutinised by C. L. Davis, Fuchs and Johnson (2019, 45), as they examined the ability of China and India to “use trade to reward and punish partner countries.” Their findings suggest that while China is able to convince its SOEs to reduce their imports in response to the respective trading partner's undesired policy position, it struggles to instrumentalise SOEs to limit its exports. In line with other scholars, such as Reilly (2013) or Norris (2016), C. L. Davis, Fuchs and Johnson (2019) explain this phenomenon with a potential goal divergence between the SOEs and the state. While there is little reason for China's export-

oriented SOEs to reduce their sales and bear the costs of politicised trade, the state-induced restriction of imports may be complementary with the firms' objective to fend off foreign competition (C. L. Davis, Fuchs and Johnson 2019, 428–29). As such, the scholars emphasise the importance of effective state control in aligning the operations of commercial actors with governmental preferences in order to implement an economic inducement strategy (C. L. Davis, Fuchs and Johnson 2019, 412).

In conclusion, this section reviewed the relevant literature dealing with the factors influencing the effectiveness of economic inducements, with special attention being paid to the role of the sender state and its control over commercial actors. In a next step, the accumulated knowledge is thoroughly evaluated, thus providing the foundation for the selection of the analytical framework used in this thesis.

#### 1.3.4 Evaluation of the Literature Review and Research Gap

Within the literature review, the fundamental definitions relevant to this thesis have been elaborated and established (Section 1.3.2). Thereafter, the focus has been shifted towards the determinants of effective economic inducements (Section 1.3.3).

In order to gain a comprehensive understanding of the complexity of effective economic inducements, the literature review started with discussing the most fundamental contributions relevant to this discipline, including Hirschman (1980), Mastanduno (1992) and Crumm (1995).

Subsequently, the focus of the literature review briefly shifted to the specific case study presented in this thesis. Here, valuable research has been conducted by A. Wong (2019b). In her study on the impact of the Philippine's level of public accountability on the effectiveness of the Chinese economic inducement strategy, A. Wong (2019b) primarily focused on explanatory variables anchored in the target state, thus leaving factors concerning the sender state unaddressed. This research gap provides the opportunity to complement A. Wong's (2019b) fundamental work by enriching her findings with empirical evidence from the sender state's perspective.

Therefore, after general and case specific knowledge on the effectiveness of economic inducements has been acquired, the focus of the literature review turned to the perspective of the sender state, with particular attention being paid to China's ability to control commercial actors (see Table 2):

Scholar	Analytical Angle	Determinants / Impact on Effectiveness
<i>Fundamental Contributions Relevant to this Thesis</i>		
Hirschman (1945;1980)	Asymmetric trade dependence and subjective value	<ul style="list-style-type: none"> <li>• Sender's ability to stop / start trade</li> <li>• Sender's market power</li> <li>• Target's wealth</li> <li>• Availability of substitutes</li> </ul> <p><i>Eventually, the concessions are stimulated by affected actors in the target state, which pressure their own government in favour of the sender.</i></p>
Mastanduno (1992)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Sender's regime type and decision-making authority</li> <li>• Sender's control over commercial actors</li> </ul> <p><i>Democracies with a decentralised economy are less likely to control commercial actors.</i></p>
Crumm (1995)	Inducement Value	<ul style="list-style-type: none"> <li>• Characteristics of the sender state (see below)</li> <li>• Characteristics of the target state</li> <li>• Characteristics of goods and services offered</li> <li>• World market conditions</li> </ul> <p><i>The effectiveness of economic inducements eventually relies on the perceived inducement value by the target state, which in turn relies on various aspects within and outside the target country – including the characteristics of the sender state.</i></p>
A. Wong (2019b)	Characteristics of the target state	<ul style="list-style-type: none"> <li>• Level of public accountability in the target state</li> </ul> <p><i>Economic inducement is more effective in countries with a low level of public accountability.</i></p>
Scholar	Analytical Angle	Determinants / Impact on Effectiveness or State Control
<i>Studies Focusing on the Sender State and State Control</i>		
Crumm (1995) (continued)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Economic control</li> <li>• Economic stability</li> <li>• Political stability</li> </ul> <p><i>The inducement value and therefore its effectiveness is increased by economic control of the sender state as well as economic and political stability within the sender state.</i></p>
Long (1996)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Sender's institutional capability to implement incentives</li> <li>• Strong domestic political and economic allies</li> </ul> <p><i>Effective economic inducement strategies require a sender state that is able to extract and direct resources.</i></p>
Newnham (2002)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Economic coordination and control</li> </ul> <p><i>The effectiveness of economic inducements increases with the sender's level of economic control.</i></p>
Mastanduno (2003)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Economic control over commercial actors</li> <li>• Political consensus in the sender state</li> </ul> <p><i>Effective economic inducement relies on the degree of economic control as well as the political consensus in the sender state.</i></p>
Kahler and Kastner (2006)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Sender state's economic control over its economy</li> </ul> <p><i>Conditional economic inducement is less effective when the sender state is a democracy (=low economic control).</i></p>

Scholar	Analytical Angle	Determinants / Impact on Effectiveness or State Control
<i>Studies Focusing on the Sender State and State Control (continued)</i>		
P. A. Davis (1999)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Sender as a “trading state” (functional autonomy, coordination and continuity within the bureaucratic process &amp; institutionalised links to businesses)</li> <li>• Sender’s capacity to extract and direct domestic resources</li> </ul> <p><i>Eventually, the effectiveness of economic inducements relies on the sender’s control over its own economy and therefore its capacity to extract and direct domestic resources.</i></p>
Gill & Reilly (2007)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Governmental control over commercial actors &amp; activities</li> </ul> <p><i>The effectiveness of economic inducement relies on the sender’s control over commercial actors and activities. Complex bureaucratic mechanisms, goal divergence and geographical distance decrease the level of such control.</i></p>
Norris (2010; 2016)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• State Control: <ul style="list-style-type: none"> <li>- Market structure</li> <li>- Relative resources</li> <li>- Reporting relationship</li> <li>- Goal compatibility</li> <li>- Unity of the state</li> </ul> </li> </ul> <p><i>The higher the degree of state control, the higher the effectiveness of economic inducements.</i></p>
G. Smith and D’Arcy (2013); Zhou (2010)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Government collusion</li> <li>• principal-supervisor-agent problem</li> </ul> <p><i>Governmental collusion, which multiplies in a transnational context, decreases the level of state control over commercial actors and therefore the effectiveness of economic inducements.</i></p>
F. Wu and De Wei (2014)	Characteristics of the sender state	<ul style="list-style-type: none"> <li>• Domestic power sources (SOEs, state-owned banks, sovereign wealth funds)</li> <li>• Economic gain for recipient country</li> </ul> <p><i>The effectiveness of Chinese economic inducements is determined by the actions of its domestic power sources as well as the economic gains perceived by the target state.</i></p>
Pearson (2015)	State control	<ul style="list-style-type: none"> <li>• The Chinese government’s degree of state control varies depending on the sector of the economy <ul style="list-style-type: none"> <li>- Top-tier industries</li> <li>- Middle-tier industries</li> <li>- Bottom-tier industries</li> </ul> </li> </ul> <p><i>The state’s regulatory oversight and wish to exercise control decreases from top- to bottom-tier industries.</i></p>
Reilly (2013, 2021)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• State control over commercial actors <ul style="list-style-type: none"> <li>- Dispersal of power</li> <li>- Goal divergence</li> </ul> </li> </ul> <p><i>State control is reduced by goal divergence as well as the dispersal of power among actors involved in the process, leading to incoherent and ineffective inducement efforts.</i></p>
G. Song (2014)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Goal compatibility between state and commercial actors</li> </ul> <p><i>A conflict of the agent’s commercial goals with the national interests of the state ought to be avoided.</i></p>
B. Wu (2008)	Characteristics of the sender state	<ul style="list-style-type: none"> <li>• Policy formation process</li> </ul> <p><i>The Chinese state is not monolithic when it comes to the policy formation process of economic inducements. Instead, a complex variety of actors is involved, including commercial actors.</i></p>

Scholar	Analytical Angle	Determinants / Impact on Effectiveness or State Control
<i>Studies Focusing on the Sender State and State Control (continued)</i>		
X. Zhu (2015)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• State control over SOEs</li> <li>• Power of SOEs</li> </ul> <p><i>SOEs now act like market actors pursuing their commercial interests. Exercising a coherent national strategy through SOEs becomes increasingly difficult for the Chinese government.</i></p>
A. Wong (2018)	Characteristics of the sender state	<ul style="list-style-type: none"> <li>• Unity of the Chinese state</li> </ul> <p><i>Ultimately, China's foreign policy-making is determined by provincial and commercial actors.</i></p>
C. L. Davis, Fuchs and Johnson (2019)	Characteristics of the sender state / state control	<ul style="list-style-type: none"> <li>• Capacity of the Chinese state to control actors and align operations</li> </ul> <p><i>SOEs tend to act according to own commercial interests and are reluctant to bear policy-induced losses.</i></p>

Table 2: Overview of the Literature Review  
Source: Author's design.

In conclusion, both Western and Chinese scholars have emphasised the complexity of domestic processes and the importance of government-business dynamics for the effectiveness of economic inducements.

The discourse on the characteristics of the sender state derived from rather general remarks raised by scholars such as Mastanduno (1992; 2003) or Crumm (1995), who questioned the ability of certain sender states to sufficiently exercise control over commercial actors. Long (1996) eventually argued that sender states require a sufficient degree of “institutional capability” in order to mobilise the domestic resources necessary for the execution of economic inducements. P. A. Davis (1999) asked not only how to mobilise resources in general, but also how to direct them in the desired direction, adding a new sphere to the concept of control over domestic actors.

One of the first works particularly dealing with China as the initiator of economic inducements was eventually presented by Gill and Reilly (2007), as they examined coordination problems between the Chinese state and its commercial actors operating in Africa. However, it was not until (Norris 2010; 2016, 20) that a comprehensive analytical framework “that links the behavior of commercial actors to the grand strategy of the state” was developed. In an effort to explain how economic inducements actually work, Norris (2010; 2016) introduced the concept of “state control”, thus underscoring the need to thoroughly understand “how the state controls the commercial actors responsible for conducting the economic interaction” (Norris 2016, 25).

Other studies presented in the literature review were subsequently analysing China's domestic processes from a particular angle, a number of which share interdependencies with the comprehensive framework provided by Norris (2010; 2016). While some have analysed the role of different Chinese actors in the execution of economic inducement strategies (B. Wu 2008; F. Wu and De Wei 2014; X. Zhu 2015; C. L. Davis, Fuchs and Johnson 2019), others particularly focused on issues like the goal compatibility between principal and agent (Reilly 2013; G. Song 2014) or the dynamics among Chinese bureaucratic entities (Zhou 2010; G. Smith and D'Arcy 2013; A. Wong 2018).

Nevertheless, the framework presented by Norris (2010; 2016) remains the only approach that combines the different perspectives into a comprehensive tool that allows for a systematic analysis of the degree of Chinese state control during its economic inducement efforts towards the Philippines. Accordingly, the first part of the research question is answered by leveraging Norris's (2010; 2016) framework.

However, answering the second part of the research question – which examines the impact of the level of state control on the effectiveness of China's economic inducement efforts – requires an understanding of whether or not the Chinese inducement strategy is to be considered effective.

In an effort of gaining this fundamental understanding, this thesis follows the notions of Mastanduno (1999), who suggested to distinguish economic inducement strategies into tactical and structural components. Hence, the Chinese economic inducement strategy is examined in terms of its short- and long-term effectiveness. To reduce subjectivity in assessing the effectiveness of the Chinese economic inducements, this thesis draws on the findings of previous research, such as the case studies presented by Baviera (2016) and A. Wong (2019b).

Linking the results generated by the analytical framework to the actual short- and long-term effectiveness of China's economic inducement strategy vis-à-vis the Philippines allows this thesis to draw nuanced conclusions regarding the impact of the level of state control on the strategy's effectiveness, thus answering the second part of the research question. Further information on this matter is provided in Section 3.2 and in Section 5.2.

However, the scope of the present project is not to explain the outcome of the Chinese engagement in the Philippines by advancing a “monocausal theory” (Blanchard and Ripsman 2008, 372). Instead, the level of state control is considered as one possible explanatory variable for the (in)effectiveness of the Chinese economic inducement efforts.

# Chapter 2: Analytical Framework

## 2.1 Introduction

In consistence with the evaluation of the literature review in Section 1.3.4, the research scope of this thesis is shifted towards China as the sender state of economic inducements, with particular attention being paid to its ability to control commercial actors. Although the relationship between the government and its commercial actors has been subject to a substantial amount of research, it was not until Norris (2010; 2016) that an analytical framework for systematically assessing the extent of China’s state control in a given inducement case was established. Consequently, the two cases of Chinese economic inducements towards the Philippines presented in this thesis are analysed using the framework introduced by Norris (2010; 2016).

As illustrated in Figure 3, the framework comprises three levels of analysis (economic actor, relational, state), which in turn rely on a total of five IVs:

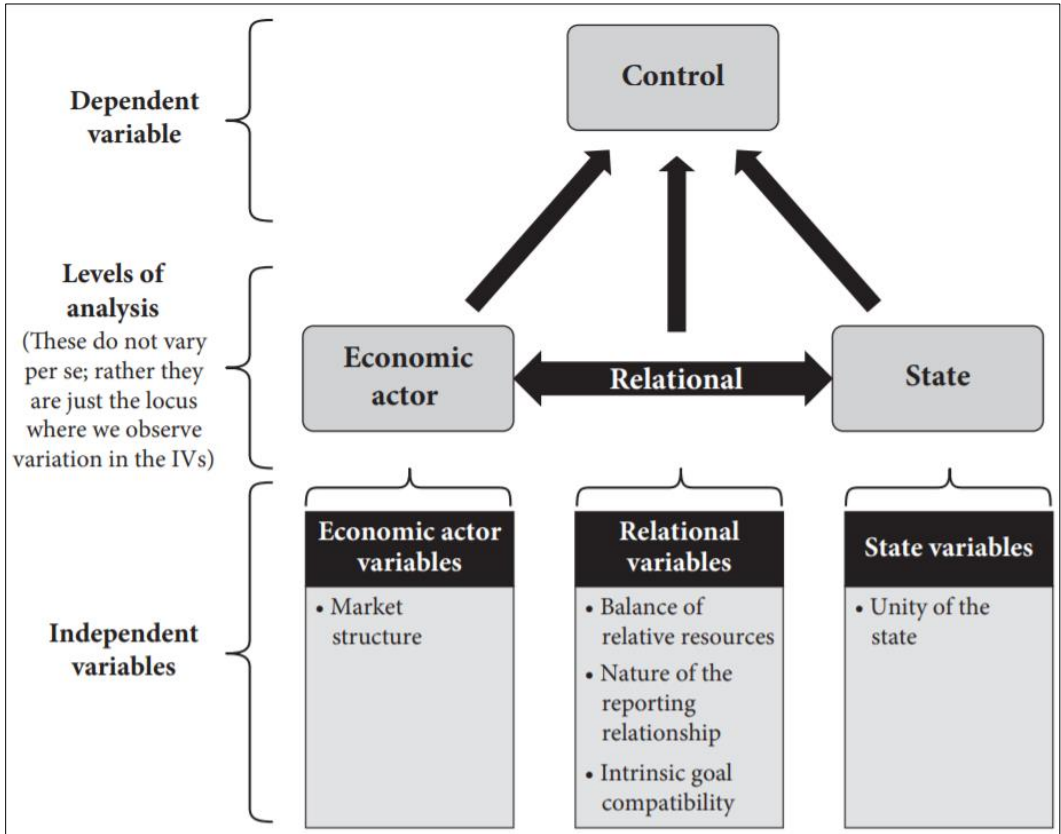


Figure 3: Framework for State Control  
Source: Norris (2016, 28).

In a next step, this chapter provides an in-depth discussion of the selected analytical framework, including its different levels, IVs and indicators. This involves a clear definition of the “range

of values that the [independent] variable can take on as well as three observable indicators that help determine that variable's value in any particular case" (Norris 2016, 235).

In this context, it is crucial to acknowledge that the value for the IVs in reality may be scattered over a wide range of possibilities. This variety cannot be reflected in the present study. In order to allow for a clear theoretical evaluation, the values of the variables (IVs and DVs) are defined in a dichotomous manner (Norris 2016, 235–39). However, a special case constitutes the evaluation of the market structure. Further details are provided in the next section.

## 2.2 Economic Actor Variable: Market Structure

Drawing on the principal-agent theory, Norris (2016, 27) argues that the degree of state control over commercial actors depends on the market structure of the industry in which the respective commercial actor operates. If the number of actors is too high, the government will not be able to sufficiently trace their economic activities. State control will also be difficult if a market is dominated by only a few powerful players, as governmental directives may be ignored.

The analysis of the market structure is to be further narrowed down depending on the specific agent the Chinese state seeks to control (Norris 2016). In the present case, two major Chinese companies were entrusted with executing the respective ODA projects in the Philippines. Accordingly, the focus of this work is shifted towards the market structure of the sender state. As Chinese economic inducement strategies are generally carried out by Chinese companies, the analysis of the domestic market structure furthermore only considers Chinese enterprises, with no distinction being made between private or state-owned entities (Gill and Reilly 2007; A. Wong 2016).

Ultimately, the empirical analysis of the market structure aims not only to determine whether the state was able to control its commercial actors in the market, but also to gain an understanding of possible alternative actors that would have been available to the state to operationalise its economic inducement strategy (Norris 2016, 27).

### **Values**

The values that the IV "Market Structure" can assume range from highly fragmented to oligopolistic to highly concentrated, thus disrupting the dichotomous principle. In terms of state control, oligopolistic market structures are the most favourable, as there are neither too many actors for sufficient monitoring nor too few to lack alternatives (Norris 2016, 27, 235). Furthermore, it is argued that the Chinese state, due to its ability to favour those actors that are willing to support governmental agendas, is able to at least partly compensate for the problems arising



from a fragmented market structure (Norris 2016, 223). However, it needs to be highlighted that the assessment of a specific market space can be challenging, as the lines between concentrated, oligopolistic and fragmented markets “are blurry in practice” (Norris 2016, 249).

### **Indicators**

To assess the IV’s value, three indicators are consulted, namely the number of firms, the market concentration and the pricing power of the industry’s largest players (Norris 2016, 235–36). At this point, it is crucial to emphasise that although the IV itself can take on three different values (concentrated, oligopolistic, fragmented), the individual indicators continue to be assessed in a dichotomous way (Norris 2016, 235–36).

#### **Number of Firms**

- **Concentrated:** one to three non-competitive, monopolistic firms.
- **Oligopolistic:** more than two competing actors.

For coding purposes, no upper limit of actors within oligopolistic market structures is defined. Instead, the distinction between oligopolistic and fragmented markets relies on the remaining two sub-indicators (Norris 2016, 235–36). For example, more than two competing firms in a market space that is highly fragmented in terms of market share would indicate a rather fragmented market structure. Conversely, more than two competing firms in a market space that is fairly concentrated in terms of market share would indicate an oligopolistic market structure (Norris 2016, 292).

#### **Market Share**

- **Concentrated:**  $\geq 50\%$  of the market share belongs to  $\leq$  six firms.
- **Fragmented:**  $\geq 50\%$  of the market share belongs to  $>$  six firms.

#### **Pricing Power**

- **Concentrated:** top one or two firms as price makers or reports and exhibits of cartel pricing.
- **Fragmented:** competitive pricing.

Competitive pricing can inter alia be observed when Chinese companies compete with each other in bidding for state-funded ODA projects or in fighting for market share (Gill and Reilly 2007; Norris 2016).

## 2.3 Relational Variables

### 2.3.1 Overview Relational Variables

To evaluate the relationship between state and commercial actors, Norris (2016, 28) suggests examining their reporting relationship, the compatibility of their intrinsic goals and the relative distribution of resources. The analysis of relational variables in this thesis refers to the Chinese state or parts of the state as principals on the one hand and to the two Chinese companies as agents on the other hand (Norris 2016).

### 2.3.2 Independent Variable: Reporting Relationship

An important aspect for the relational dimension of the analytical framework is the reporting relationship between principal and agent (Norris 2016, 28).

#### **Values**

The values of this IV range from a direct to an indirect reporting relationship between state and commercial actor. The principal-agent theory suggests that the level of state control is increased by a direct reporting relationship (Norris 2016, 237).

#### **Indicators**

The nature of the reporting relationship between principal and agent is determined by the commercial actor's ownership, management and financing structure. The evaluation of the respective indicators is guided by the observable evidence outlined below (Norris 2016, 237):

#### **Ownership Structure**

- “Does the state have a controlling interest in the ownership of the economic actor?”
- Is the economic actor entirely or majority held by the state?
- Is there no state ownership at all?” (Norris 2016, 237)

To assess the Chinese state's controlling interest in an economic actor, SASAC's classification of strategic, pillar and basic industries is taken as a reference. With this classification, the Chinese government sought to reaffirm its control over strategic companies and sectors, while easing its influence over non-strategic enterprises. This categorisation therefore provides a useful proxy for the state's interest in controlling a particular company. In addition, higher state ownership in a commercial actor indicates a more direct reporting relationship (Norris 2010, 191; Reilly 2021, 44).

### Management Structure

- “Are the individuals state employees?”
- Are senior posts in the entity appointed by the Organization Department of China’s Communist Party or another government body?
- Does the firm have to report to SASAC, the State Council, or some other portion of the Chinese party-state?
- Is there an explicit consultative role for the state in firm decision making?
- Does the firm operate in a heavily regulated sector?” (Norris 2016, 237)

To evaluate the agent’s regulatory environment, the concept of the “tiered-economy” is applied (Pearson 2015).

Overall, if the questions outlined above can be answered in the affirmative, a greater involvement of the government in the firm’s management is to be expected, thus suggesting a more direct reporting relationship between principal and agent (Norris 2016, 237).

### Financing Structure

- Does the agent receive funds or other resources from the government (e.g., through the state budget)?
- If yes: does the agent receive the majority of its financing through state resources?
- What are the alternative funding sources for the agent?

The nature of the reporting relationship also depends on the financial involvement of the state, with a high financial dependence of the commercial actor suggesting a more direct reporting relationship with the state (Norris 2016, 237). Conversely, enterprises that are able to generate most of their funding through alternative channels, such as public markets or retained profits, can reduce their financial dependency on the Chinese state (Reilly 2021, 57).

#### 2.3.3 Independent Variable: Intrinsic Goal Compatibility

Referring to the principal-agent problem, Norris (2016, 238–39) argues that frictions should naturally be lower when the personal interests of the commercial actors correspond with the interests of the state.

### Values

The manifestations for this IV range from highly complementary to highly divergent. As for the remaining variables, there are numerous conceivable values in between these two extremes. However, to simplify the analysis and classification of the empirical evidence, it is

recommended to distinguish only between “divergent” and “convergent” objectives (Norris 2016, 238–39).

### **Indicators**

To assess the value of the IV, it is necessary to examine the respective motives of principal and agent, the process of goal definition and the exclusivity of their objectives (Norris 2016, 239).

The single indicators, including several questions that help to gather empirical evidence, are further discussed below (Norris 2016, 238–39):

#### **Goal Motives**

- Do agents “face strong, short-term oriented profit incentives that force it to optimize its activities for maximum returns?” (Norris 2016, 239).
- Does the government pursue strategic and political or rather commercial interests?

If the empirical evidence points to a highly short-term incentivised commercial actor but a rather politically and strategically oriented government, their respective “motives” ought to be classified as divergent (Norris 2016, 239).

#### **Goal Definition**

- Is the government significantly involved in the goal formulation process of the agent, e.g., through close affiliation of the top management with the Chinese Communist Party (CCP)?
- Has the state regulatory means to “substantially alter the firm’s commercial success through discretionary authority” (Norris 2016, 239)?

One way through which the state’s influence on the goal formulation process may be evidenced is a parallel political career of the commercial actor’s top management, e.g., its chairman. According to Norris (2016, 81), the correlation between a successful political career in the CCP and the management decisions of high-level company executives creates strong incentives for them to “toe the party line and avoid acting against the wishes of the state.”

Overall, a state that is significantly involved in the agent’s goal definition process or has the regulatory power to determine the economic success of the company indicates greater goal convergence between principal and agent (Norris 2016, 239).

### Exclusivity of Goals

- Intrinsic convergence: goals are complementary.
- Intrinsic divergence: goals are mutually exclusive.

The strategic interests of the state and the commercial interests of the agent (e.g., profit maximisation or market access) are not necessarily mutually exclusive. In fact, it may even increase the chance of the state to achieve its objectives “because motivating the commercial actor to pursue goals that are complementary to what it would like to do anyway is fairly easy” (Norris 2016, 239). However, it is also important to note that if the intrinsic objectives of principal and agent diverge, so do their respective priorities. This raises the possibility that the agent’s prioritisation of its own short-term goals ultimately compromises the principal’s political interests, thus making the respective goals mutually exclusive (Norris 2016, 85).

### 2.3.4 Independent Variable: Relative Resources

The evaluation of the relational dimension between principal and agent is complemented by the relative distribution of resources (Norris 2016, 28).

### Value

The value of the IV “Relative Resources” can be in favour of either the principal or the agent. Relative resources favouring the principal enable easier state control over commercial actors (Norris 2016, 237).

### Indicators

To assess the relative balance of resources, it is necessary to examine the distribution of human capital and knowledge, the available workforce of principal and agent as well as the volume of their respective financial budgets (Norris 2016, 237).

These indicators are to be approached as outlined below (Norris 2016, 238):

### Human Capital & Knowledge

- Is the principal experienced enough to regulate the agent in its specific field?
- Does the agent possess any non-accessible technical know-how?
- Does the agent operate in a fast-developing industry that makes it hard for outsiders to keep track with the current state-of-the-art technology?

A useful indicator to evaluate whether the agent holds any exclusive technical expertise is the general development mechanism of the respective industry. A development that is mainly led

and dictated by the firms themselves is indicative of the technical expertise being tilted in favour of the commercial actors. Conversely, if the state acts as the main driver for the development of an industry, it can be assumed that the state is also familiar with the relevant technological specifications and trends (Norris 2016, 61). Overall, an agent holding exclusive technical know-how in a rapidly developing industry compared to a rather inexperienced principal would suggest a resource balance in favour of the agent (Norris 2016, 237).

#### Personnel Count

- Is there enough manpower on behalf of the principal to supervise the agent and enforce the desired behaviour?

#### Budgeted Endowments

- Are the financial budgets of the principal and agent roughly on the same level?
- Does their respective budget allocation “provide any other relevant information that can speak to the ability of the state to control the commercial actors?” (Norris 2016, 237).

As for the latter two indicators, an understaffed and underfinanced governmental agency is less likely to appropriately exercise supervision and assert the desired behaviour on the agent (Norris 2016, 237). For the purpose of this study, the comparison is narrowed down to the agents’ formal regulators, such as for example SASAC or the “Department of Foreign Aid” (Norris 2016, 81). The Department of Foreign Aid is adjunct to the Ministry of Commerce (MofCom) and “takes direct responsibility for the safety and quality of construction in China’s aid projects” (Gill and Reilly 2007, 43). To gain an understanding of the financial endowment of the agents, the focus within this thesis is shifted on commercial indicators, such as the agent’s annual revenue, profits or expenditures (budgets) (Norris 2010; 2016).

### 2.4 State Actor Variable: Unity of the State

The ability of a state to control commercial actors also relies on its internal unity (Norris 2016, 27–28). An internally divided Chinese state may not even be able to reach a consensus on its strategic goals in the first place, and even less be able to operationalise them through steering commercial actors (Norris 2016, 223).

#### Values

The spectrum in which this IV varies ranges from “fragmented” to “unified”, with state control being more likely if the government acts in a unified manner (Norris 2016, 237).

## Indicators

The variations in a government's unity derive from three sources, namely bureaucratic divisions, competition among personal and ideological factions as well as geographical frictions (Norris 2016, 236).

The indicators are evidenced as illustrated below (Norris 2016, 236–37):

### Bureaucratic and Institutional Friction

- “bureaucratic reorganizations,
- contests over jurisdiction in a particular issue area or topic, and
- classic organizational competitions for budget and personnel.” (Norris 2016, 236)

### Contest among Personal or Ideological Factions

- “promotion patterns,
- purges,
- elite networks and known rivalries,
- corruption cases, and
- a host of other publicly observable manifestations of ideological inclinations and personal ties at the top of the Chinese state hierarchy.” (Norris 2016, 236)
- Top-level guidance on a certain issue area (Norris 2016, 82).

To capture personal and ideological factions, special attention is paid to China's factional groups within the political system, such as the Shanghai Gang or the Chinese Communist Youth League (CCYL), including their representation in important governmental bodies (Norris 2016, 48–50). However, Norris (2016, 82) further emphasises that state unity can be demonstrated by high-ranking officials focusing on a certain issue area. It is argued that through such top-level guidance, other divisions in the state's unity, for example at a personal or institutional level, can effectively be overcome. Therefore, frequent state visits or meetings of Chinese officials with officials of the respective target country serve as a useful indicator.

### Geographical Division

- centre-local tensions.
- tensions among local governments of rich and poor provinces.

Evidence as outlined above, particularly with regard to the context of the specific inducement project, would indicate a rather fragmented government (Norris 2016; A. Wong 2018).

## 2.5 Overview of the Final Framework

The final framework applied in this thesis is illustrated in Table 3:

Level of Analysis	Independent Variable	Indicators	Observable Evidence
<b>Economic Actor</b>	<b>Market Structure (Sender State)</b> Concentrated – Fragmented	Number of Firms	<b>Concentrated</b> 1-3 non-competitive, monopolistic firms.
			<b>Oligopolistic</b> > 2 competing firms; no upper limit defined, depends on market share and pricing power.
		Market Share	<b>Concentrated</b> ≥ 50% of market share belongs to ≤ 6 firms.
			<b>Fragmented</b> ≥ 50% of market share belongs to > 6 firms.
		Pricing Power	<b>Concentrated</b> Top 1-2 firms as price makers or reports and exhibits of cartel pricing.
			<b>Fragmented</b> Competitive pricing (e.g., competitive bidding).
<b>Relational Variables</b>	<b>Reporting Relationship</b> Direct – Indirect	Ownership Structure	Is there any state interest in controlling the agent (e.g., is the firm operating in a strategic or pillar industry)?  Is the commercial actor entirely or majority held by the state?
		Management Structure	“Are the individuals state employees?  Are senior posts in the entity appointed by the Organization Department of China’s Communist Party or another government body?  Does the firm have to report to SASAC, the State Council, or some other portion of the Chinese party-state?  Is there an explicit consultative role for the state in firm decision making?  Does the firm operate in a heavily regulated sector?” (Norris 2016, 237)
		Financing Structure	Does the agent receive funds or other resources from the government (e.g., from the state budget)?  If yes: does the agent receive the majority of its financing through state resources?  Are there alternative financing sources for the agent (e.g., equity markets or retained profits)?



Level of Analysis	Independent Variable	Indicators	Observable Evidence
<b>Relational Variables</b> (continued)	<b>Intrinsic Goal Compatibility</b> Convergent – Divergent	Goal Motives	Agent's short-term, commercial goals vs. principal's strategic and political goals.
		Goal Definition	State plays a role in defining the agent's goal (e.g., through managing executives' political career) or can "alter the firm's commercial success through discretionary authority" (Norris 2016, 81, 239).
		Exclusivity of Goals	Mutually exclusive vs. complementary? What were the priorities of principal and agent?
	<b>Relative Resources</b> Favouring State – Favouring Agent	Human Capital & Knowledge	Does the agent possess any non-accessible technical know-how? Is the principal experienced enough to regulate the agent in its specific field? Does the agent operate in a fast-developing industry that makes it hard for outsiders to keep track with the current state-of-the-art technology?
		Personnel Count	Are there enough personnel to monitor and control the agent?
		Budget Endowments	Does one financial budget outnumber the other?
	<b>State Actor</b>	<b>State Unity</b> Unified – Fragmented	Bureaucratic & Institutional Friction
Personal & Ideological Factions			<b>Observable Patterns (Fragmented)</b> Promotion patterns, purges, elite networks, known rivalries, corruption, ideological struggles, divided political focus.
Geographic Division			<b>Observable Patterns (Fragmented)</b> Centre-local tension. Rich-poor tensions.

Table 3: Overview of the Analytical Framework

Source: Structure of the Framework based on Norris (2010; 2016). Author's design.

As mentioned before, the analysis of the IV "Market Structure" refers to Chinese enterprises in the Chinese market. Likewise, the relational variables cover the relationship between the Chinese state (or parts of the Chinese state) on the one hand and the two Chinese enterprises responsible for executing the infrastructure projects on the other.

# Chapter 3: Empirical Evidence

## 3.1 Introduction

Chapter 3 starts with a concise outline of the two case studies analysed within this thesis. Thereafter, the empirical evidence for the respective cases is collected in accordance with the framework outlined in Chapter 2.

## 3.2 Case Outline

This section offers a brief case outline of the Chinese economic inducement strategy towards the Philippines. Following Mastanduno’s (1999) definition, a clear distinction between the tactical and structural level of the strategy is made. Overall, this thesis analyses two Chinese inducement cases:

1. The North Luzon Commuter Railway (NorthRail)
2. The National Broadband Network (NBN)

In doing so, the two projects are considered as part of both the tactical and structural dimension of China’s economic inducement strategy towards the Philippines (Mastanduno 1999, 303–4) (see Figure 4):

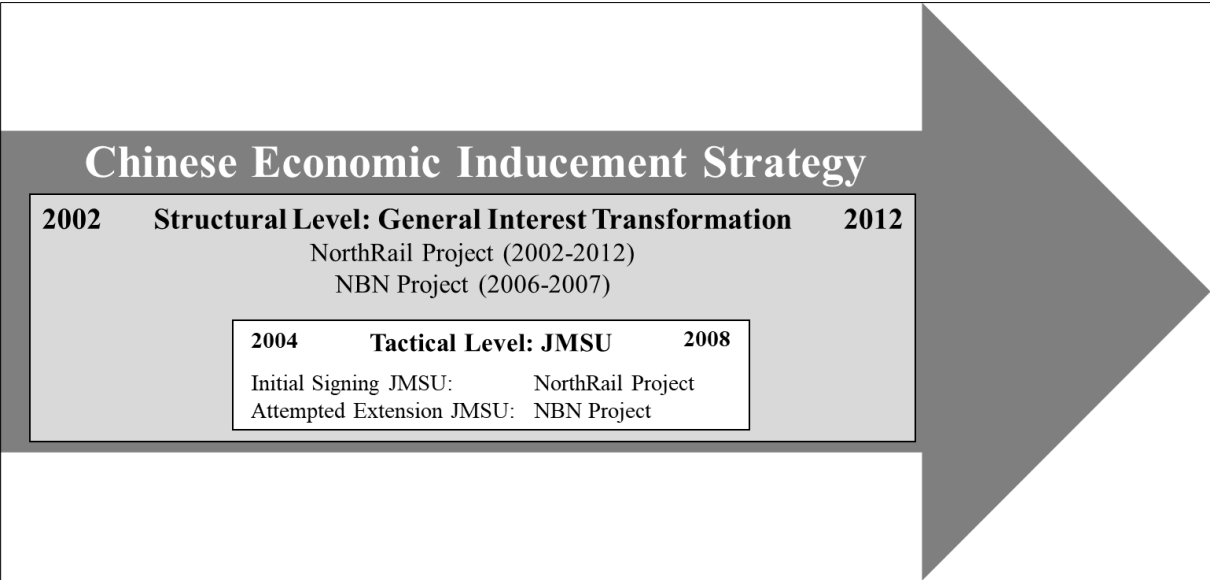


Figure 4: Overview of the Chinese Economic Inducement Strategy  
 Source: Author’s design based on De Guzman (2014); Baviera (2016); A. Wong (2019b) and A. C. Wong (2019).

The relationship between the projects and the structural and tactical level of the strategy is further explained below.

### **Structural Level**

On a structural level, the Chinese economic inducements vis-à-vis the Philippines were aimed at altering the Philippines' position in the South China Sea dispute in general (A. Wong 2019b, 18). To change the Philippines' policy preferences, Beijing offered economic inducements in the shape of two infrastructure projects, namely the construction of the NorthRail as well as the development of the NBN (Landingin 2010; Baviera 2016; Gong 2017; A. Wong 2019b).

Hence, the NorthRail and the NBN project are considered as the core elements in China's efforts to structurally transform the Philippines' policy on the South China Sea. Therefore, both projects are analysed according to the framework presented by Norris (2016), aiming to identify the level of state control in each case. As a consequence, to evaluate the impact of state control on the effectiveness of China's structural economic inducement strategy and therefore to answer the second part of the research question, the results of both case studies are used (A. Wong 2019b).

The timeframe of China's structural inducement strategy subject to this analysis moreover corresponds with the period of the NorthRail project, which stretched from 2002 to 2012 and thus also covered the NBN deal (2006-2007) (A. Wong 2019b).

### **Tactical Elements**

However, China's structural inducement strategy also entailed tactical "quid-pro-quo" elements, which were defined as the exchange of economic inducements for specific political concessions (Mastanduno 1999). The Philippines' most crucial political concession to China was the controversial Joint Marine Seismic Undertaking (JMSU) (A. Wong 2019b).

The initially bilateral contract between China and the Philippines was concluded in September 2004 and enabled their respective national oil companies to conduct a joint seismic journey in the South China Sea (Storey 2008, 7). The total area of the agreement covered 142,886km<sup>2</sup> and included not only disputed territory claimed by China and the Philippines but also by Vietnam<sup>8</sup> (see Figure 5) (De Guzman 2014, 74):

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<sup>8</sup> Due to the scope of this thesis, the role of Vietnam is not further elaborated on.



Figure 5: The Scope of the JMSU  
 Source: De Guzman (2014, 74).

The specific location of the JMSU was initially held under disclosure but became public in early 2008 (International Crisis Group 2016). Not only did the JMSU enable China to conduct operations within the 200-nautical-miles radius of the Philippines’ claimed exclusive economic zone (Camba 2017, 7), “approximately one-sixth of the area designated for the seismic survey lay within Philippine territorial waters, and outside the claims of both China and Vietnam” (Storey 2008, 8). Thus, President Arroyo (Philippines) was accused of having made “breath-taking” concessions to China with regard to the South China Sea (Wain 2008, 46–47).

To make the Philippines agree to the JMSU in the first place, China provided substantial economic inducements (De Guzman 2014, 92; Yung and McNulty 2015, 290). In 2004, China approved to provide US \$400 million out of the US \$503 million estimated for the first phase of the NorthRail project (Landingin 2010, 87; Kang 2010; Dreher et al. 2017). The NorthRail project is therefore seen as a crucial element when it comes to the initial signing of the JMSU (Baviera 2016, 113). The timing of the JMSU, just a few days before the NorthRail project was

sealed, suggests that it “was signed at a time when Chinese influence was peaking in Manila” (Bower 2010, 4). Chinese government officials were even quoted saying “No JMSU, no Northrail” (De Guzman 2014, 92).

Nevertheless, in 2008, the Philippine government eventually decided to refrain from renewing the agreement (Goh 2011, 21). Ahead of the cancellation, the Chinese government offered additional economic inducements to persuade the Philippines to extend the JMSU, most crucially a US \$329.5 million loan for the NBN project in 2007 (De Castro 2010; Baviera 2016; A. Wong 2019b).<sup>9</sup> As such, while being integral to Beijing’s structural inducement strategy to change the Philippines’ policy preferences in general, the NBN project is also tightly connected to the JMSU and therefore the tactical level of China’s inducement efforts (A. C. Wong 2019, 186; A. Wong 2019b).

### **Summary of the Case Outline**

China’s structural inducement strategy to change the Philippines’ policy preferences and thus assert its own territorial claims over the South China Sea was driven by two specific infrastructure deals, namely the NorthRail and the NBN project (Kang 2010; A. Wong 2019b). At the same time, both projects also played a vital role with regard to the signing and further development of the JMSU (A. C. Wong 2019, 186; A. Wong 2019b).

In conclusion, the NorthRail and the NBN project were highly crucial components of the Chinese economic inducement strategy towards the Philippines at both the structural (general interest transformation) and tactical (JMSU) level (Bower 2010; Goh 2011; Yung and McNulty 2015; De Guzman 2014; Baviera 2016; A. Wong 2019b).

Accordingly, to answer the first part of the research question and to assess the *level of Chinese state control over commercial actors during the economic inducement efforts towards the Philippines*, the analytical framework is applied to the NorthRail and the NBN project.

Moreover, to address the second part of the research question and to evaluate the *impact of the level of state control on the effectiveness of Chinese economic inducements*, the findings produced by the analytical framework are leveraged as outlined in Table 4:

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<sup>9</sup> The NBN project intended to “establish an e-government presence throughout the country by linking 2,295 national offices and 23,549 village and municipal offices” (A. Wong 2019b, 23).

Strategy Level	Cases	Objectives	State Control (DV)?	Impact of State Control on...	
<b>Short-term</b> (Tactical)	NorthRail	Signing of JMSU.	Findings of the analytical framework	Short-term, tactical effectiveness. → <b>signing of JMSU</b>	
	NBN	Extension of JMSU.		Short-term, tactical effectiveness. → <b>extension of JMSU</b>	
<b>Long-term</b> (Structural)	NorthRail	Change of the Philippines' policy preferences regarding the South China Sea in general.		Findings of the analytical framework	Long-term, structural effectiveness.
	NBN				→ <b>general interest transformation</b>

Table 4: Impact of the Cases on the Effectiveness of the Chinese Inducement Strategy  
Source: Author's design.

In a first step, the extent of Chinese state control in the NorthRail and the NBN project is determined. Next, the impact of the level of state control on the effectiveness of China's economic inducement strategy is evaluated. By distinguishing between short-term (tactical) and long-term (structural) effectiveness and the respective impact of state control on these, the research question is answered in a nuanced and comprehensive way (Mastanduno 1999; Norris 2010; 2016).

### 3.3 Case Study #1: The NorthRail Project

#### 3.3.1 Economic Actor Variable: Market Structure

Within this section, empirical evidence for assessing the economic actor variable in the NorthRail case is gathered. The NorthRail project was officially managed by the North Luzon Railway Corporation (NLRC), a state-run firm from the Philippines. After signing a Memorandum of Understanding (MoU) for conducting a feasibility study in late 2002, the project was eventually contracted by the China National Machinery and Equipment Group in December 2003 (CNMEG, also known as Sinomach) (Landingin 2010, 87; Supreme Court, Republic of the Philippines 2012).

Considering the objective of analysing the IV “Market Structure”, namely to identify alternative commercial actors available to the state, the data collection is narrowed down to the years from the signing of the MoU (2002) to the final contracting of the project (2003 and 2004) (Norris 2016, 27).<sup>10</sup> If relevant, this information is complemented by additional evidence from previous or subsequent years.

In accordance with the analytical framework, the indicators to be examined include the number of firms, the concentration of the market share as well as the pricing dynamics in the Chinese railway construction industry.

#### **Number of Firms**

To determine the number of firms that could potentially compete with CNMEG for the NorthRail project, the data collection relies on two pillars, namely the Engineering News Record (ENR) ranking from 2005 as well as complementary qualitative evidence. It should be noted, however, that the ENR ranking of 2005 only covers the year 2004, while the year 2003 is only partially included. Unfortunately, earlier rankings were not or only partially accessible to the author.

According to the Chinese government, there were more than 47,500 registered construction companies between 2002 and 2004 (National Bureau of Statistics of China 2011). Arguably, this number is irrelevant for the analysis of this indicator, as contracting overseas construction and railway projects requires not only a certain company size, but also proven experience and qualifications in that particular field (Gill and Reilly 2007; China Railway Construction Engineering Group n.d.).

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<sup>10</sup> As the project was contracted only in December 2003, also the year 2004 will be covered in the analysis.

In an effort to include only companies of a relevant size in this analysis, the ENR rankings are leveraged. As of 2000, a total of 35 Chinese enterprises were listed in the ENR “Top 225 International Contractors” report, which ranks the firms according to construction revenue generated overseas. This number eventually increased to 49 companies in 2004 (Lan 2010, 1).

With respect to total construction revenue (domestic and abroad), a total of 22 Chinese companies were among the “Top 225 Global Contractors” in 2004, up from 18 in 2003 (Reina and Tulacz 2005, 48–63). In 2004, CNMEG ranked twelfth among the Chinese companies, generating the majority of its revenues abroad (62%) (see Table 5):

<b>The Top 225 Global Contractors (Chinese Enterprises in the ENR Ranking 2005)</b>								
Global Rank	Year*	Name of Enterprise	Contracting Gross Revenue, in million US \$ [2004]		New Contracts in 2004, in million US \$	Market Share [2004]		
			Total	International		[acc.]		
11	14	China Railway Engineering Corp.	11,612.6	678.6	16,881.0	17%	17%	
15	15	China Railway Construction Corp.	10,493.2	48.3	17,668.9	16%	33%	
17	16	China State Construction Eng'g Corp.	10,271.7	2,124.3	13,957.5	15%	49%	
27	28	China Metallurgical Constr. Corp.	6,003.0	197.0	7,973.0	9%	58%	
31	40	China Harbour Engineering Co.	4,429.7	925.2	5,580.3	7%	64%	
40	41	Shanghai Constr. (Grp.) General Co.	3,810.8	381.2	3,683.2	6%	70%	
48	56	China Road & Bridge Corp.	2,990.7	290.6	4,044.3	4%	75%	
49	53	Sinohydro Corp.	2,989.9	303.2	4,639.2	4%	79%	
59	83	Beijing Construction Eng'g Group Co.	2,224.5	37.9	1,995.2	3%	82%	
73	78	Zhejiang Constr. Invest. Group Co.	1,909.1	118.8	2,213.1	3%	85%	
78	54	Beijing Urban Construction Group Co.	1,685.9	15.1	2,743.9	3%	88%	
<b>96</b>	<b>100</b>	<b>China National Machinery &amp; Equipment Group</b>	<b>1,138.0</b>	<b>708.0</b>	<b>1,792.0</b>	<b>2%</b>	<b>90%</b>	
99	104	Beijing Uni-Construction Group Co.	1,093.8	37.0	546.5	2%	91%	
102	116	China National Chemical Eng'g Corp.	1,042.0	192.0	1,462.0	2%	93%	
113	121	Shandong Electric Power Constr.	935.9	188.4	1,298.1	1%	94%	
114	152	China Gezhouba Construction Co.	932.2	59.4	1,052.2	1%	96%	
134	**	Beijing Municipal Engineering Group Co.	689.1	40.6	896.0	1%	97%	
142	**	Guangdong Xinguang Int'l Group	611.4	73.9	478.1	1%	98%	
169	147	China Petroleum Eng'g & Constr. Corp.	500.2	500.2	670.7	1%	98%	
198	188	China Civil Engineering Constr. Corp.	407.8	379.7	381.8	1%	99%	
215	**	Sei Engineering Inc.	361.7	46.5	825.4	1%	99%	
222	**	Xinjiang Beixin Constr. & Eng'g Co. Ltd.	352.7	16.9	366.3	1%	100%	

\* Year refers to the actual calendar year.  
 \*\* Not represented.  
 [acc.] = accumulated

Table 5: ENR Ranking 2005: “Top 225 Global Contractors”  
 Source: Reina and Tulacz (2005). Design, ranking and calculation of the market share done by the author.



Consequently, measured by revenue generated abroad, CNMEG ranks third among the Chinese companies (see Table 6):<sup>11</sup>

<b>The Top 225 International Contractors (Chinese Enterprises in the ENR Ranking 2005)</b>								
Global Rank	Year*	Name of Enterprise	Contracting Gross Revenue, in million US \$ [2004]		New Contracts in 2004, in million US \$	Market Share [2004]		
			International	Total		[acc.]	[acc.]	
17	17	China State Construction Eng'g Corp	2,124.3	10,271.7	13,957.5	24%	24%	
39	36	China Harbour Engineering Co.	925.2	4,429.7	5,580.3	10%	35%	
<b>47</b>	<b>37</b>	<b>China National Machinery &amp; Equipment Group</b>	<b>708.0</b>	<b>1,138.0</b>	<b>1,792.0</b>	<b>8%</b>	<b>43%</b>	
48	48	China Railway Engineering Corp.	678.6	11,612.6	16,881.0	8%	50%	
58	54	China Petroleum Eng'g & Constr. Corp.	500.2	500.2	670.7	6%	56%	
68	50	Shanghai Constr. (Grp.) General Co.	381.2	3,810.8	3,683.2	4%	60%	
69	63	China Civil Engineering Constr. Corp.	379.7	407.8	381.8	4%	65%	
81	81	Sinohydro Corp.	303.2	2,989.9	4,639.2	3%	68%	
84	71	China Road & Bridge Corp.	290.6	2,990.7	4,044.3	3%	71%	
101	98	China Metallurgical Constr. Corp.	197.0	6,003.0	7,973.0	2%	73%	
102	112	China National Chemical Eng'g Corp.	192.0	1,042.0	1,462.0	2%	76%	
103	97	China Int'l Water & Electric Corp. (Cwe)	190.2	274.7	568.3	2%	78%	
105	99	Shandong Electric Power Constr.	188.4	935.9	1,298.1	2%	80%	
116	105	China Wanbao Engineering Corp.	130.5	130.5	182.0	1%	81%	
121	110	Zhejiang Constr. Invest. Group Co.	118.8	1,909.1	2,213.1	1%	83%	
123	109	China Jiangsu Int'l Econ-Tech. Coop.	110.1	170.6	248.2	1%	84%	
126	135	China National Overseas Eng'g Corp.	97.5	100.6	197.9	1%	85%	
131	**	China Nat'l Machinery Import & Export Corp.	92.4	92.4	110.2	1%	86%	
139	117	Harbin Power Engineering Co. Ltd	82.1	147.8	153.3	1%	87%	
142	124	China Wu Yi Corp. Ltd.	79.5	183.1	194.0	1%	88%	
...	...	....	...	...	...	...	...	
156	142	China Camc Engineering Co. Ltd.	57.4	57.4	36.4	1%	92%	
201	**	China Electric Power Tech. Import & Export	22.6	42.2	-	0%	99%	
209	199	China Shenyang Int'l Eco. & Tech. Coop.	17.1	30.4	60.5	0%	99%	
...	...	....	...	...	...	...	...	

\* Year refers to the actual calendar year.  
 \*\* Not represented.  
 [acc.] = accumulated

Table 6: ENR Ranking 2005: “Top 225 International Contractors”

Source: Reina and Tulacz (2005). Design, ranking and calculations of the market share done by the author.

After distinguishing by company size, the ENR ranking suggests that the number of companies eligible for contracting overseas construction projects is likely to have been between 18 and

<sup>11</sup> Table 6 only shows the top 20 (+3) companies. The “+3” were added as those companies have been active in the Philippines in 2004.

49.<sup>12</sup> Yet, despite the rather high number of companies operating in (overseas) construction, it is noteworthy that contracting railway projects requires the firms to hold the “Special-Grade Qualification for General Contracting of Railway Projects” (China Railway Construction Engineering Group n.d.). Accordingly, to accurately display the relevant market structure and capture CNMEG’s competitors, only the companies that were entitled to contract railway projects ought to be considered.

However, determining which construction enterprises were in possession of the special-grade qualification between 2002 and 2004 proves challenging, as Chinese enterprises regularly change names or reorganise into different entities. For instance, the China Harbour Engineering Company and the China Road and Bridge Corporation (CRBC) were merged into the China Communications Construction Corporation (CCCC) in 2005 (Prasso 2018). According to company information, CCCC does have the required special-grade qualification, but it is not stated whether the two subsidiaries were in possession of such a qualification prior to the merger. This makes it difficult to determine whether or not they were in a position to actually compete for the NorthRail project (CCCC n.d.; CRBC n.d.).

As such, alternative approaches for identifying potential competitors need to be pursued. One way of doing so is to capture comparable Chinese railway projects starting from 2002 onwards, thus gaining an understanding of companies that evidently have been able to execute projects such as the NorthRail (Dreher et al. 2017).

In 2002, for instance, the China National Technical Import and Export Corporation and the China National Machinery Import and Export Corporation signed a MoU with the Philippines for the rehabilitation and construction of the Mainline South Railway (Dreher et al. 2017).

In 2005, the China Railway Construction Corporation contracted a US \$1.27 billion high-speed railway project in Turkey (Ohashi 2013, 90). One year later, the firm signed an agreement for the reconstruction of a railway in Angola (Dreher et al. 2017).

In the same year, a railway project in Gabon was contracted to the China Railway Engineering Corporation. One year later, the company agreed to construct a railway in Sudan (Foster, Butterfield and Chen 2009, 95–96).

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<sup>12</sup> This figure is based on the lowest and the highest number of Chinese companies represented in the 2005 ENR ranking in terms of international and global revenue (Reina and Tulacz 2005).

In 2006, the China Civil Engineering Construction Corporation was contracted in order to pursue the modernisation of the Nigerian Railway, while Guangdong Xinguang International Group was involved in the Abuja Rail Mass Transit Project. In 2007, Transtech Engineering agreed to construct a 430km railway in Mauritania (Foster, Butterfield, and Chen 2009, 95–96).

However, in addition to the mere number of the firms, it is also necessary to examine their competitive relationship (Norris 2016). While this particular aspect is further addressed in the section on the pricing behaviour, it can be stated that the Chinese companies regularly engaged in fierce competition with each other when contracting ODA projects. As such, the firms operating in the railway construction industry can be considered as competitive and thus as rivals (Burke 2007; Hu 2014; Y. Sun 2014).

### **Market Share**

Corresponding with the arguments raised in the previous section and due to the lack of industry-specific data, determining the market share of the Chinese railway construction industry proves challenging.

Therefore, the “market share”<sup>13</sup> among the Chinese enterprises represented in the 2005 ENR ranking is examined. In this regard, both the market share of the global and the international ranking indicate a rather concentrated market.

Out of the 22 Chinese companies listed among the “Top 225 Global Contractors” in 2004, only four account for more than 50% of the total turnover (see Table 5). The same applies to the “Top 225 International Contractors”, with CNMG holding the third largest market share in 2004 (8%) (see Table 6). This general observation is further confirmed by the distribution of new contracts concluded in 2004, with the three largest companies claiming 53% of the future contract volume (Reina and Tulacz 2005).

Yet, with particular attention to the railway construction industry, two aspects need to be considered. First, not all contractors listed by ENR are relevant for the calculation of the industry-specific market share. Second, individual railway construction companies may occasionally not be represented in the ranking. Accordingly, it is not possible to conclusively determine the exact market concentration of the railway construction industry.

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<sup>13</sup> Due to the lack of data, the “market share” is calculated based on the overall annual turnover of the enterprises represented in the respective lists.

## **Pricing Power**

In a final step, the pricing behaviour within the Chinese railway construction industry is examined, serving as indicator for the degree of competition between the firms. Competitive pricing behaviour is reflected, among other things, by Chinese companies competing with each other for state-funded ODA projects or in the fight for market share (Gill and Reilly 2007; Norris 2016).

In this regard, Chinese railway construction firms can be described as highly competitive, especially when it comes to contracting government-led ODA projects (Y. Sun 2014).

In May 2014, for instance, Kenya and China signed an agreement for the funding of the East Africa Railway Project. Prior to the signing ceremony, the two leading competitors “had been attacking each other in the local media on an almost daily basis” (Hu 2014; Y. Sun 2014).

In the same year, China Harbour Engineering Company and China Civil Engineering Construction Corporation engaged in fierce competition for a cross-border rail contract in Kenya and Uganda (Hu 2014). Reportedly, a MoU over US \$1.75 billion signed by China Civil Engineering in 2012 was undercut by a US \$1.25 billion proposal by China Harbour in 2013, causing a “small local political crisis” (Y. Sun 2014).

In conclusion, Hu (2014) argues that when competing for overseas projects, “Chinese firms are facing other Chinese firms.” This view is shared by Burke (2007, 332), who notes that bidding and competition among Chinese construction companies can be “extremely fierce.”

In sharp contrast to the evidence presented above, investigations on the NorthRail project revealed that the contract signed between CNMEG and NLRC has never been subject to an official bidding process. The agreement was therefore seriously overpriced, as the lack of competition in the NorthRail case allowed CNMEG to set the contract parameters, including a bill of quantities, according to its own preferences (Landingin 2010, 88–89).

3.3.2 Relational Variables

3.3.2.1 Reporting Relationship

To assess the IV “Reporting Relationship”, CNMEG’s formal ownership structure, management structure as well as financing structure are examined (Norris 2016). The period under review covers the entire period of the NorthRail project (2002-2012).

**Ownership Structure**

To determine the agent’s ownership structure, two sub-indicators are examined. First, the state’s controlling interest in the agent and second, its formal shareholder structure (Norris 2016; 237).

To answer these questions, a brief look in CNMEG’s company history is necessary. In 1997, following the approval of the State Council, CNMEG was established and assigned to the former Ministry of Machinery Industry (Sinomach 2011). In the course of its “grasp the big and let go of the small” policy, the Chinese government sought to concentrate its resources on “the larger SOEs, while relaxing state control over smaller SOEs” (Mattlin 2007, 8). The enterprises that were not directly assigned to the state “were restructured through sale or lease” (L. Song 2018, 352). Subsequently, CNMEG was listed as one of 520 key-SOEs and therefore directly administered by the central government (Sinomach 2011). In 2003, CNMEG was declared a so-called central SOE and therefore directly managed by the newly established SASAC. SASAC, in turn, is subordinate to the State Council, which therefore illustrates the state’s interest in maintaining control over CNMEG (Mattlin 2007 10; Sinomach 2011) (see Figure 6):

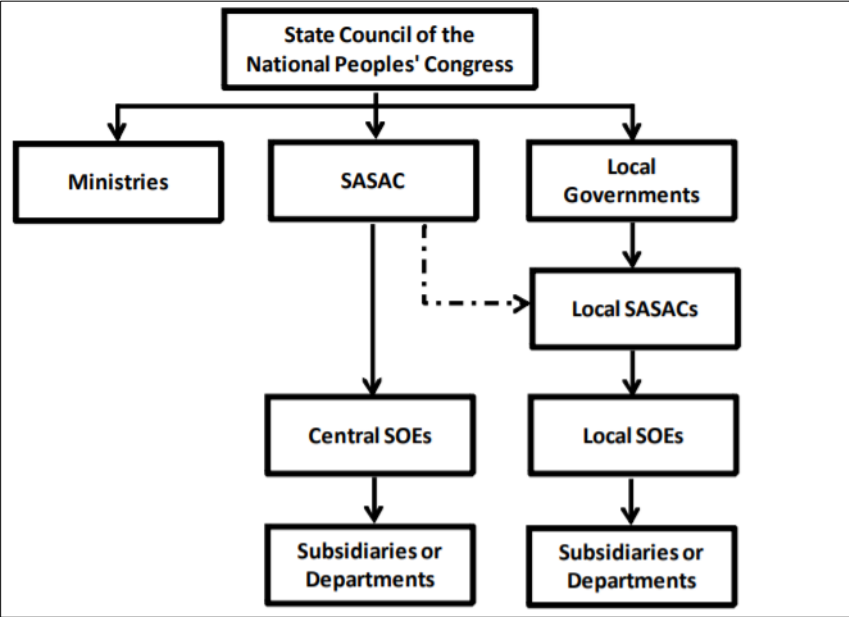


Figure 6: Ownership Structure of Chinese SOEs  
Source: Szamosszegi and Kyle (2011, 6).

Further evidence for the state’s interest in controlling CNMEG may be retrieved from the “Chinese government’s new policy goals on state ownership in key industries”, which were introduced by SASAC (Mattlin 2007, 16) (see Table 7):

Category description	Industries included	Ownership goal	Approximate number of companies
<i>Strategic and key industries</i>	Defence, power generation and distribution, oil & petrochem, telecom, coal, civil aviation, shipping.	Maintaining 100% state ownership or absolute control; increasing state-owned assets in these industries.	40
<i>Basic and pillar industries</i>	Machinery, auto, IT, construction, steel, base metals, chemicals, land surveying, R&D.	Absolute or conditional relative controlling stake; enhancing the influence of state ownership even as the ownership share is reduced where appropriate.	70
<i>Other industries</i>	Trading, investment, medicine, construction materials, agriculture, geological exploration.	Maintaining necessary influence by controlling stakes in key companies; in non-key companies state ownership will be clearly reduced.	50

Table 7: Key Industries as Defined by SASAC  
Source: Mattlin (2007, 16).

Based on the definition provided by SASAC, CNMEG operates in what is considered a “pillar-industry.” Although being listed in a pillar industry theoretically raises the possibility of minority private shareholders, Mattlin (2007, 44) argues that these companies “will be indefinitely off limits to foreign or private control”, thus reaffirming the state’s controlling interest in such enterprises.

As far as CNMEG is concerned, and thus to answer the second sub-indicator, the company does not have any other shareholder besides SASAC and is therefore classified as a wholly state-owned enterprise (100%) (Sinomach 2012, 14).

**Management Structure**

The assessment of a company’s management structure depends on a variety of aspects. These include the legal status of the firm’s employees, its formal reporting structure, the role of the government in firm decision-making and executive appointments as well as the regulatory environment of the industry in which the company operates.

With regard to the legal employee status, the entirety of CNMEG’s 40,000 (2006) staff are classified as state employees (Sinomach 2011; China Economic Review 2014). Turning to the formal management structure, as a central SOE, CNMEG is directly administered and controlled by SASAC, which in turn is subordinate to the State Council (Mattlin 2007, 10).

Accordingly, by reporting to SASAC, CNMEG also reports to the central level of the Chinese party-state (Szamosszegi and Kyle 2011, 5; L.-W. Lin and Milhaupt 2013, 711).

To examine the role of the state in the CNMEG’s decision-making process, a thorough understanding of China’s SOE management approach is required (L.-W. Lin and Milhaupt 2013; L.-W. Lin 2014).

Generally, SOEs are overarched by two parallel systems, the corporate management system and the party system (L.-W. Lin 2014, 754; J. Wang 2014, 657). Thus, in addition to the monitoring structure through SASAC, there exists a “party-based structure that shadows the corporate hierarchy” (see Figure 7) (L.-W. Lin and Milhaupt 2013, 711):

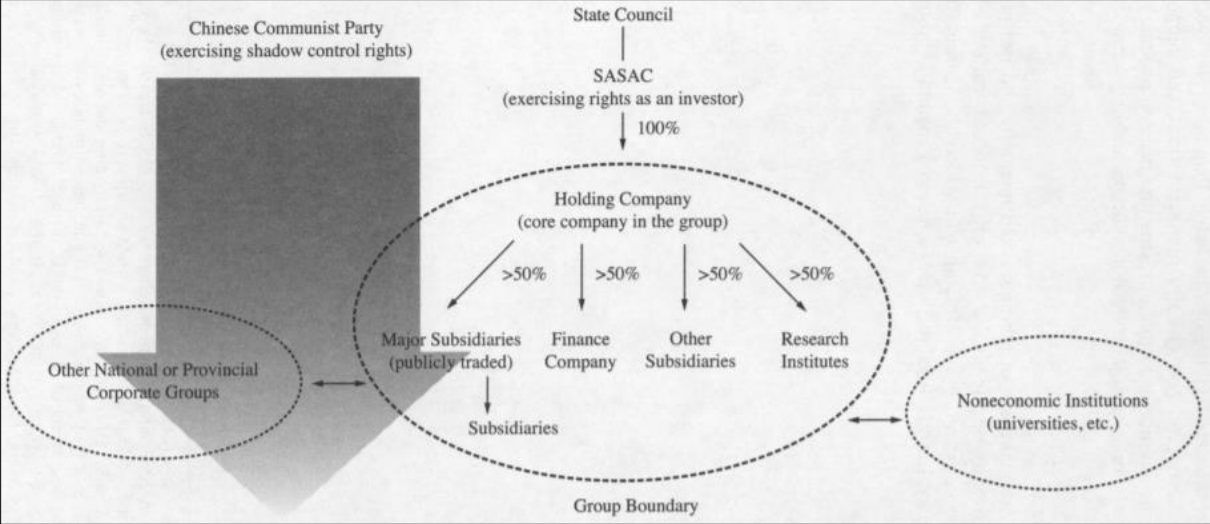


Figure 7: Chinese Management Structure of SOEs  
 Source: L.-W. Lin and Milhaupt (2013, 710).

While the corporate management structure includes positions such as the board of directors, the chief executive officer (CEO) or the chief accountant, the party system comprises the secretary and deputy secretary of the Party Committee as well as the secretary of the Discipline Inspection Commission (L.-W. Lin 2014, 754) (see Figure 8):

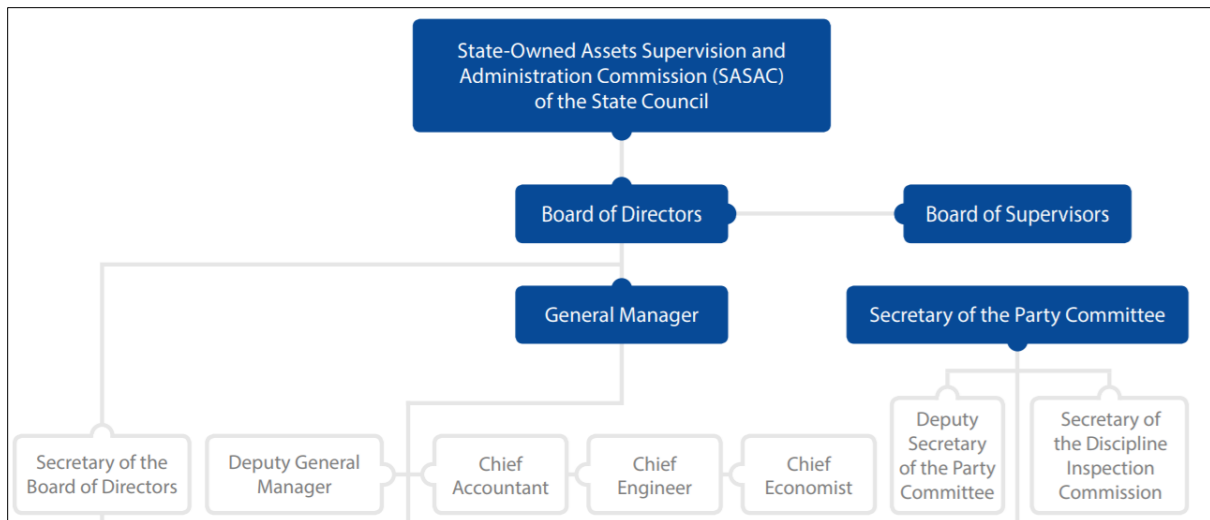


Figure 8: Management Structure of CNMEG (2013)  
Source: Sinomach (2013).

The linkage between corporate and party leadership “aims to ensure consistency between corporate decision-making and party policy” (L.-W. Lin 2014, 754). Consequently, the board of directors or the general manager are obliged to respect and consult the Party Committee’s opinion before making important strategic and material moves (J. Wang 2014, 656). In an attempt to further specify the party’s competence in consulting and supervising SOEs, the CCP announced that such “important strategic and material moves” include matters concerning “the SOE’s development strategy, medium and long-term planning, production and business operation policies [as well as its] annual financial budget” (J. Wang 2014, 656). In view of the far-reaching competences of the Party Committee, it can be concluded that the Chinese state has an “explicit consultative role” in CNMEG’s decision making, thus wielding significant influence over it (J. Wang 2014; Norris 2016).

As a fourth sub-indicator, the state’s role in executive appointments and promotions is examined. In the case of high-ranking SOE employees, such as the board of directors and its chairman, this responsibility is exclusively within the authority of the CCP or SASAC (J. Wang 2014, 653–58). Overall, the CCP and its Organisation Department are responsible for a total of 53 enterprises under the central nomenklatura system, while the remaining SOEs fall under the jurisdiction of SASAC (Brødsgaard 2012, 627). Concerning CNMEG, it should be noted that its chairman Ren Hongbin was appointed to the company’s top in January 2002, one year before SASAC was established (Liu et al. 2020, 13). As prior to SASAC the selection of SOE executives was exclusively determined by various party organs, it can be concluded that his appointment was initiated by the CCP itself (L.-W. Lin and Milhaupt 2013, 737). However, since CNMEG was not among the 53 companies subject to the central nomenklatura system, it can



also be expected that the management, evaluation and promotion of CNMEG executives fell within the responsibility of SASAC from 2003 onwards (Brødsgaard 2012, 635–38; L.-W. Lin and Milhaupt 2013, 738).

In order to determine CNMEG’s regulatory environment and therefore the final sub-indicator, a distinction between top-tier, middle-tier and bottom-tier industries is made. As emphasised in the analytical framework, governmental regulation and control in top-tier industries is expected to be higher than in middle- or bottom-tier industries (Pearson 2015, 32). The top-tier category includes, among others, “most of China’s largest companies in the heavy industry [or sectors such as] construction, banking, and insurance” (Pearson 2015, 32). The middle-tier category, on the other hand, covers companies operating in sectors comprising pharmaceuticals, chemicals, steel, telecommunications equipment and heavy industrial machinery (Pearson 2015, 34). However, Pearson (2015, 32) also underlines that the assignment of individual industries to the three-tier system, just as the assignment of companies to specific industries, is associated with certain ambiguities, especially when it comes to diversified enterprises.

In the case of CNMEG, the information retrieved from SASAC and the company’s website indicates its core business to be focused on sectors such as construction, infrastructure or machinery (Mattlin 2007, 42; Sinomach 2011; n.d.; ChinaDaily 2019). Ultimately, neither the classification provided by SASAC nor the information obtained from government sources allow CNMEG to be clearly assigned to an industry within the tiered-economy system. Nevertheless, considering that CNMEG was contracted to conduct an international infrastructure project and “construction” is listed among the most regulated industries, the assignment of CNMEG to the top-tier category appears to be reasonable (Pearson 2015, 32).

### **Financing Structure**

As a final indicator of the IV “Reporting Relationship”, CNMEG’s financing structure is analysed. If a firm receives most or a substantial part of its funds from the state, the reporting relationship is expected to be more direct. Conversely, enterprises that are able to generate most of their funding through alternative channels, such as public markets or retained profits, tend to have a rather indirect reporting relationship with the state (Norris 2016; Reilly 2021).

Since no comprehensive evidence concerning CNMEG’s financing structure could be retrieved, it is necessary to take a step back and look at studies on the financing structure of SOEs in general (see Figure 9) (K. J. Lin et al. 2020, 40):

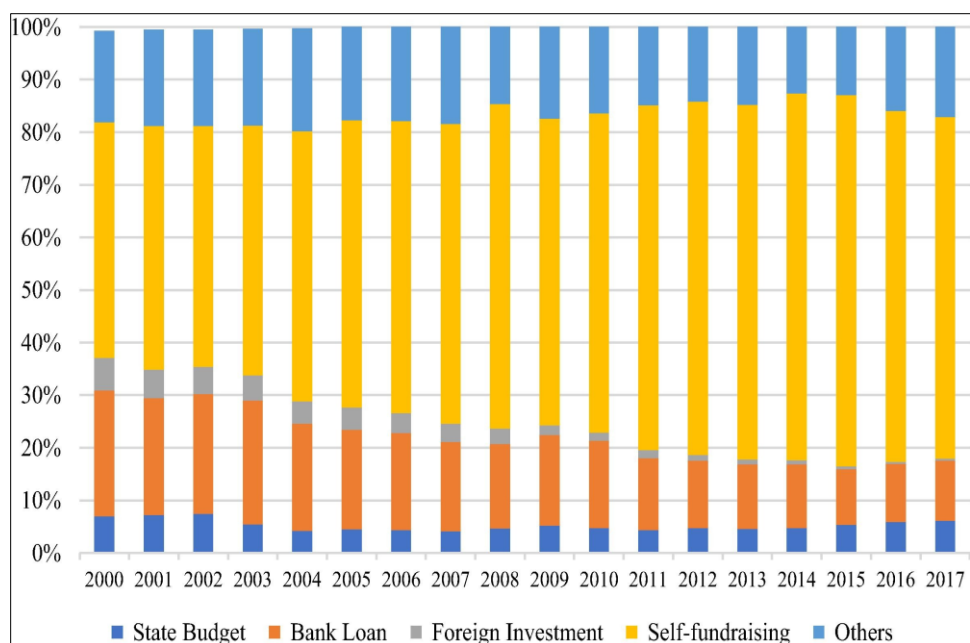


Figure 9: Financing Structure<sup>14</sup> of SOEs (fixed assets)<sup>15</sup>  
 Source: K. J. Lin et al. (2020, 40).

Figure 9 shows that Chinese SOEs mainly rely on national bank loans and self-financing, while the state budget plays a minor role (Allen, Qian and Qian 2005; K. J. Lin et al. 2020). In 2000, self-raised funds accounted for roughly 45% of the firms’ financing, whereas around 25% was obtained through national bank loans. In 2004, the share of self-raised funds eventually exceeded the 50% mark and subsequently continued to grow (K. J. Lin et al. 2020, 40).

However, as it remains unknown to what extent CNMEG received financial support from the state, the focus is shifted to alternative funding sources available to the commercial actor, namely stock markets and the retention of profits (Norris 2016; Reilly 2021). As for the former, CNMEG itself is not publicly listed, thus limiting the firm’s ability to raise funds through stock markets. Nevertheless, as of 2012, CNMEG was the majority owner of eight publicly listed companies, which provides the possibility to internally redistribute the funds raised on stock markets (Mattlin 2007, 13; Sinomach 2011; 2012). Yet, a careful examination of the firm’s corporate structure shows that almost none of the subsidiaries were listed or even part of CNMEG at the start of the NorthRail project (see Table 8):

<sup>14</sup> Self-fundraising is defined as “capital raised from local governments (beyond the state budget), communities, other investors, internal financing channels such as retained earnings, and all other funds raised domestically by the firms” (Allen, Qian, and Qian 2005, 79–80). Accordingly, funds raised at domestic stock markets are taken into account, while stocks issued overseas (including Hong Kong) are considered as foreign investment (National Bureau of Statistics of China 2018).

<sup>15</sup> Fixed asset investments are defined as non-rural capital investments, such as buildings, engineering construction, roads as well as machinery and equipment (Xu 2021; Investing.com n.d.).

Stock Code	Listed Company (2011)	Listing Date	Part of CNMEG (if after listing)
HK00038	YTO (China First Tractor)	1990	2008
SH600710	Changlin	1996	2008
SH600099	Linhai Power	1997	2008
SH600335	Dingsheng Tiangong	2001	2004
SZ002046	ZYS	2005	
SZ002051	Lamce	2006	
SH601798	Lanpec	2011	
HK01829	CMEC	2012	

Table 8: Listed Subsidiaries of CNMEG as of 2012

Sources: China Economic Review Publishing (2004); Sina (2004); Sinomach (2008; 2011; 2012); First Tractor Company Limited (n.d.); Shanghai Stock Exchange (n.d.); China Foma (n.d.); eWorldTrade.com (n.d.); China CAMC Engineering Co. Ltd (n.d.). Author's design.

The first channel to the stock market was created in 2004, when the Tianjin Engineering Machinery Research Institute, a subsidiary of CNMEG, acquired the majority of Dingsheng Tiangong (Sina 2004).<sup>16</sup> CNMEG's access to public markets was further facilitated by the Initial Public Offerings (IPOs) of ZYS (2005) and Lamce (2006), as well as the transfer of YTO and China Foma – including Changlin and Linhai Power – to the company portfolio in 2008. Therefore, based on the development of CNMEG's market access, it may be argued that its self-funding capability increased from 2004 onwards.

However, besides equity markets, retaining profits constitutes another important source of self-financing for companies (Allen, Qian and Qian 2005). In this respect, CNMEG has constantly been profitable throughout the period under review (2002-2012). In 2002, the firm's profit after tax amounted to a total of Renminbi (RMB) 460 million.<sup>17</sup> In the subsequent years, with 2003 being a notable exception, CNMEG's profits constantly increased, surpassing the one billion RMB mark in 2006 until eventually peaking at RMB 8.6 billion<sup>18</sup> in 2012 (see Figure 10):

<sup>16</sup> At the time of the acquisition "Dingsheng Tiangong" was named "China Foreign Construction Development."

<sup>17</sup> Approximately US \$55.5 million in 2002 (National Bureau of Statistics of China 2015).

<sup>18</sup> Approximately US \$1.3 billion in 2012 (National Bureau of Statistics of China 2015).

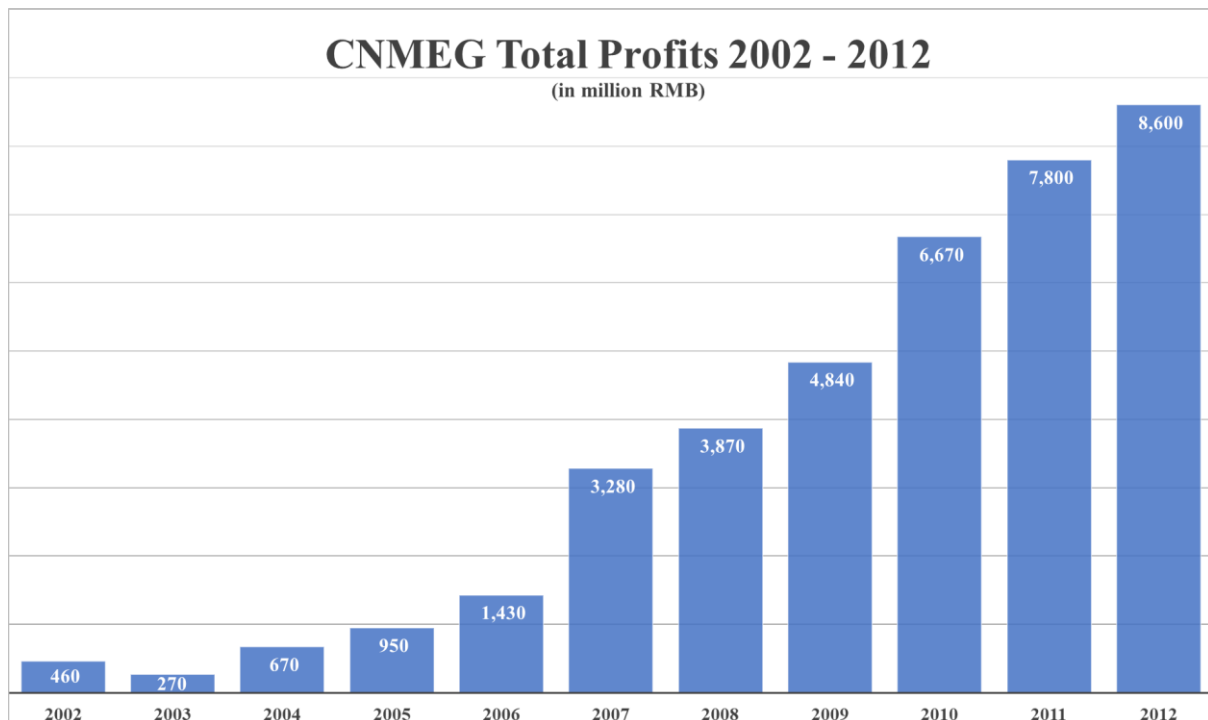


Figure 10: CNMEG Total Profits (2002-2012)

Sources: Data for 2002-2005: Sinomach (2010); Data for 2006-2012: Sinomach (2011; 2012; 2013). According to CNMEG, the total profits are profits after tax. Author's design.

Considering that central SOEs did not pay dividends to the Chinese state between 1994 and 2007 (Naughton 2008), Kratz (2013, 95) argues that “the totality of the profits [...] is automatically reinvested internally, creating liquidity reserves and a significant capacity for self-financing of future projects.” Even after the government decided to collect dividends from selected SOEs, the rate of zero to ten percent remained comparatively low, providing a solid foundation for self-financing (Milhaupt and Zheng 2016, 7).

### 3.3.2.2 *Intrinsic Goal Compatibility*

An essential determinant for state control is whether or not the personal interests of the agent correspond with the interests of the principal. To sufficiently address this aspect, the two actors' goal motivation, goal-definition process as well as the exclusivity of the respective objectives are examined (Norris 2016).

### **Goal Motives**

If the empirical evidence points to a highly short-term incentivised commercial actor but to a rather politically and strategically oriented government, their respective “motives” ought to be classified as divergent (Norris 2016, 239).

With regard to the principal, scholars argue that by financing the NorthRail project, the Chinese state sought to convince the Philippines to sign the highly controversial JMSU, thus

safeguarding its strategic interests in the South China Sea (Goh 2011; De Guzman 2014; Yung and McNulty 2015). As such, the NorthRail project is to be regarded as an integral part of China's inducement strategy towards the Philippines on both a tactical and structural level, thus suggesting the government's strategic and political goal motives (Norris 2016; A. Wong 2019b)

Turning to the agent, while ODA projects arguably serve governmental and political objectives (Camba 2017, 4), they can also yield commercial and strategic long-term rewards for the implementing entity (Burke 2007; Kurlantzick 2007). Most notably, winning an ODA project serves as a government-backed market entry strategy into a certain country, as first-hand knowledge can be gained and business contacts may be generated (Burke 2007, 328). Nevertheless, considering the financial benefits involved, it occurs that Chinese companies start acting according to their corporate, profit-driven interest rather than state's strategic objectives (Kurlantzick 2007, 85).

Therefore, it is necessary to elaborate on CNMEG's goal motivation in the specific case of the NorthRail project. In this context, is notable that the contract signed between CNMEG and the NLRC was highly overpriced, thus indicating the firm's pursuit of commercial interests (Landingin 2010, 88–89). Further evidence for CNMEG's pursuit of commercial interests can be obtained from its actions in 2008. Following unresolved issues with the NLRC, CNMEG unilaterally suspended the work and requested an additional US \$299 million from the Philippine government (Jimenez 2008; Landingin 2010). After governmental invention, the dispute could be settled and a new agreement with increased project costs of US \$99 million came into effect (Landingin 2010, 90). In 2012, it was revealed that the NLRC has paid more than US \$210 million for work that was worth only US \$80.5 million, overpaying CNMEG by US \$129 million (Cheung and Hong 2019, 94-95). At the same time, the first section of the project was completed by only 22.94% (De Guzman 2014, 82).

### **Goal Definition**

A second crucial aspect for analysing the intrinsic goal compatibility of principal and agent is the influence of the state on the goal definition process of the commercial actor. If the state can influence the agent's goal setting by directing the parallel political careers of the firm's top management, especially its chairman, or if the state has the power to alter the commercial success of the agent through discretionary authority, convergence ought to be higher (Norris 2016, 81, 239).

To capture the first aspect and identify the convergence between corporate and state interests, the political career of Ren Hongbin, who was the chairman of CNMEG at the time of the NorthRail project, is examined (Norris 2016, 80–81).

Ren Hongbin is a member of the CCP. His political career began in July 1986, when he became the deputy secretary of the CCYL Committee at the Beijing Agricultural Engineering University (SASAC 2018). In 2012, Ren Hongbin became part of the 18<sup>th</sup> and subsequently the 19<sup>th</sup> Central Committee of the Communist Party of China. Reportedly, he was among several influential individuals of the so-called “Sixth-Generation Corps of Cadres”, a group of “officials born in the 1960s who are positioned to move up the party hierarchy at the 20th Party Congress in 2022” (Lam 2014, 5). In 2012, he also publicly emphasised the role of central SOEs in operationalising party policies, thus reasoning against upcoming voices demanding further privatisation of the economy (C. Zhu and Hornby 2012).

In addition to his presence in the 18<sup>th</sup> and 19<sup>th</sup> Central Committee, he was also a member of the 11<sup>th</sup> Standing Committee of the Chinese People’s Political Consultative Conference (CPPCC; 2008-2013), an influential political advisory body (SASAC 2018; CPPCC n.d.; China.org.cn 2012). After departing from CNMEG in 2018, Ren Hongbin became the new vice chairman of SASAC (SASAC 2018). When his SASAC appointment was announced, Ren Hongbin was publicly praised for persistently pursuing government-backed reforms during his time at CNMEG and is thus considered closely aligned with the Chinese state (Rong and Jia 2018). This finding is further reinforced by the fact that CNMEG itself states that corporate goals are defined in accordance with the respective “Five-Year Plan” of the Chinese government and the requirements set by SASAC and the CCP Central Committee (Sinomach 2011, 3).

However, in addition to state’s influence through steering Ren Hongbin’s political career, it is also important to address the government’s “king-making ability”, which is employed “to encourage or discourage the commercial success of enterprises” (Norris 2016, 124). In this context, especially SASAC exercises significant authority over the assets of central SOEs, thus wielding the bureaucratic power to determine their economic performance (Naughton 2008, 3; Pearson 2015, 37). Being wholly-owned by SASAC, it can therefore be concluded that the state arguably had the power to substantially alter CNMEG’s commercial success (Naughton 2008, 3–5).

### **Exclusivity of Goals**

Although divergent goals of principal and agent are not necessarily mutually exclusive, they tend to lead to a different priority setting. This in turn creates the risk of one objective being overwhelmed by the other. As such, despite controlling for the exclusivity of the objectives themselves, special attention is paid to empirical evidence suggesting a divergent priority setting, such as actions strongly indicating the agent's pursuit of profits (Norris 2016, 85).

While the NorthRail project primarily served the Chinese state's strategic objectives with regard to the South China Sea, it ultimately relied on the execution by a commercial actor (Goh 2011; De Guzman 2014; Yung and McNulty 2015). In this context, the commercial interests of the agent and the political, strategic interests of the state are not necessarily mutually exclusive (Baviera 2016; G. Lim 2017). In addition to achieving foreign policy goals, Chinese aid also serves a commercial agenda, such as enabling Chinese SOEs to set foot abroad (Trinidad 2016, 302). Accordingly, successfully executing the NorthRail project could have served as a strategic, government-sponsored market entry into the Philippines, providing the foundation for CNMEG's long-term engagement in the region (Fuchs and Rudyak 2019). Hence, from this point of view, the respective objectives of principal and agent can be regarded as complementary (Norris 2016).

Yet, the empirical reality of the NorthRail case suggests that CNMEG's priorities were directed towards the realisation of short-term profits, which is *inter alia* reflected in a highly overpriced contract, the company's request for additional funding, the unilateral suspension of work as well as the slow project progress in general (Jimenez 2008; Landingin 2010; De Guzman 2014; Cheung and Hong 2019). Accordingly, the agent's prioritisation strongly diverged from the state's political and strategic intentions behind the NorthRail project and therefore its economic inducement efforts towards the Philippines in general (Goh 2011; De Guzman 2014; Yung and McNulty 2015; Norris 2016; A. Wong 2019b).

### *3.3.2.3 Relative Resources*

To assess the distribution of relative resources between principal and agent, the respective human capital, personnel count and financial budgets are examined. As for the quantitative indicators (personnel count and budget endowment), the evidence – if available and relevant – is collected for the entire period of the NorthRail project (2002-2012).

#### **Human Capital & Knowledge**

To adequately assess the distribution of human capital and knowledge, Norris (2016) suggests examining the principal's experience in the specific technological field, potential non-accessible technical know-how located within the agent as well as the speed of technological development in the respective industry.

Starting with the principal's experience in monitoring CNMEG's railway construction activities, it is important to note that the NorthRail project was originally planned and designed as a conventional commuter railway (Landingin 2012). In contrast to high-speed railways, whose development was only spurred by foreign technology transfer in the mid-2000s, the conventional railway construction technology can be considered well established (Xue, Schmid and Smith 2002; Z. Sun 2015; Ker 2017). Furthermore, since railways served as crucial infrastructure for China's economic and social development, the government was historically involved in its planning and construction (Xue, Schmid and Smith 2002; Lixin and Fengli 2017). Accordingly, Xue, Schmid, and Smith (2002, 157) argue that starting from 1949, "the railway system was truly and completely centralized by the central government."

Turning to the dynamics of China's railway construction industry, its technological development started to advance significantly after the announcement of China's "Eighth Five Year Plan" (1991-1995), which was aimed at the improvement and modernisation of existing railways (Xue, Schmid, and Smith 2002; World Bank 2009; Z. Sun 2015). Following the prioritisation of the Chinese government, "there was a high level of railway construction unprecedented in China's history" (Xue, Schmid and Smith 2002, 159). Additionally, the Chinese Ministry of Railways also sought to increase the average speed on conventional railways, which was eventually achieved through six "Speed-Up" campaigns between 1997 and 2007 (Takagi 2011, 38). Consequently, scholars argue that China's railway industry was experiencing "the most rapid development in its 125 year history" (Xue, Schmid and Smith 2002, 163). Considering that the "Speed-Ups" were initiated and guided by the Ministry of Railways, Z. Sun (2015, 655) notes that the technological transformation and advancement was primarily led by the



Chinese state, thus suggesting that the principal has always been capable of keeping track with technological innovations within the industry (Norris 2016, 61).

Lastly, with regard to exclusive know-how on behalf of CNMEG, it is noteworthy that the feasibility study of the NorthRail project was conducted by the agent itself (Landingin 2010, 89). Therefore, CNMEG can be considered as the only state corporation in China “being fully familiar with the [...] requirements of the Northrail Project” (Supreme Court, Republic of the Philippines 2012). However, considering that the railway construction industry was guided by the Chinese state itself and that several other railway construction companies were involved in major overseas projects at that time, it can be concluded that while CNMEG arguably possessed project specific knowledge, the general technical expertise is not to be considered an exclusive asset (Xue, Schmid and Smith 2002; Foster, Butterfield and Chen 2009; Z. Sun 2015).

### **Personnel Count**

In order to evaluate the distribution of relative resources between principal and agent, also their respective personnel count needs to be taken into consideration (Norris 2016, 238).

In the case of SASAC, CNMEG’s formal regulator and mainly in charge of overseeing SOE-related affairs, no official data has been made available (Chen 2017). Nevertheless, L.-W. Lin and Milhaupt (2013, 735) put the number of SASAC employees at around 800, with the staff being arranged into various bureaus and departments (see Figure 11):

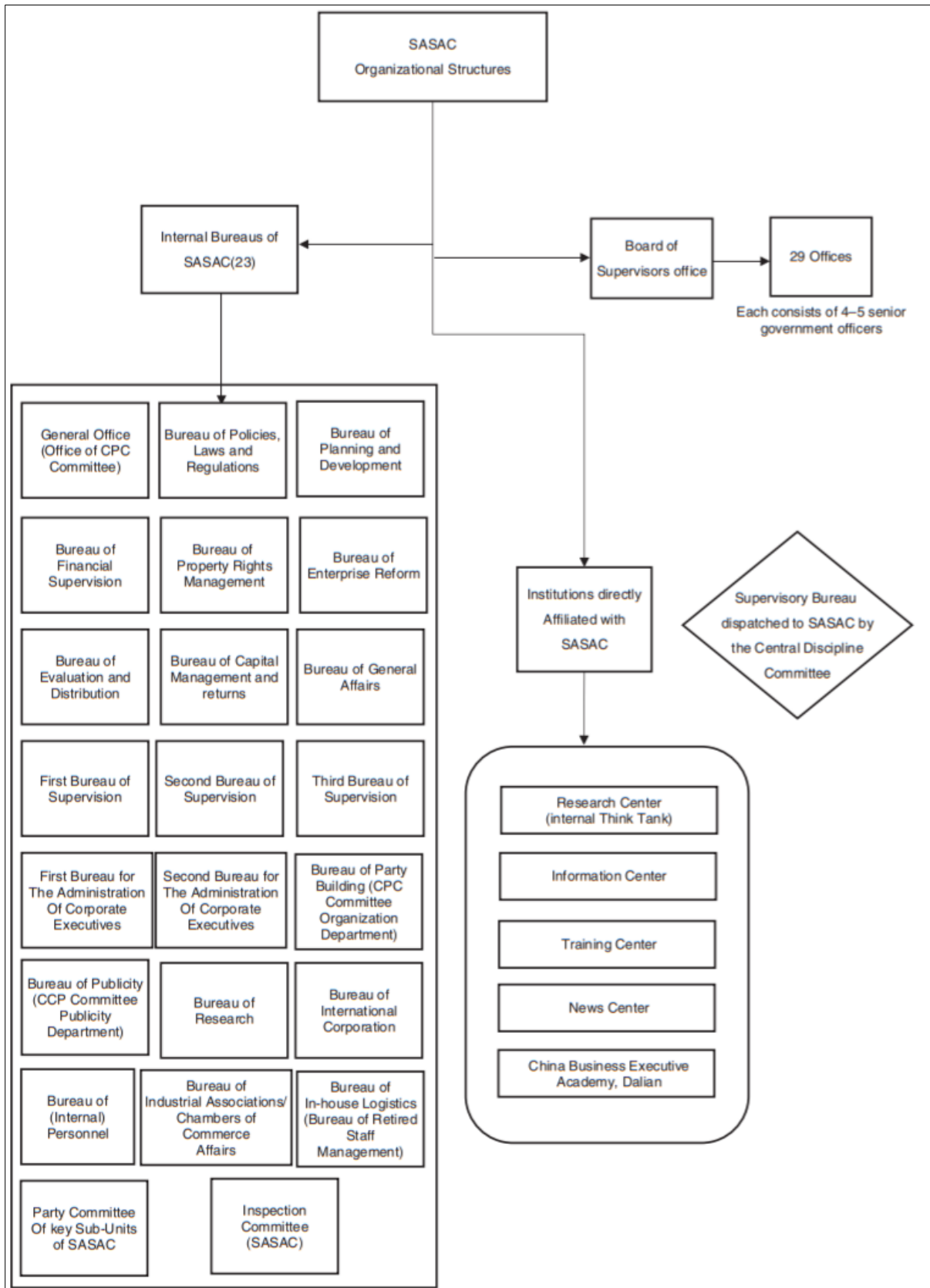


Figure 11: Organisational Structure of SASAC  
 Source: Chen (2020, 180).

The supervision of central SOE is predominately carried out by so-called supervisory board offices dispatched by SASAC (en.people.cn 2003; SASAC 2003; Chen 2017). No detailed organisational chart could be retrieved for the early years of SASAC, but in 2017 SASAC maintained a total of 29 supervisory offices (Chen 2017). Each of these offices consists of four to five senior officials and is entrusted with the overall supervision of four to five SOEs. To this end, the responsible officials are permanently placed at the company's headquarter (Chen 2020, 181). The respective officials "have the right to audit conferences and meetings, and check accounting documents" (Chen 2020, 181). In June 2004, SASAC formally established its supervisory delegation at CNMEG's company headquarter (Sinomach n.d.).

At this stage of research, it remains unknown how many officials were permanently seconded to conduct the monitoring of CNMEG's business activities. However, considering SASAC's organisational structure and personnel count as of 2017, it can be expected that at maximum, four to five officials were simultaneously monitoring one central SOEs. At the other extreme, it might also be possible that only one official was assigned to one SOE. Comparing the actual man count of each office and the number of SOEs to be monitored, the latter assumption appears to be more reasonable, leading to SOEs being able to evade SASAC officials and their supervision (Chen 2020, 181). This view is shared by Liou (2010, 42), who argues that due to manpower and information constraints, SASAC struggles to provide adequate monitoring of SOEs.

In addition to SASAC, the Department of Foreign Aid, which was adjunct to the MofCom and seconded by the State Council, can be considered as a relevant supervisory authority in the context of this study (Corkin 2011; Trinidad 2016). Being formally responsible for the quality of China's aid projects, the Department of Foreign Aid was directly overseeing CNMEG's construction activities in the Philippines (Corkin 2011; Trinidad 2016). However, in terms of personnel count, the department was "unbelievably small" (Bräutigam 2009, 109), with its staff only amounting to about 100 people. The low number also results from the fact that the Department did not maintain an overseas presence. Instead, the Department of Foreign Aid had to coordinate with the Chinese Economic and Commercial Counsellor's Office attached to the Chinese embassy, which designated "one or more staff to oversee the aid program, troubleshooting, monitoring, and checking up at their completion" (Bräutigam 2009, 109). According to Lynch, Andersen and Zhu (2020), the number of these officials was usually between one and two people, who were *inter alia* responsible for "the entire Chinese aid program in that country." Overall, considering China's huge foreign aid programme, the Department of Foreign Aid can be regarded as vastly understaffed (Bräutigam 2009, 109).

Turning to the agent, CNMEG employed about 40,000 people in 2006, of whom more than 5,000 were described as “senior technical professionals” (Sinomach 2011, 71). At the same time, CNMEG’s board of directors, the company’s most important decision-making body, consisted of a total of seven people (Sinomach n.d.). The board size thereafter increased to eleven in 2012, not including CNMEG’s core management team, such as its chief financial officer or its chief legal adviser (Sinomach 2011; 2012).

### **Budget Endowments**

By studying the respective budgets, it is examined how principal and agent compare in financial terms. A financially highly inferior principal is less likely to adequately exercise supervision and impose the desired behaviour on the agent (Norris 2016, 238). To adequately capture the financial budget of the agent, the focus is placed on commercial indicators, such as the annual revenue, net profit and – if available – the detailed expenditures (Norris 2016).

As for the previous category, retrieving reliable and consistent data on the annual financial budget of SASAC proves challenging. Even though the State Council encouraged governmental institutions to publicly disclose such information, the first figure available only dates from the year 2010 (The Economic Observer 2011).

According to The Economic Observer (2011), SASAC’s annual budget accounted for roughly RMB 3.9 billion in 2010 and RMB 3.95 billion in 2011.<sup>19</sup>

With respect to the Department of Foreign Aid, no official budget figured for the relevant time period could be retrieved either. However, in an effort to increase governmental oversight, China’s foreign aid management has been restructured in 2018, with the Department of Foreign Aid being succeeded by the China International Development Cooperation Administration (CIDCA) (Y. Sun 2019). In this process, CIDCA was equipped with an annual administrative budget of RMB 105 million in 2018 and RMB 122 million in 2019 (Y. Sun 2019; Lynch, Andersen and Zhu 2020).<sup>20</sup> As CIDCA inherited most of its roughly 100 employees from its predecessor, it appears to be reasonable to put the Department of Foreign Aid’s administrative budget within the same range as CIDCA’s 2018 budget (Rudyak 2019).

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<sup>19</sup> Corresponding to approximately US \$576 million (2010) and US \$612 million (2011) (National Bureau of Statistics of China 2015). While SASAC also disposed over the bulk of dividends central SOEs were obliged to pay from 2007 onwards, the majority of these funds were directly re-distributed to the SOEs themselves, supporting inter alia restructuring efforts or pension programmes (Borst 2012; Naughton 2015). Accordingly, those sums are not further considered as counting into SASAC’s administrative budget.

<sup>20</sup> Corresponding to approximately US \$15 million (2018) and US \$18 million (2019) (Y. Sun 2019).

Turning to the agent, although CNMEG occasionally releases company figures, it does not disclose its full financial budget. The information publicly available nevertheless allows to draw meaningful conclusions concerning its budget endowment. CNMEG’s operating revenue, for instance, increased from RMB 17.3 billion in 2002 to RMB 214 billion in 2012 (see Figure 12):<sup>21</sup>

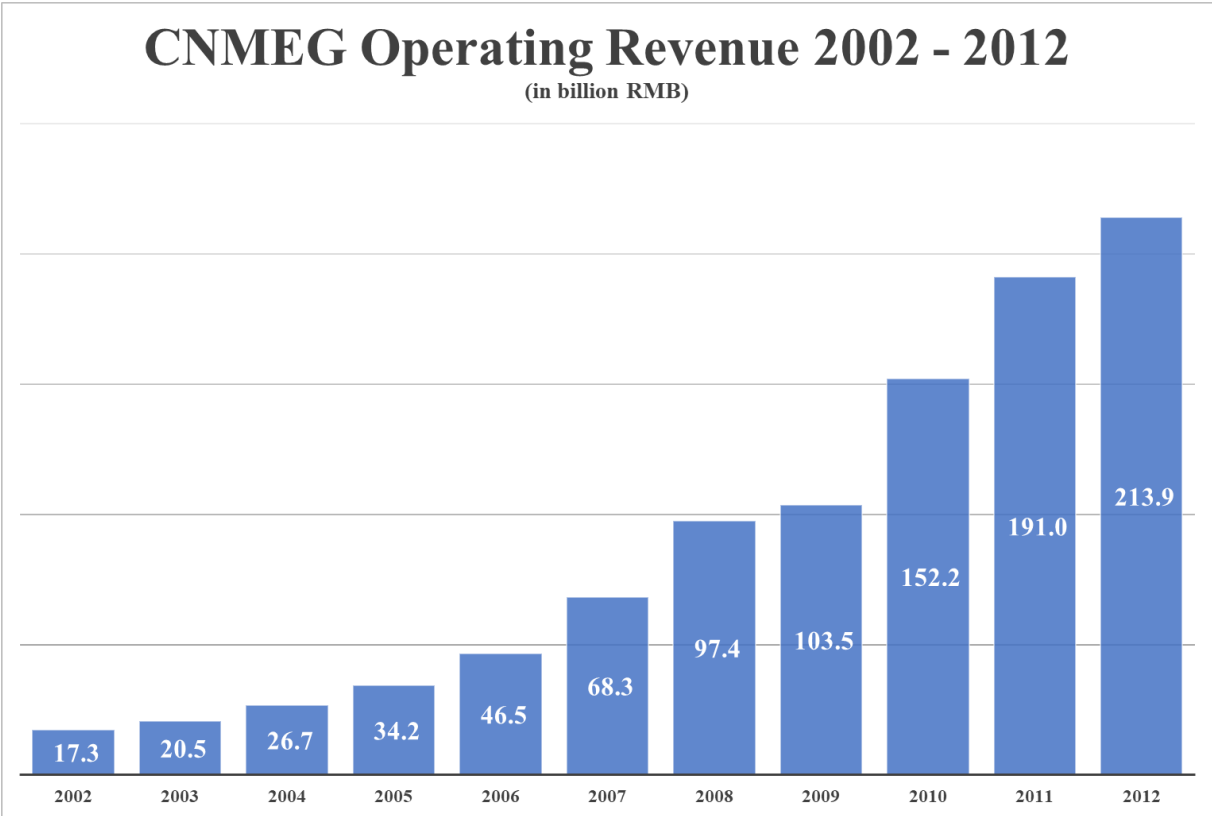


Figure 12: CNMEG Operating Revenue 2002-2012  
 Source: Sinomach (2010; 2011; 2013).<sup>22</sup> Author’s design.

Throughout the period under review, CNMEG has constantly been profitable (see Figure 10), with its profit of 2010 (RMB 6.7 billion) and 2011 (RMB 7.8 billion) almost doubling SASAC’s total budget of the respective year.<sup>23</sup> Unfortunately, no detailed breakdown of CNMEG’s expenditures and budgets could be obtained.

<sup>21</sup> Corresponding to approximately US \$2.09 billion (2002) and US\$ 33.9 billion (2012) (National Bureau of Statistics of China 2015).  
<sup>22</sup> The figures from 2002-2006 show the company’s “Main Business Income” (主营业务收入, zhǔ yíng yèwù shōurù) (Sinomach 2010, 30). From 2007-2012, the data represent the company’s “Operating Revenue” (营业收入, yíngyè shōurù) (Sinomach 2011; 2013). CNMEG uses both terms interchangeably. In this thesis, the data is referred to as “Operating Revenue.”  
<sup>23</sup> Corresponding to approximately US \$985 million (2010) and US \$1.2 billion (2011) (National Bureau of Statistics of China 2015).

### 3.3.3 State Actor Variable: Unity of the State

Within this section, empirical evidence for assessing the IV “Unity of the State” is gathered. To this aim, the period under consideration will cover the years from 2002, in which the Chinese government engaged in talks with the Philippines about the NorthRail project, until 2012, the year in which the project was officially cancelled (Dreher et al. 2017).

The methodology of data collection applied throughout this section follows the structure of the framework presented in Chapter 2 and therefore covers bureaucratic and institutional frictions, personal and ideological factions as well as potential geographical division.

#### **Bureaucratic & Institutional Friction**

To capture the bureaucratic and institutional frictions within the Chinese party-state, Norris (2016) proposes to examine possible bureaucratic reorganisations, contests over jurisdiction and organisational competition over budget and personnel.

As for the former, Hu Jintao succeeded Jiang Zemin as secretary general of the CCP at the 16<sup>th</sup> National Party Congress in November 2002, just two months after China and the Philippines initiated talks on financing the NorthRail project. In March 2003, Hu Jintao eventually became China’s head of state (Fewsmith 2003). Nevertheless, with regard to bureaucratic security and foreign policy-making processes, the political power and decision-making competences continued to be centralised “in the supreme CCP leading bodies, such as the Politburo Standing Committee (PBSC), the Central Military Commission (CMC) and various leading groups dealing with foreign affairs” (Cabestan 2009, 64). Accordingly, there is no evidence suggesting that “under Hu Jintao, China’s foreign and security policy is made and implemented very differently than under his predecessor Jiang Zemin” (Cabestan 2009, 64).

It is noteworthy, however, that in terms of foreign affairs, and in particular China’s foreign aid policy, there have been jurisdictional struggles between the MofCom, the Ministry of Finance (MoF) as well as the Ministry of Foreign Affairs (MFA). While all these institutions are subordinate to the State Council, they nevertheless pursue different interests. This is reflected, for instance, in discussions about the selection, design and purpose of foreign aid activities (Corkin 2011, 73–79; Trinidad 2016). The MFA considers foreign aid primarily as a tool to foster China’s foreign relations. The MofCom, instead, leverages foreign aid as a government-sponsored market entry strategy for Chinese enterprises and goods. Lastly, regarding the financial modalities, the MoF prefers loans to be structured in a commercially viable way, which occasionally conflicts with the objectives pursued by the MFA and the MofCom (Corkin 2011, 73).

Another aspect that deserves consideration when examining bureaucratic and institutional frictions is the reorganisation of the governmental management structure of SOEs (Mattlin 2007; Liou 2010). Through the establishment of SASAC in 2003, the Chinese government sought to redefine its relationship with central SOEs, thus adequately addressing emerging principal-agent challenges (Mattlin 2007, 7). The reorganisation aimed at increasing the central government's authority by assembling SOEs "under the unitary supervision of an organ that reports directly to the State Council" (Mattlin 2007, 8). Yet, SASAC initially struggled to adapt "to the workings of the elephantine Chinese bureaucracy and the legal basis for its mandate has been subject to intense debate" (Liou 2010, 42). As such, the bureaucratic reorganisation led to a significant competition over authority, with old bureaucratic agencies seeking "to preserve their influence on the policy process" (Liou 2010, 43). This institutional competition was particularly evident in the debate between the MoF and SASAC over the retention of dividends from SOEs. Likewise, the shared responsibility between the CCP's Organisation Department and SASAC in the appointment of SOE executives indicates relevant jurisdictional struggles (Naughton 2006, 5–10). In 2007, SASAC eventually started collecting dividends from SOEs, which therefore can be regarded as a partial success in reaffirming its authority within the Chinese bureaucratic system. Nevertheless, SASAC's mandate continued to be challenged, not only by other bureaucratic agencies but also by powerful and politically well-connected enterprises. This even led to incidences where SOEs relied on "higher-level patrons" within the CCP to assert their interests against SASAC directives (Naughton 2008, 5).<sup>24</sup>

### **Personal & Ideological Factions**

For the assessment of personal and ideological factions, it is necessary to examine promotion patterns, purges, elite networks, known rivalries, corruption cases, ideological struggles as well as the political focus of China's top leadership (Norris 2016). To this aim, special attention is paid to the transition period from Jiang Zemin to Hu Jintao, including the 16<sup>th</sup> and 17<sup>th</sup> National Party Congress. Accordingly, in terms of personal factions, the focus is set on Jiang Zemin's "Shanghai Gang" as well as the Chinese Communist Youth League (CCYL), which is closely affiliated with Hu Jintao (Bo 2008, 333).<sup>25</sup> To provide for a better overview and understanding, this section is further structured by sub-headlines.

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<sup>24</sup> The next major reform and bureaucratic reorganisation with regard to the management of SOEs has been initiated in 2016 and is therefore not subject to this analysis (Leutert 2016).

<sup>25</sup> Besides the "Shanghai Gang" and the "CCYL", there are two additional interest groups, namely the "Qinghua Clique" and the "Princelings." However, as argued by Bo (2008, 334), the "Qinghua Clique" is more of a corporate group, whereas the Princelings are considered a categorical group rather than a factional group. In order to provide a clear overview of the factional camps, those groups are not included in the subsequent analysis.

### Elite Networks and Personal Rivalries (Purges, Promotion Patterns, Corruption Cases, etc.)

The first point of reference for examining elite networks and personal rivalries poses the 16<sup>th</sup> Party Congress held in November 2002, which took place with an unusual delay of two months and was marked by excessive “backroom politics” (Fewsmith 2003, 6–7). Jiang Zemin and his allies “cajoled, connived and coerced other members of the ruling elite until they capitulated, leading to a sweeping victory for Jiang’s forces” (Fewsmith 2003, 7). Eventually, Jiang Zemin managed to place six allies – namely Wu Bangguo, Zeng Qinghong, Huang Ju, Chen Liangyu, Wu Guanzheng, Jia Qinglin and Li Changchun – in the PBSC, which is described as “the source of ultimate power in China” (Szamosszegi and Kyle 2011, 80; Fewsmith 2003; Dittmer 2003; C. Li 2007; Bo 2008). While Wu Bangguo was actively involved in the NorthRail project, Zeng Qinghong was considered to be Jiang Zemin’s right-hand man (Fewsmith 2003, 1). Furthermore, it is reported that no one challenged Hu Jintao “more vehemently, more frequently, or more directly than Chen Liangyu” (C. Li 2007, 2).

Besides the composition of the PBSC, another aspect suggesting personal rivalries and factions is the fact that while Hu Jintao became secretary general in 2002 and head of state in 2003, he did not become chairman of the CMC until September 2004 (Bo 2008, 337). This is therefore considered as a breach of the so-called “three in one principle”, according to which the presidency and the CMC chairmanship was to be held by the secretary general simultaneously (Cabestan 2009, 69). The “three in one principle” was eventually restored when Jiang Zemin, who refused to hand over the position in 2002, was pressured to step down from the chairmanship in 2004. Until the transition of power to Xi Jinping in 2012, Hu Jintao remained in all three leadership positions (Bo 2008; Fewsmith 2021).

As indicated by the events cited above, by the time of the 16<sup>th</sup> Party Congress in 2002, the Shanghai Gang was a powerful political faction. In the following years, however, various incidences of purges and dismissals contributed to its decline in power. In 2003, Zhang Wenkang, health minister and supporter of Jiang Zemin, was dismissed due to mismanagement of the SARS crisis (FAZ 2003; Bo 2008). Jiang Zemin’s handover of the CMC chairmanship in 2004 was followed by the purge of Chen Liangyu for his involvement in corruption cases in 2006 (C. Li 2007, 2; Bo 2008, 338). In 2007, the Shanghai Gang’s loss of power in the PBSC was further facilitated by the death of Huang Ju, the final dismissal of Chen as well as the retirement of Zeng Qinghong (Bo 2008, 338–39). After the 17<sup>th</sup> Party Congress in 2007, the only remaining member in the PBSC affiliated with the Shanghai Gang was Wu Bangguo. At the same time, the number of politicians with links to the Shanghai Gang represented in the Central Committee



of the CCP decreased from 17 (2002) to nine (2007). The Shanghai Gang was therefore “significantly weakened” (Bo 2008, 340).

Conversely, the CCYL managed to increase its presence in the Central Committee of the CCP to 82 members (41 full, 41 alternate) at the 17<sup>th</sup> Party Congress, thus consolidating its power (Bo 2008; Miller 2011). Furthermore, two members of the PBSC (Hu Jintao, Le Keqiang) as well as six members of the Politburo had a history in the CCYL (Bo 2008, 340). Additionally, with Wen Jiabao, a third member of the PBSC can be assigned to Hu Jintao’s camp (C. Li 2007, 5; Cho 2008, 159). In conclusion, while the Shanghai Gang experienced a significant decline in power as well as in group cohesion, the CCYL became “the most powerful factional group by a large margin” (Bo 2008, 363).

This finding is reaffirmed by Francois, Trebbi and Xiao (2016, 12), who sought to convert the “share of official positions allocated to a faction”, weighted by their value<sup>26</sup>, into a so-called “power score” (see Figure 13).<sup>27</sup> The results ultimately show an increasing power base for Hu Jintao during his tenure and a decreasing power base for the Shanghai Gang after 2002 (Francois, Trebbi and Xiao 2016, 58):

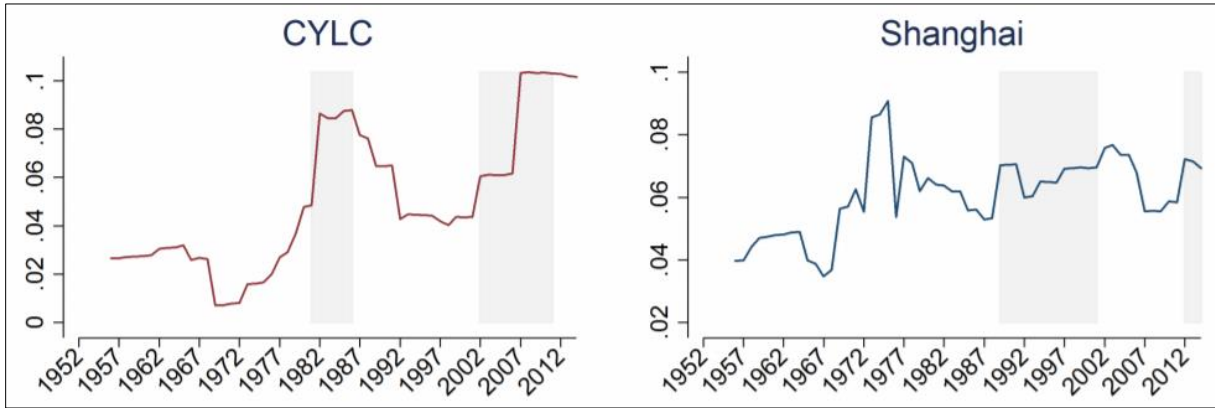


Figure 13: Power Score of the CCYL and Shanghai Faction  
Source: Francois, Trebbi and Xiao (2016, 12).

Nevertheless, there is evidence that the Shanghai Gang, despite suffering certain losses, retained at least some political leverage (C. Li 2007). First, besides dismissing Zhang Wenkang for his failures during the SARS epidemic, Hu Jintao “also had to sacrifice one of his minor allies, Beijing Mayor Meng Xuenong” (Gilley 2003). Second, instead of replacing Chen Liangyu’s post as the CCP’s secretary in Shanghai with a close protégé, Hu Jintao surprisingly appointed

<sup>26</sup> The four levels were defined as follows: 1. Member of the PBSC (highest value); 2. Member of the Politburo; 3. Member of the Central Committee; 4. Alternate Member of the Central Committee (lowest value) (Francois, Trebbi and Xiao 2016, 12).

<sup>27</sup> In Figure 13, the CCYL is displayed as the “Communist Youth League of China” (CYLC).

Shanghai mayor Han Zheng, who was seen as “a rising star of the Shanghai Gang” (C. Li 2007, 2). Accordingly, even after the 17<sup>th</sup> Party Congress, some critical positions, particularly in party bodies maintaining investigative power, were occupied by members of the Shanghai Gang, making further purges of Jiang Zemin protégés rather unlikely (Fewsmith 2021, 108). In fact, with the notable exception of the Bo Xilai scandal, Hu Jintao did not go after other allies of Jiang Zemin (Fewsmith 2013, 2). During the 18<sup>th</sup> Party Congress in 2012, the Shanghai Gang managed to regain its former power base, securing six out of seven places in the PBSC.<sup>28</sup> At the same time, Hu Jintao’s camp was represented in the PBSC only by Li Keqiang (C. Li 2014).

### Ideological Factions

However, besides personal struggles, also ideological factions could be observed. In 2000, Jiang Zemin introduced the concept of the “Three Represents”, which thereafter was “advertised as the core element of the ideological reconstruction of the CCP’s legitimacy as ruling party” (Holbig 2009, 41). According to the “Three Represents”, the legitimacy no longer derives from the CCP’s revolutionary history, but from its ability to innovatively adapt itself and its ideology to an ever-changing environment (Holbig 2009, 41). Adversaries within the party thereafter disapproved the new ideology for making the CCP accessible to new economic elites, including private entrepreneurs. Furthermore, it was feared that in the event of a weak economic performance, the CCP’s legitimacy for power could be at stake (Holbig 2009, 46–55). Despite the opposition, Jiang Zemin’s speech at the 80<sup>th</sup> anniversary of the CCP in July 2001 is seen as a final effort to establish the new ideology before his departure. Eventually, at the 16<sup>th</sup> Party Congress in 2002, the ideology and legacy of Jiang Zemin was incorporated into the CCP’s constitution, with Hu Jintao subsequently struggling to reinterpret Jiang Zemin’s ideological moves. As a result, while the “Three Represents” formally remained present in the official discourse, by the summer of 2003 the essence of the Jiang Zemin’s original ideology “had been rendered more or less obsolete” (Holbig 2009, 48).

In the further course, Hu Jintao established his own ideological turns, seeking to reinforce the CCP’s legitimacy of power. In 2007, Hu’s ideological manifestations were not only incorporated into the CCP’s constitution but also well perceived among the party leadership (Holbig 2009).

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<sup>28</sup> The number of the PBSC was reduced to seven during the party congress (Fewsmith 2013).

### The State's Political Focus

With regard to the state's political focus, which is reflected in the frequency of diplomatic visits, multiple events could be observed (Norris 2016). In September 2002, the NorthRail talks coincided with an official goodwill visit to the Philippines by the chairman of the NPC Standing Committee, Li Peng. During his visit, he signed a MoU with the Philippine House of Representatives aimed at enhancing bilateral exchange. In the same month, another MoU on increased tourism cooperation was sealed (He 2012).

In March 2003, a meeting with Jose de Venecia Junior, House Speaker of the Philippine government, was held in China. In August 2003, Wu Bangguo, the CCP's number two, chairman of the NPC Standing Committee and one of Jiang Zemin's closest allies (Bo 2008, 334–39), paid an official visit to the Philippines (Ku 2006, 125). Alongside de Venecia and the Philippine senate president Franklin M. Drilon, Wu Banguo witnessed the signing of the US \$400 million MoU for the NorthRail project (Philippine Embassy n.d.).

In 2004, a visit of Mr. Drilon and his party delegation to China was followed by the first official state visit of Gloria Macapagal-Arroyo after becoming president of the Philippines (Ku 2006, 125; He 2012). President Arroyo's trip to China was accompanied by the signing of the JMSU as well as another agreement on tourism cooperation (He 2012). In October 2004, Wu Guanzheng, member of the PBSC and Jiang Zemin protégé, held a friendly visit to the Philippines (Fewsmith 2003; He 2012).

In 2005, Chinese president Hu Jintao paid his first state visit to the Philippines. Following his three-day stay, Arroyo and Hu Jintao witnessed the signing of ten bilateral agreements and MoUs, including a general loan agreement of US \$500 million as well as a MoU between CNMEG and the NLRC for section two of the NorthRail project (Philippine Embassy n.d.).

In June 2006, the "Philippines – China Economic Partnership Forum" was held in Manila. In the face of the conference, the Chinese minister of commerce, Bo Xilai, signed a MoU with the Philippines, thus paving the way for the NBN project (Senate of the Philippines 2009, 15). Furthermore, Bo Xilai used the occasion of the visit to meet with President Arroyo to discuss bilateral cooperation prospects. The meeting was also attended by the Chinese ambassador to the Philippines, Li Jinjun, and the Philippine Speaker of the House, de Venecia Junior (Chinese Embassy n.d.).

In January 2007, the next official state visit to the Philippines in the person of Premier Wen Jiabao was recorded. Afterwards, the two nations issued a joint statement, thus "reaffirming the

commitment of taking further steps to deepen the strategic and cooperative relationship” (Mendoza and Heydarian 2012, 60).

In the subsequent months, President Arroyo made multiple visits to China. During her first trip to the Bao Forum held in April 2007, the NBN deal was eventually finalised and signed. Further trips followed in June and October 2007, where she personally conveyed the preliminary cancellation of the NBN project to Hu Jintao (Mendoza and Heydarian 2012, 60; Baviera 2016, 18). After the project was cancelled, Arroyo made three additional trips to China in 2008 (Mendoza and Heydarian 2012, 60).

In November 2009, Jia Qinglin, chairman of the CPPCC National Committee conducted another goodwill visit to the Philippines, thus marking the last official high-level visit to the Philippines during President Arroyo’s tenure. In 2011, the Philippine’s new president Benigno S. Aquino III made his first state visit to China (He 2012).

As shown in Figure 14, the period under examination was characterised by frequent high-level diplomatic visits and numerous bilateral agreements between the two nations (Clemente 2016):

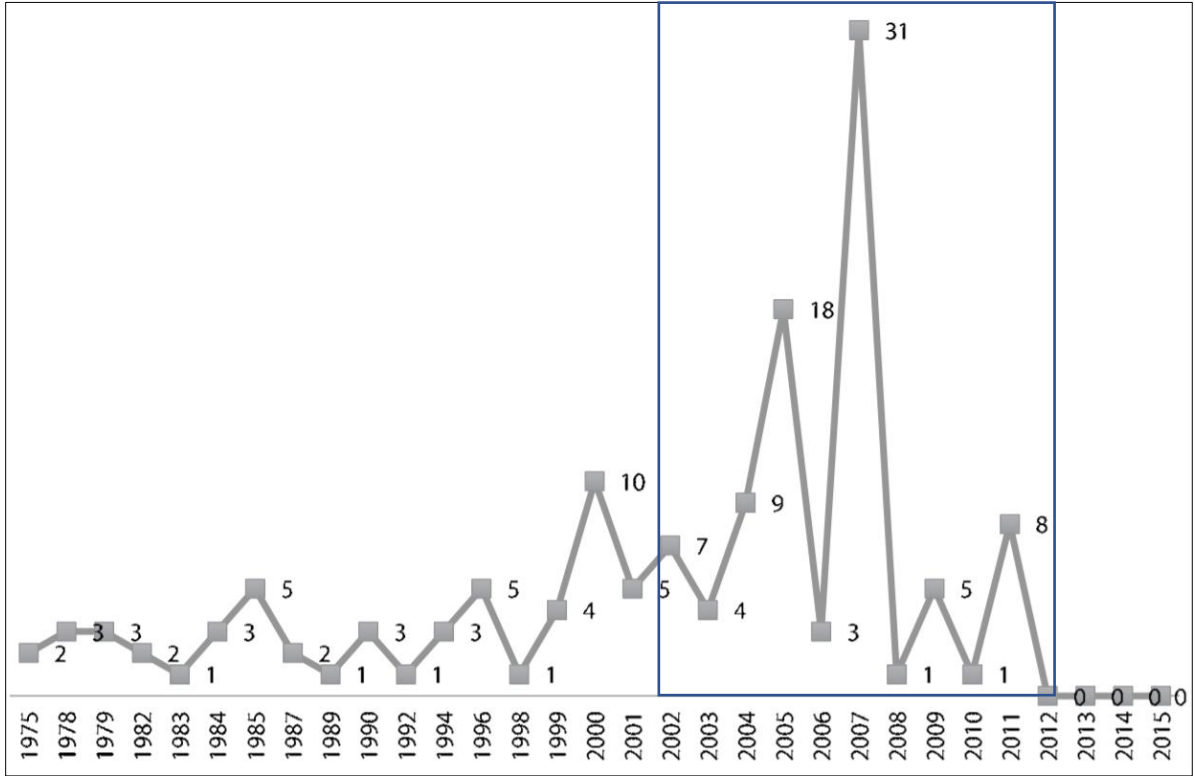


Figure 14: Number of Bilateral Agreements: China-Philippines (1975-2015)  
 Source: Clemente (2016, 222). Emphasis by the author.

## **Geographical Division**

To illuminate geographical divisions within the Chinese party-state, potential centre-local as well as rich-poor tensions are examined. To this aim, special attention is paid to the political dynamics between China's provinces (Norris 2016; A. Wong 2018).

As a result of the 16<sup>th</sup> Party Congress, the provincial representation in the Politburo increased from five to seven. In this context, the composition of the Politburo points to an “apparent bias towards the eastern seaboard” (Fewsmith 2003, 9), as five out of seven members were simultaneously serving as the party secretary of coastal provinces.<sup>29</sup> Overall, 65% of the members of the 16<sup>th</sup> Politburo were affiliated to leadership positions in coastal regions at some point in their political career, whereas only 35% had served in inner regions (C. Li and White 2003, 574). This disparity is exacerbated by the several members of the PBSC having a history in coastal provinces (Fewsmith 2003, 9–12). After the 17<sup>th</sup> party congress in 2007, the ratio of the provincial representation in the Politburo remained unchanged, with five seats being covered by coastal and two by inner provinces (Fewsmith 2008; Miller 2011).<sup>30</sup>

However, despite the coastal-inland disparity, no further evidence suggesting major geographical divisions, particularly concerning the Chinese inducement efforts towards the Philippines, could be retrieved.

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<sup>29</sup> Beijing is considered a coastal region (C. Li and White 2003, 574).

<sup>30</sup> In 2008, Beijing's mayor Wang Qishan was appointed as vice premier, thus reducing the number of regional representatives to six (four coastal, two inner provinces) (Fewsmith 2008; Miller 2011).

## 3.4 Case Study #2: The NBN Project

### 3.4.1 Economic Actor Variable: Market Structure

Within this section, empirical evidence for assessing the IV “Market Structure” in the context of the NBN project is gathered. The foundation for the NBN agreement was laid in June 2006, as China and the Philippines agreed to strengthen their cooperation in the field of information and communication technology (ICT) (ABS-CBN 2008; Baviera 2016). Only one month later, the Philippine government and ZTE Corporation (hereafter ZTE) concluded a MoU concerning “investments in a nationwide government broadband communication infrastructure project” (Committee on Accountability of Public Officers and Investigations 2009, 16). The final deal providing the required funding of US \$329.5 million was signed by President Arroyo during a meeting on Hainan Island in April 2007 (Storey 2008, 7). The concessional loan provided by the China Export-Import Bank was tied to the condition of appointing ZTE as the exclusive supplier and provider of the NBN project (Storey 2008, 7).

The data collection for the assessment of the market structure will thus be narrowed down to the years from the signing of the first MoU (2006) until the final contracting (2007). If available and relevant, this information is complemented by additional evidence from previous and subsequent years.

The structure of this chapter follows the analytical framework and therefore covers the number of firms, the concentration of the market share as well as the pricing dynamics in the Chinese telecommunications (telecom) equipment industry.

#### **Number of Firms**

In order to adequately assess the number of firms competing with ZTE, it is indispensable to gain a basic understanding of the structure of China’s telecommunications industry.

The most important distinction to be made is the one between network service providers on the one hand and network infrastructure suppliers on the other hand (EU SME Centre 2011, 6). While the former, represented by companies such as China Telecom, obtain licenses issued by the Chinese government to develop telecommunication networks, they eventually rely on the technological capacity and know-how of the network infrastructure suppliers (Hong, Bar and An 2012, 915–17; Kwak, Lee and Chung 2012, 969). Network infrastructure suppliers are also referred to as network or telecom equipment manufacturers (Hong, Bar and An 2012, 915–17; Kwak, Lee and Chung 2012, 969). The value chain of the telecom industry is displayed in Figure 15 (H. Zhu and Pasadilla 2016, 314):

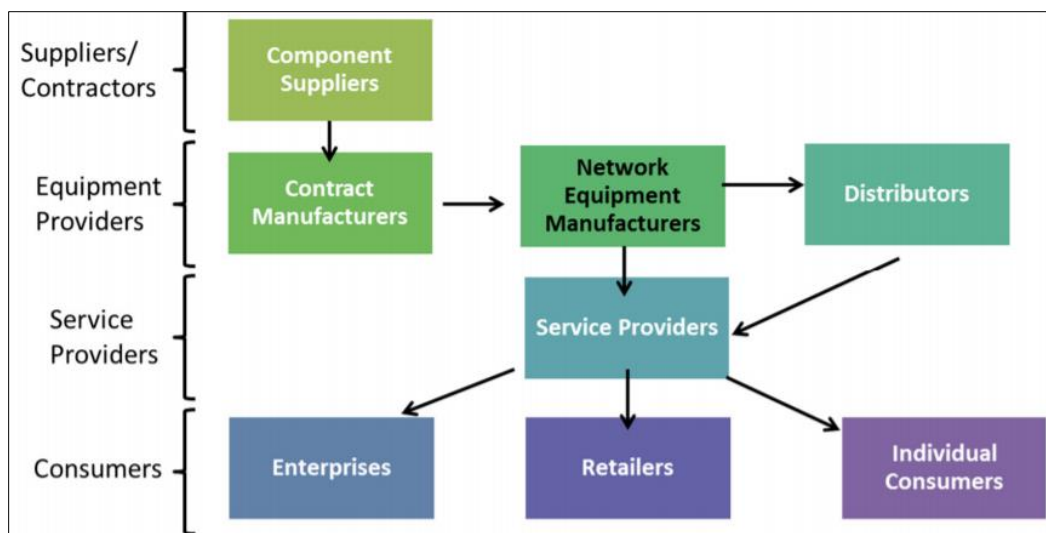


Figure 15: Value Chain of the Telecommunications Industry  
 Source: H. Zhu and Pasadilla (2016, 314).

As the technological know-how for the development of (broadband) telecommunication infrastructure primarily resides within the telecom equipment manufacturers, the scope of the further analysis is adjusted accordingly (Fan 2006; Stewart et al. 2011).

Around the year 2000, the four leading Chinese manufacturers of telecom equipment were Huawei Technologies, ZTE, Datang Telecom as well as Julong Group (Smith-Gillespie 2001, 46; B. Low 2005).<sup>31</sup> As of 2005, however, the state-owned Julong Group faced various obstacles and therefore “seemed to be struggling to find its place in the equipment arena” (Harwit 2007, 324). This development is reflected in an industry analysis released in 2011, in which Julong Group was not included among the major domestic equipment manufacturers (see Table 9) (EU SME Centre 2011, 5):

<b>Telecom. Equipment Manufacturers</b>	
<i>Domestic Chinese Firms</i>	<i>Foreign Firms</i>
Huawei	Alcatel (Alcatel Shanghai Bell)
ZTE	Nortel Networks
Datang Telecom Co.	Motorola
	Ericsson
	Cisco
	Nokia Siemens

Table 9: Telecom Equipment Manufacturers Operating in China (2011)  
 Source: EU SME Centre (2011, 5). Design adapted by the author.

<sup>31</sup> For a detailed overview of these four enterprises see Smith-Gillespie (2001, 46).

In absence of consistent empirical evidence for the years under examination, it is not possible to conclude whether the number of major Chinese equipment manufacturers at the time of the NBN project was three or four.

However, as argued by Norris (2016), the assessment of this indicator depends not only on the mere number of market participants but also on their competitive relationship. As such, it is crucial to recognise that since 2004, Chinese telecom equipment manufacturers have actively been competing in the development of 3G technology (Hong, Bar and An 2012, 919). This competition was intentionally encouraged by the Chinese state itself, aiming at creating an “efficient, rational and highly effective system of telecommunications equipment production and network deployment” (Harwit 2007, 312). Hence, the Chinese telecom equipment industry is described as “highly competitive” (Low 2007, 140). The competition between Chinese telecom equipment manufacturers also stretched beyond China’s borders, with particularly Huawei and ZTE becoming “increasingly bitter rivals in international markets” (Mthembu-Salter 2011, 1).

**Market Share**

When analysing the concentration of the Chinese telecommunication equipment market, one has to recognise that until 2008, China’s telecommunication network was still dominated by 2G technology (Hong, Bar and An 2012, 919). As it was not disclosed whether the NBN project was to be implemented with the 2G or 3G standard, the subsequent analysis remains deliberately broad (Clendenin 2007; Stewart et al. 2011, 799).

Unfortunately, no industry-specific data for the telecom equipment market in 2006 could be obtained. As of 2007, however, the national 2G market has been highly concentrated, with Ericsson claiming a market share of 42%. At the same time, Huawei and ZTE were holding a combined market share of 13%, whereas no data for Datang or Julong Group could be obtained (Hong, Bar and An 2012, 919).

By 2008, Huawei and ZTE managed to significantly increase their presence in the 2G market, each claiming 22.5% and 15% respectively (see Table 10) (Hong, Bar and An 2012, 919):

China's telecommunication equipment market share, 2008–2009.						
Enterprises	Huawei (%)	ZTE (%)	Ericsson (%)	Nokia Siemens (%)	Alcatel-Lucent (%)	Others (%)
2008 2G	22.5	15	22	15	12	13.5
2009 3G	28	25	12	10	8	17

Table 10: Chinese Telecommunication Equipment Industry Market Share (2008-2009)  
Source: Hong, Bar and An (2012, 919).



After China initiated the construction of national 3G networks in 2007, ZTE (29.1%), Huawei (22%) and Datang (12.7%) emerged as market leaders in 2008 (ZTE Corporation 2009; Clendenin 2007; Stewart et al. 2011). By 2009, Huawei managed to gain the market lead, leaving ZTE to the second place, while neither Datang nor Julong Group were among the top five telecom equipment suppliers in the 3G market (see Table 10) (Hong, Bar and An 2012, 920).

Overall, despite the lack of comprehensive industry-specific data for 2006 and 2007, the fact that only a maximum of four Chinese companies (Huawei, ZTE, Datang, Julong Group) were active in the telecom equipment industry between the early 2000s and 2011 suggests a fairly concentrated market (Smith-Gillespie 2001; Harwit 2007; EU SME Centre 2011; Hong, Bar and An 2012).

### **Pricing Power**

Lastly, the pricing behaviour within the Chinese telecom equipment industry is examined. Competitive pricing behaviour is reflected, for instance, by Chinese companies competing with each other for state-funded ODA projects or in the fight for market share (Gill and Reilly 2007; Norris 2016).

Due to its great potential, the Chinese telecom equipment sector “has often been seen as one of the most open and competitive markets in the world” (C. Li 2006, 5). Despite enjoying significant pricing advantages in tendering for domestic 2G networks compared to foreign competitors, Chinese companies continued to compete against each other, thus suggesting a competitive pricing behaviour (Gagliardone 2019; Hong, Bar and An 2012, 919–20).

Particularly Huawei and ZTE were actively competing for contracts and market share at home and overseas, with both companies pursuing a low price strategy (Stewart et al. 2011; Pawlicki 2017, 26). Evidence from Africa shows that ZTE and Huawei were simultaneously competing for government resources, with one company being asked to step in if the other failed to deliver satisfactory results (Gagliardone 2019). Accordingly Huawei and ZTE were considered fierce rivals, even causing disputes among the two (Mthembu-Salter 2011).

Furthermore, no evidence of cartel pricing among the Chinese telecom equipment manufacturers, neither overseas nor in domestic markets could be retrieved.

Although the analysis of pricing behaviour aims at the telecom equipment industry as a whole, it is nevertheless noteworthy that as an official government-to-government agreement, the NBN project was not “subject to Philippine public bidding rules” (Baviera 2016, 18). Eventually, the

contract was signed with ZTE at a price of US \$329.5 million, which in the aftermath caused critics for various reasons. Not only was the contract considered as vastly overpriced, but the Philippine government had also received more favourable offers from two non-Chinese bidders, thus having viable alternatives at its disposal (Camba 2017, 7; Pastrana 2008; Batalla 2020).

### 3.4.2 Relational Variables

#### 3.4.2.1 Reporting Relationship

To assess the reporting relationship between the Chinese state and ZTE, the agent's ownership, management and financing structure are examined. Particular attention is paid to the period between 2006 and 2007, during which the NBN project took place.

#### **Ownership Structure**

In accordance with the analytical framework, the assessment of this indicator is based on ZTE's formal ownership structure as well as the state's controlling interest in the agent.

As for the former, ZTE's history dates back to 1985, when two Chinese SOEs and a third shareholder from Hong Kong established a joint venture called Shenzhen Zhongxing Semiconductor, with Mr. Hou Weigui being appointed as the company's president. In 1992, Hou Weigui, along with several technicians and managers from Shenzhen Zhongxing Semiconductor, formed a private company named Shenzhen Zhongxing Weixiantong Equipment (hereafter Zhongxing WXT) (R. Li and Cheong 2016, 253).

In 1993, Zhongxing WXT and two SOEs, namely Xi'an Microelectronics and Shenzhen Aerospace Guangyu (hereafter Aerospace Guangyu), jointly established a company named Zhongxingxin, which later became known as ZTE Holding. As a result of this process, Zhongxing WXT became the largest single shareholder (49%), whereas the majority of the shares (51%) was distributed among the two SOEs (34% and 17% respectively), making the state the majority shareholder of Zhongxingxin (ZTE Corporation 2007, 24; Hawes and Li 2017, 68). Subsequently, the two state shareholders "authorize[d] the minority private shareholders to assume sole responsibility for managing the firm" (Milhaupt and Zheng 2016, 676), thus establishing the so-called "state-owned, privately managed model." Being majority owned by two SOEs, "the conventional definition of a state enterprise applies to ZTE Holdings" (R. Li and Cheong 2016, 258).

In 1997, Zhongxingxin (hereafter ZTE Holding or Holding) eventually established the ZTE Corporation (ZTE), which was listed at the Shenzhen Stock Exchange (Hawes and Li 2017, 68). In official terms, ZTE is classified as a "state-holding enterprise", which is defined as the

state either being the majority shareholder (>50%) or at least the largest single shareholder. The definition also applies to enterprises in which the state “exercises control through other state-controlled shareholders” (R. Li and Cheong 2016, 251).

As of 1998, 68.8% of ZTE’s shares were held by state legal persons, with 62.8% being in the possession of its controlling shareholder ZTE Holding (R. Li and Cheong 2016; Hawes and Li 2017) (see Table 11):

<i>Year</i>	<i>% Shares Held by State Legal Persons</i>	<i>Reason(s) for Change in % of State Ownership</i>	<i>% Shares Held by ZTE Holdings</i>	<i>% Shares Held by HKSCCNL</i>
1998	68.80	Share structure at formation of Shenzhen ZTE Corporation.	62.80	N/A
1999	64.90	Share placing was adopted to all shareholders with total 19,500,000 shares. But state legal person shareholders gave up the placement. As a result, the general capital was increased without the state legal person shares’ increases.	59.24	N/A
2001	57.90	Since 13 March 2001, 50,000,000 shares were issued to the public.	52.85	N/A
2004	48.18	ZTE Corporation issued 160,151,040 H-shares which were circulated in at Hong Kong Stock Exchange on December 9. It regulated that the state corporation shareholders had to reduce to hold some shares as the amount as 0.9% of those H-shares.	44.10	14.80
2005	40.86	Since ZTE Corporation adopted the split share structure reform, holders of non-tradable shares paid 2.5 shares for every 10 shares to holders of tradable shares as a sort of compensation.	37.41	16.62
2008	39.07	Through share placement, 58,294,800 H-shares were issued.	35.52	16.66
2009	37.25	85,050,238 shares were granted to 4,022 qualified employees.	33.87	15.89
2010	35.73	58,294,800 H-shares were issued and a warrant call “ZTE ZXC1” exercised the option at the price 42.39 Yuan per share and 21,523,441 A-shares were subscribed successfully.	32.45	18.27

Table 11: ZTE Share Distribution (1998-2010)  
Source: R. Li and Cheong (2016, 256).

In 2004, ZTE was listed at the Hong Kong Stock Exchange, leading to 18.28% of the company’s shares being transferred to foreign investors. Subsequently, from 2005 to 2008, the stake of ZTE Holding remained stable at 37.41% (R. Li and Cheong 2016; Hawes and Li 2017).

Although the shares of ZTE Holding gradually declined over the years, it nevertheless remained the ZTE’s largest single shareholder, thus managing to retain full control (ZTE Corporation 2007; R. Li and Cheong 2016, 258). R. Li and Cheong (2016, 258) therefore argue that through its majority stake in ZTE Holding, the Chinese state has also managed to secure its control over ZTE (see Figure 16):

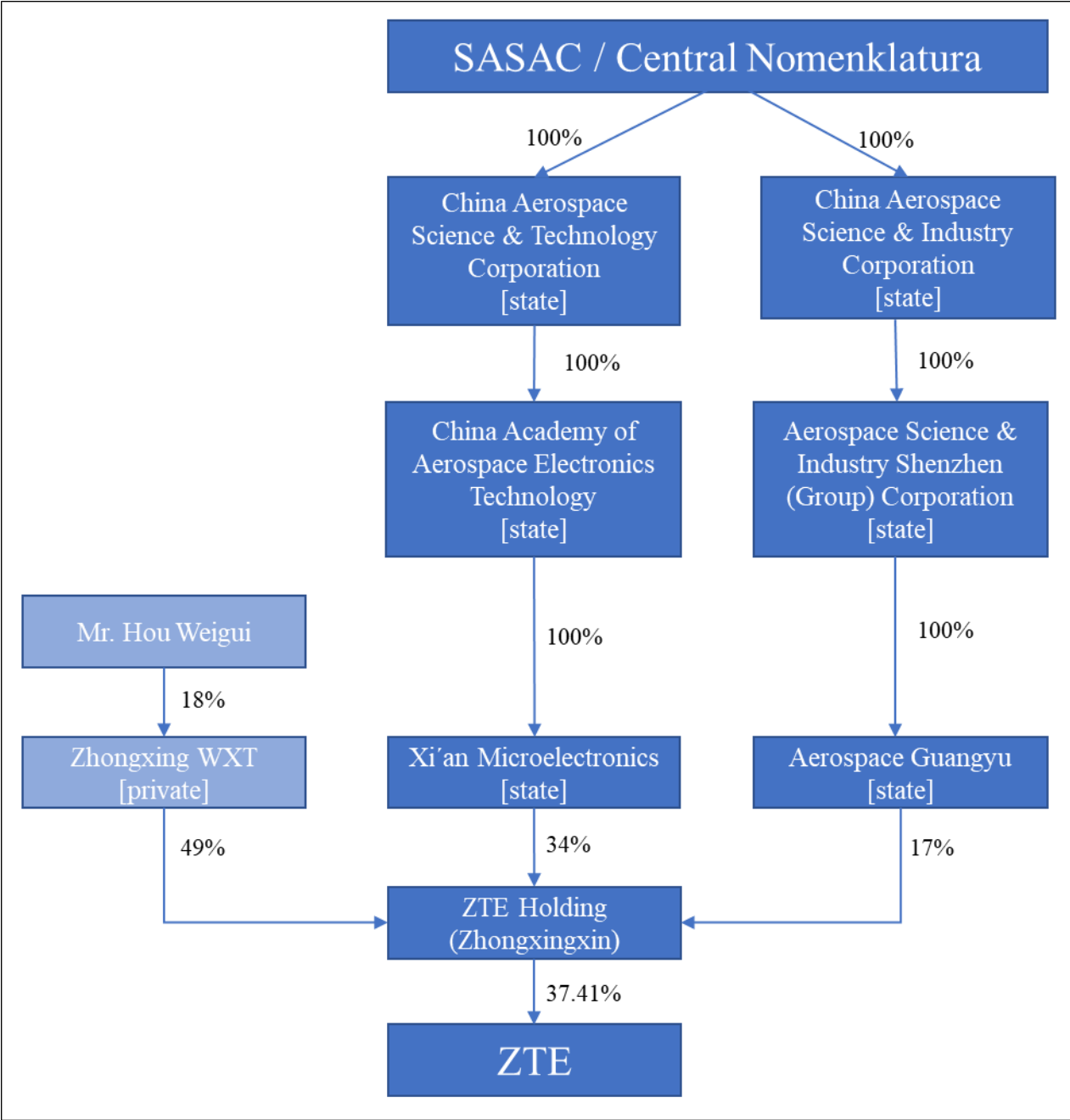


Figure 16: Ownership Structure of ZTE Holding and ZTE (2005-2008)  
 Sources: ZTE Corporation (2007); Milhaupt and Zheng (2015); R. Li and Cheong (2016). Author's design.

When turning to the state's controlling interest in the commercial actor, it is notable that ZTE was declared a key high-tech enterprise as well as one of 300 key state enterprises by the State Council in 1996 (R. Li and Cheong 2016, 262). Further evidence for the state's controlling interest in ZTE can be retrieved from the ownership structure itself. Although ZTE is not directly owned by SASAC, its intermediary shareholders suggest a strong interest in governmental control. As illustrated in Figure 16, between 2005 and 2008, the top of ZTE's ownership structure was occupied by China Aerospace Science & Technology Corporation and China Aerospace Science & Industry Corporation (R. Li and Cheong 2016, 257). Both companies are not

only wholly-owned by SASAC, but are also closely linked to the Chinese military and listed third and fourth on the central nomenklatura, illustrating their strategic importance to the Chinese government (Brødsgaard 2012, 635; Kawase 2018).

As outlined in the analytical framework, further evidence for assessing the state's interest in controlling the commercial actor can be obtained from the industry categories as defined by SASAC (Mattlin 2007; Norris 2016). In the case of ZTE, however, such a classification proves challenging, as it is not specified under which category telecom equipment manufacturers fall. While telecom companies are considered to be strategic, firms affiliated with information technology have been classified as pillar companies (Mattlin 2007, 16). Ultimately, as an equipment manufacturer and ICT company, it is more reasonable to assign ZTE to the pillar industries rather than to the strategic industries, where mainly telecom operators, such as China Telecom, can be found (Mattlin 2007; Zenglein and Holzmann 2019).

### **Management Structure**

As defined by the analytical framework, the empirical evidence for analysing ZTE's management structure includes the status of its employees, the company's formal reporting structure, the state's role in firm decision making and management appointments as well as the regulatory properties of the industry ZTE is operating in (Norris 2016).

With regard to the former, ZTE's staff are not considered state employees and are paid by ZTE itself rather than the state (Brødsgaard 2012, 634; R. Li and Cheong 2016, 257).

When analysing the mechanism for appointing senior posts, a distinction between the ZTE Holding and ZTE is required. In the case of the former, five out of the nine board members represent the two state-owned shareholders and are consequently appointed by the state (R. Li and Cheong 2016, 258).

As for ZTE, the positions on the board are determined through a shareholder election at the company's annual meeting rather than through a governmental body such as the CCP's Organisation Department or SASAC (Hawes and Li 2017, 72). Likewise, senior management positions are selected from within the company, with the Chinese state having no official influence on these decisions (R. Li and Cheong 2016, 259).

Although decisions on the appointment of personnel within ZTE are made independently from the state, Hawes and Li (2017, 72) argue that the five ZTE Holding nominees on ZTE's board, who thus form a majority, could also have some influence the appointment of executives. This

would therefore imply a certain role for the Chinese state as well. At this stage of the research, however, the actual influence of the state on ZTE's executive appointments and promotions remains speculation.

In collecting evidence for the assessment of the commercial actor's reporting structure, the distinction between ZTE Holding and ZTE is maintained. To begin with the former, the ZTE Holding formally reports to its three shareholders, Zhongxing WXT (private), Xi'an Microelectronics (state) and Aerospace Guangyu (state) (ZTE Corporation 2008). Therefore, although the ZTE Holding formally reports to two SOEs, it does not directly report to SASAC, the State Council or any other portion of the Chinese party-state (Norris 2016, 49).

Likewise, as a publicly listed company, ZTE formally reports to its shareholders. Accordingly, there is no direct reporting line to SASAC, the State Council or any other portion of the Chinese party-state (ZTE Corporation 2007; 2008; Hawes and Li 2017; R. Li and Cheong 2019).

However, it is noteworthy that the Chinese state is the majority shareholder of ZTE Holding and thus also holds significant shares in ZTE (R. Li and Cheong 2016, 257). One may therefore argue that to some degree, ZTE and the Holding are required to report to SASAC, the State Council or another portion of the Chinese party-state (R. Li and Cheong 2016, 255). However, the extent to which ZTE or the Holding are ultimately held accountable to the Chinese state remains unclear at this stage of the research (R. Li and Cheong 2016, 259).

In terms of the state's influence on the firm's decision-making process, ZTE, like other major state enterprises, is obliged to maintain an internal Party Committee (Hawes and Li 2017, 72–73).<sup>32</sup> According to the criteria set out in the analytical framework, it can therefore be concluded that the Chinese state indeed enjoys an “explicit role” in the company's decision-making.

In the case of ZTE, however, the role of the Party Committee had reportedly been far less prominent than in other companies, having only little influence on the firm's decision-making process and day-to-day operations (R. Li and Cheong 2016, 260). Therefore it is argued that “for major decisions, ZTE Corporation did not rely on the state but took decisions deemed to be in the best interest of the corporation” (R. Li and Cheong 2016, 259).

To assess ZTE's regulatory environment, and thus to answer the final sub-indicator, the previously introduced “tiered-economy framework” is applied. As a telecom equipment

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<sup>32</sup> As mentioned above, due to the fact that the operational management was incumbent on the Corporation, the scope will be adjusted accordingly (Milhaupt and Zheng 2016).

manufacturer, ZTE can be assigned to the group of “middle-tier” companies, indicating a moderate level of regulatory supervision compared to “top-tier” companies (Pearson 2015, 32–34). Ultimately, however, it is notable that two central SOEs with links to the military and therefore “top-tier” companies are involved in ZTE (Pearson 2015). However, whether or to which extent the narrow regulatory environment of its shareholders affects ZTE’s activities remains unknown.

### **Financing Structure**

To capture the financing structure of ZTE, the financial involvement of the state is scrutinised. This includes examining whether the agent received the majority or a substantial part of its funding from the state or whether the agent was able to raise sufficient funds independently (Norris 2016).

Considering that ZTE’s financing structure is not comprehensively disclosed, the criterion of alternative sources of funding is consulted.

As a publicly listed enterprise in both Shenzhen (1997) and Hong Kong (2004), ZTE managed to secure sufficient funding through financial markets (R. Li and Cheong 2019, 172). Moreover, ZTE has consistently generated profits over the years. In 2006 and 2007, the firm’s profits amounted to RMB 767 million and more than RMB 1.25 billion respectively (see Figure 17):<sup>33</sup>

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<sup>33</sup> Approximately US \$96 million (2006) and US \$165 million (2007) (National Bureau of Statistics of China 2015).

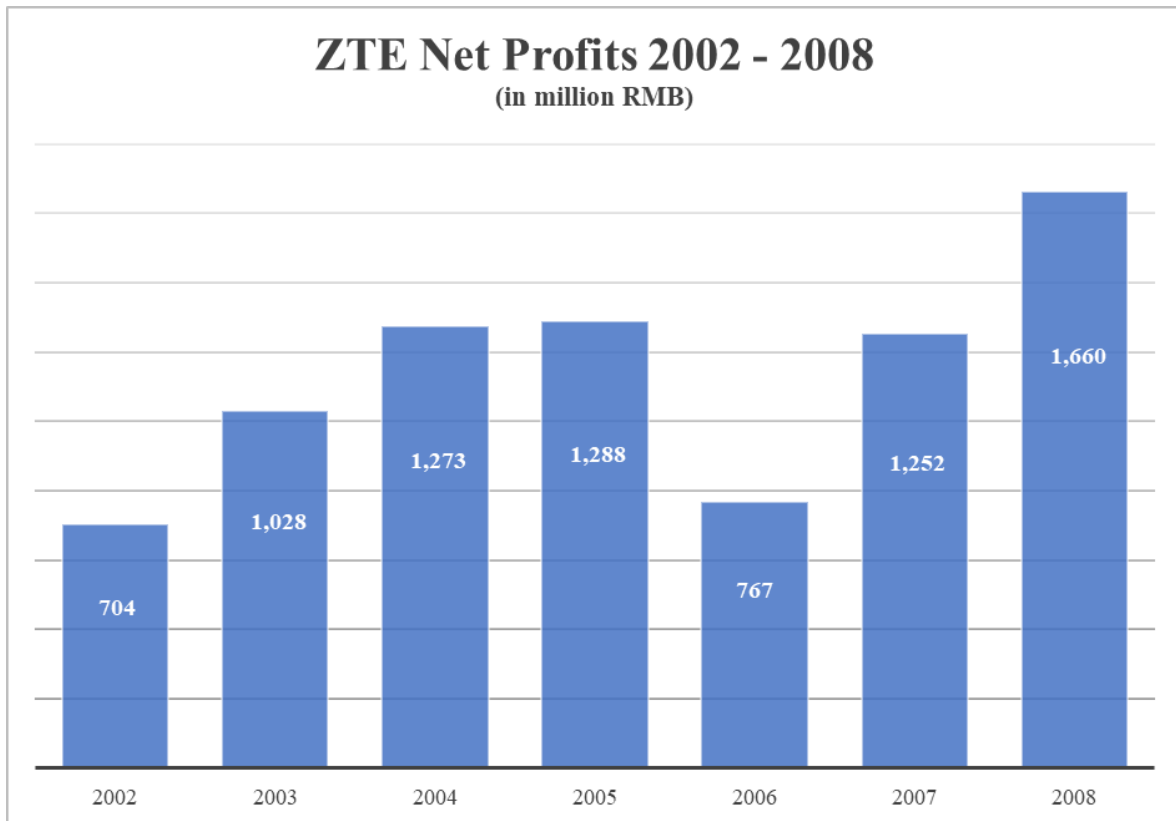


Figure 17: ZTE Net Profits (2002-2008)  
 Source: R. Li and Cheong (2016, 263). Author's design.

With regard to dividends, it is notable that unlike other state enterprises, ZTE is not required to remit parts of its net profit directly to the Chinese state. Instead, ZTE pays annual dividends to its shareholders (R. Li and Cheong 2019, 139).

In the run-up to the NBN deal, dividends amounting to around 19% of ZTE's net profit were distributed. Thus, the majority of the net profit remained within the company and served as a viable basis for self-financing (R. Li and Cheong 2019) (see Figure 18):



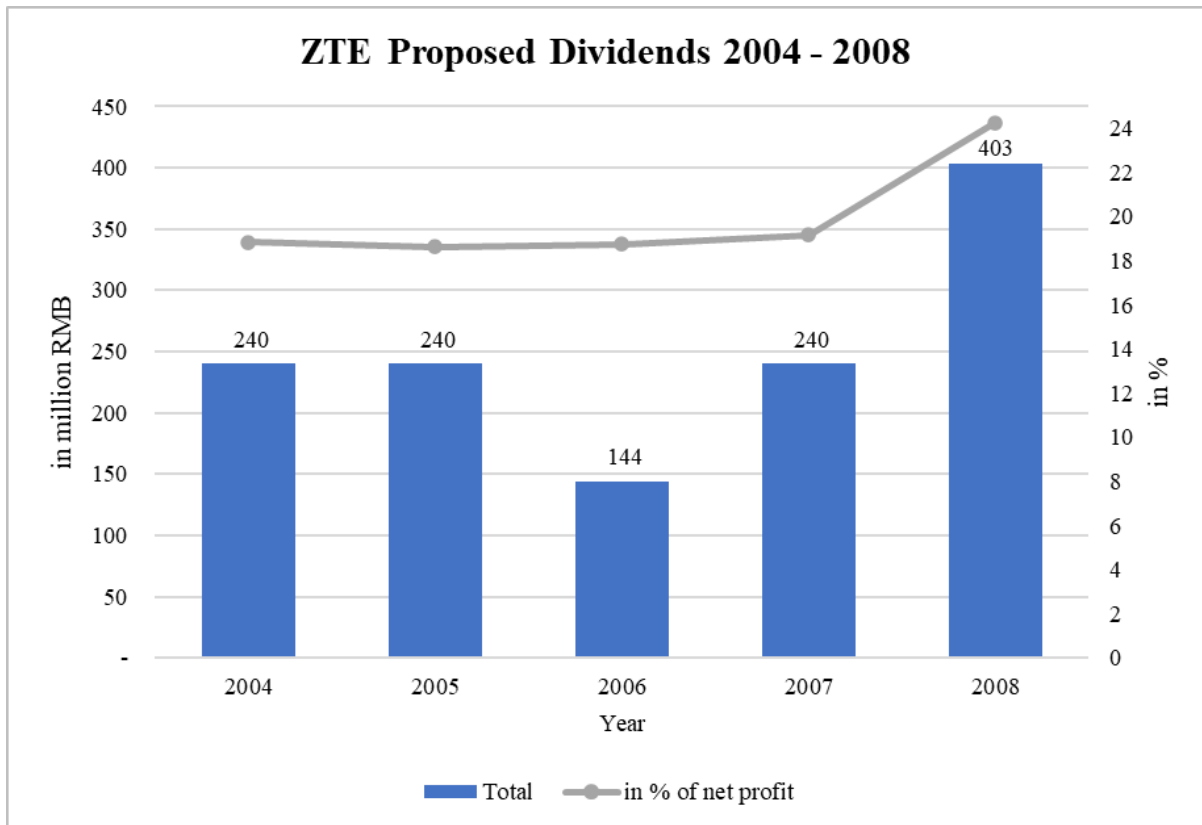


Figure 18: ZTE Proposed Dividends (2004-2008)  
 Source: ZTE Corporation (2006; 2007; 2008; 2009a). No earlier data available. Author's design

Nevertheless, there is also evidence suggesting a certain financial involvement of the Chinese state. As ZTE's business activities were in line with the government's general technology strategy, the Chinese state provided financial assistance in areas of common interest. Therefore, ZTE managed to relatively easy obtain funds for the development of science and technology. Other financial benefits included cheap loans, tax cuts and investment subsidies. Additionally, ZTE received preferential treatment when bidding for deals with other SOEs or major projects overseas. Overall, these financial benefits are regarded as the most important dimension of state support for ZTE (R. Li and Cheong 2016, 262; 2019).

### 3.4.2.2 Intrinsic Goal Compatibility

An integral part of the relationship between principal and agent is their intrinsic goal compatibility (Norris 2016). To this aim, ZTE's goal definition process as well as the motives and exclusivity of the two actors' objectives are examined.

### Goal Motives

If the empirical evidence points to a highly short-term incentivised commercial actor but to a rather politically and strategically oriented government, their respective "motives" ought to be classified as divergent (Norris 2016, 239).

Starting with the state's motives, the NBN deal is considered to be tightly connected to the JMSU with the Philippines, which in turn was a crucial element of Beijing's overarching economic inducement strategy aimed at altering the Philippines' policy stance on the South China Sea dispute (A. C. Wong 2019, 186; A. Wong 2019b). The timing of the deal, which was signed two years after the JMSU was initiated and one year before it was up for renewal, furthermore suggests that the inducement was intended to reaffirm China's political foothold in the region and to convince the Philippines to extend the joint undertaking (De Castro 2010; Baviera 2016).

With regard to ZTE's intrinsic motives, it is crucial to note that the company, although considered as a state-holding enterprise, was listed at stock exchanges in Hong Kong and Shenzhen (R. Li and Cheong 2016; Milhaupt and Zheng 2015). Such stock market presence establishes a direct link between the financial performance of the company and the career advancement of its executives. As such, listed state-enterprises face strong incentives to maximise short-term profits (Liou 2010, 46). This incentive is amplified by the fact that ZTE's top management was part of a company equity scheme rewarding good financial performance (R. Li and Cheong 2016, 255). Given the personal financial involvement, high-level managers tend to be "reluctant to bear policy-induced losses without any compensation" (Liou 2010, 47). At the same time, however, ZTE was also known for its willingness to act in compliance with state directives (R. Li and Cheong 2019, 172). Adherence to the government's strategic goals brought significant benefits to the company itself, particularly in terms of overseas market access and technological development through subsidies (R. Li and Cheong 2019, 140–42).

Yet, in the particular case of the NBN project, there is evidence suggesting a rather profit-driven commercial actor. With the Philippine government failing to provide the minimum requirements for the project, ZTE was able to determine "what should and should not be included in the NBN project, [and] what technology should be used" (Fabella and Dios 2007, 13). This eventually contributed to a vastly overpriced but lucrative NBN contract, thus serving the agent's commercial interests (Conde 2007; Baviera 2016).

### **Goal Definition**

To assess the government's influence on ZTE's goal definition process, two aspects are examined. Firstly, the power of the state to determine the political careers of high-ranking ZTE executives, thereby creating incentives to follow the party line. Secondly, the state's ability to alter the agent's commercial success through discretionary power (Norris 2016, 80–81).

As for the former, at the time the NBN deal was initiated, only one director of the board, Mr. Wang Zongyin, could be directly linked to the CCP (ZTE Corporation 2008, 32). Most crucially, ZTE's chairman, Mr. Hou Weigui, was neither a member of the CCP nor of the Party Committee (R. Li and Cheong 2016, 260). Hence, the state's potential influence through determining the political career of ZTE senior executives was limited (Norris 2016, 81).

Turning to the state's ability to wield influence through regulatory power, it is crucial to acknowledge that ZTE was not directly owned by SASAC (ZTE Corporation 2007; Milhaupt and Zheng 2015). Thus, the Chinese state did not have the means to significantly alter the firm's commercial success through a formal, institutional framework (Pearson 2015; Milhaupt and Zheng 2015). Nevertheless, the state's "king-making ability" can be regarded as an important driver of ZTE's economic performance. In addition to various state funds for the development of desirable technology, large-scale projects with other Chinese SOEs have been awarded to ZTE. Furthermore, the firm's internationalisation strategy was enhanced by significant state support. Additional preferential treatment included the company's involvement in government-sponsored technology projects, tax-cuts, investment subsidies, cheap land as well as bureaucratic exceptions that would allow ZTE to attract talented workforce more easily. These measures can ultimately be considered highly conducive to the firm's commercial success (R. Li and Cheong 2016, 261–62; 2019; Fuchs and Rudyak 2019).

### **Exclusivity of Goals**

Although divergent goals of principal and agent are not necessarily mutually exclusive, they tend to lead to a different priority setting. This in turn creates the risk of one objective being compromised by the other. Thus, despite controlling for the exclusivity of the objectives themselves, special attention is paid to empirical evidence suggesting a divergent priority setting, such as actions strongly indicating the agent's pursuit of profits (Norris 2016; 85).

Starting with the principal's objectives, the Chinese government was primarily pursuing political and strategic interests with the NBN project. Most crucially, the deal aimed at convincing the Philippines to extend the JMSU, which in turn was highly conducive to China's structural inducement efforts (Baviera 2016; A. C. Wong 2019).

Turning to the agent, Chinese ODA projects served as an important driver for ZTE's organisational development in technological, financial and strategic terms (R. Li and Cheong 2016; Fuchs and Rudyak 2019). It can therefore not be ruled out that ZTE was also pursuing strategic interests by contracting the NBN project. Nevertheless, it is argued that by demonstrating

compliance with state objectives, ZTE was “able to pursue primarily commercial objectives” (R. Li and Cheong 2019, 174). Such prioritisation of commercial motives, which is conditioned by the financial incentives associated with being publicly listed, was also evident in the NBN case, most notably through a highly overpriced but lucrative project contract (Conde 2007; Liou 2010; Baviera 2016). The agent’s priority setting thus strongly diverged from the state’s political and strategic intentions behind the NBN project (Baviera 2016; A. C. Wong 2019).

### *3.4.2.3 Relative Resources*

To assess the distribution of relative resources between principal and agent, the respective human capital, personnel count and financial budgets are examined. With regard to the quantitative indicators, the scope for the data collection – if available – is set on the year 2006 and 2007.

#### **Human Capital & Knowledge**

The evaluation of this indicator is guided by three key questions. First, was the principal experienced enough to regulate and oversee ZTE in its specific field? Second, was the agent operating in a fast-developing industry that made it hard for outsiders to keep track with the current state-of-the-art technology? Third, did the agent possess any non-accessible technical know-how that would grant him an advantage over the principal (Norris 2016)?

To answer the first question, it needs to be noted that the Chinese telecom equipment market was initially characterised by low-end manufacturing. Only in the late 1990s, the Chinese market developed into a technology-driven one (B. Low 2005, 101). In this process, the Chinese government played a “key role at nearly every stage of development” (Harwit 2007, 330). The state actively steered the technological evolution by crafting regulations and industry standards, thus indicating sufficient sector-specific knowledge and experience on the part of the Chinese government (Low 2005, 101).

Regarding the second question, due to its technology-driven evolution, the Chinese telecom equipment industry is described as being highly dynamic at the time of the NBN project (H. Zhu and Pasadilla 2016, 314). This development was primarily facilitated by the Chinese government and its efforts to overcome the reliance on foreign technology by establishing independent network standards (Stewart et al. 2011, 776). Accordingly, the state provided massive funds supporting state research centres and created an industry alliance consisting of major actors in the telecommunications market.<sup>34</sup> Hence, it is concluded that despite the dynamic

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<sup>34</sup> The so-called “TD-SCDMA Industry Alliance” included ZTE, Huawei, Datang Mobile and Lenovo, among others. For further information see (Stewart et al. 2011, 777).

development, the Chinese state has always played a decisive role in the technological progress of the industry and is therefore to be considered an insider within this process (Stewart et al. 2011; Hong, Bar, and An 2012; Norris 2016, 61).

As for the final question, in the absence of any project parameters, ZTE could virtually define its own terms and conditions, including the technical specifications of the broadband network. It is therefore argued it was almost impossible for outsiders to thoroughly comprehend the proposed deal (Fabella and Dios 2007, 13–14). While this circumstance provides ZTE with exclusive project-specific knowledge, it does not necessarily result in advantages on general technological aspects (Norris 2016). In fact, due to its role in ZTE's corporate development, the Chinese government was well informed about the current state of the firm's technology (R. Li and Cheong 2016, 259).

### **Personnel Count**

By examining the indicator personnel count, it is to be identified whether the principal was equipped with sufficient manpower to adequately oversee the agent and its activities.

However, when comparing the quantitative personnel count of principal and agent, it is important to recognise that ZTE was not directly supervised by a formal state agency.

Nevertheless, its ODA activities in the Philippines were still subject to the scrutiny of the Department of Foreign Aid (Gill and Reilly 2007; Bräutigam 2009). As outlined in the section on the NorthRail project, the Department of Foreign Aid was highly understaffed with no more than 100 employees responsible for monitoring China's entire foreign aid activities (Bräutigam 2009, 109). Having no staff deployed overseas, the Department was forced to cooperate with the Chinese Economic and Commercial Counsellor's Office, which usually seconded one or two officials to "oversee, amongst other things, the entire Chinese aid program in that country" (Lynch, Andersen and Zhu 2020).

Additionally, considering that ZTE formally qualifies as a state-holding enterprise and that its state shareholders are subordinate to SASAC, the organisational weight of SASAC may also be consulted as a comparative variable (L.-W. Lin and Milhaupt 2013; R. Li and Cheong 2016; Kawase 2018).

As outlined before, SASAC's staff amounted to roughly 800, with the main oversight being carried out by a total of 29 supervisory boards. Each of these supervisory boards consisted of four to five officials, which in turn were responsible for monitoring four to five SOEs (Chen

2020, 180–81). In the case of ZTE, however, no evidence indicating the deployment of a supervisory delegation or any other state-led supervisory apparatus to the company’s headquarters could be found. In comparison, ZTE employed more than 48,000 people in 2007, with a total of 14 directors and key decision-makers to be monitored (ZTE Corporation 2008; L.-W. Lin and Milhaupt 2013).

### **Budget Endowments**

By studying the respective budgets, it is examined how principal and agent compare in financial terms. The theory suggests that a financially inferior principal is less likely to adequately exercise supervision and impose the desired behaviour on the agent (Norris 2016, 238). To adequately capture the financial budget of the agent, the focus is placed on commercial indicators, such as the annual revenue, net profit and – if available – the detailed expenditures (Norris 2016).

However, as for the previous section, the absence of a direct supervisor makes it challenging to compare ZTE’s financial resources with the budget of the Chinese state or parts of it. To provide a broad reference, the scope of this analysis is set on the available budget figures for the Department of Foreign Aid as well as SASAC, which is formally considered as ZTE’s “ultimate controlling shareholder” (Milhaupt and Zheng 2015, 676).

Starting with SASAC, the agency’s earliest available financial figures only cover the year 2010 and 2011, in which its regular budget accounted for roughly RMB 3.9 billion (The Economic Observer 2011).<sup>35</sup>

Turning to the Department of Foreign Aid, the exact budgetary figures for the years under examination have not been publicly disclosed. However, as CIDCA inherited the majority of its workforce and organisational structure from its predecessor (see also Section 3.3.2.3), it appears to be reasonable to set the annual administrative budget of the Department of Foreign Aid within the same range as CIDCA’s 2018 budget (RMB 105 million) (Y. Sun 2019; Rudyak 2019; Lynch, Andersen and Zhu 2020).<sup>36</sup>

In contrast to the figures presented above, ZTE’s operational revenue increased from RMB 23.2 billion in 2006 to RMB 34.8 billion in 2007<sup>37</sup>, with the net profit amounting to RMB 767 million

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<sup>35</sup> Approximately US \$576 million (2010) and US \$612 million (2011) (see Section 3.3.2.3). As for the NorthRail project, the “State Capital Management Budget” is not further considered in this analysis.

<sup>36</sup> Approximately US \$15 million in 2018 (Y. Sun 2019).

<sup>37</sup> Approximately US \$2.9 billion (2006) and US \$4.6 billion (2007) (National Bureau of Statistics of China 2015).

and RMB 1.25 billion respectively (R. Li and Cheong 2016, 263).<sup>38</sup> At the same time, ZTE's expenditures for research and development, administrative and general issues as well as marketing increased from RMB 7.2 billion in 2006 to RMB 9.4 billion in 2007 (ZTE Corporation 2008).<sup>39</sup>

### 3.4.3 State Actor Variable: Unity of the State

In this part, empirical evidence for assessing the IV "Unity of the State" is gathered. As the period of the NBN project (2006-2007) overlaps with the NorthRail case, most of the previously collected information can be leveraged for this section as well. However, considering that the NBN deal was initiated roughly four years later than the NorthRail project, stronger emphasis is placed on evidence concerning the years 2006 and 2007.

The methodology of data collection applied throughout this section follows the structure of the analytical framework and therefore covers bureaucratic and institutional frictions, personal and ideological factions as well as potential geographical division.

#### **Bureaucratic & Institutional Friction**

To capture the bureaucratic and institutional frictions within the Chinese party-state, it is necessary to examine possible bureaucratic reorganisations, contests over jurisdiction and organisational competition over budget and personnel (Norris 2016).

Starting with the former, Cabestan (2009, 64) argues that with regard to the structure of China's security and foreign policy-making processes, no significant change in the bureaucratic architecture was observed after the transition from Jiang Zemin to Hu Jintao. However, while the institutional way of making foreign policy remained unchanged, the administrative approach to SOE management was restructured substantially. The establishment of SASAC therefore not only represents an important case of bureaucratic reorganisation within the Chinese state, but also led to significant contest over jurisdiction, budget and personnel (Mattlin 2007; Liou 2010). Although ZTE is not directly subordinate to SASAC, the governmental body nevertheless remains the firm's "ultimate controlling shareholder" (Milhaupt and Zheng 2015, 676). Being established in 2003, SASAC first had to adapt to the processes of the Chinese bureaucracy and its legitimisation was debated fiercely (Liou 2010, 42). The bureaucratic reorganisation caused relevant competition over authority, for example with regard to the retention of profits or the

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<sup>38</sup> Approximately US \$96 million (2006) and US \$165 million (2007) (National Bureau of Statistics of China 2015). ZTE's dividends are not considered when quantifying the budget.

<sup>39</sup> Approximately US \$903 million (2006) and US \$1.2 billion (2007) (National Bureau of Statistics of China 2015). Directly sales related costs (e.g., cost of goods sold) as well as financial and tax expenses are not included.

responsibility for appointing high-level executives in SOEs (Naughton 2006, 5–10). In 2007, SASAC eventually prevailed over rivalling bureaucratic agencies and started collecting profits from SOEs, which therefore can be regarded as a partial success in asserting its authority within the Chinese bureaucratic system (Naughton 2008, 5; Liou 2010, 43). Nevertheless, SASAC's mandate remained challenged, not only by other bureaucratic agencies, but also by powerful and politically well-connected enterprises (Naughton 2008).<sup>40</sup>

In addition to the struggle over competence involving SASAC, China's foreign aid activities have also been subject to jurisdictional contests among different governmental agencies, namely the MofCom, MoF and the MFA. In this regard, each governmental body sought to harness Chinese ODA activities to assert its individual interests (Corkin 2011, 73–79; Trinidad 2016). While the MFA considered ODA projects primarily as a tool to foster the state's foreign relations, the MofCom leveraged them as a gateway for Chinese products and enterprises into foreign markets. The MoF, instead, preferred the respective loans to be structured in a commercially viable way (Corkin 2011, 73–79). Considering that the NBN project was implemented as a state-led ODA project, it is to be expected that the impact of such bureaucratic struggles and authority disputes within the Chinese bureaucratic system also affected ZTE as the formal contractor of the deal (Gill and Reilly 2007).

### **Personal & Ideological Factions**

For the assessment of personal and ideological factions, it is necessary to examine promotion patterns, purges, elite networks, known rivalries, corruption cases, ideological struggles as well as the political focus of China's top leadership (Norris 2016). In line with the NorthRail case, the scope of data collection is limited to Jiang Zemin and Hu Jintao, including their respective factions (Bo 2008, 333). Furthermore, although the 16<sup>th</sup> Party Congress in 2002 is briefly discussed, the focus of this section concerns the developments up to the 17<sup>th</sup> Party Congress in 2007. To provide for a better overview and understanding, this section is further structured by sub-headlines.

#### **Elite Networks and Personal Rivalries (Purges, Promotion Patterns, Corruption Cases, etc.)**

As thoroughly examined in Section 3.3.3, the 16<sup>th</sup> National Party Congress in November 2002 was characterised by factional struggles and personal rivalries between Hu Jintao and his predecessor Jiang Zemin. Eventually, Jiang Zemin managed to place six allies in the PBSC (Wu

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<sup>40</sup> The next major reform and bureaucratic reorganisation with regard to the management of SOEs has been initiated in 2016 and is therefore not subject to this analysis (Leutert 2016).



Bangguo, Zeng Qinghong, Huang Ju, Chen Liangyu, Wu Guanzheng, Jia Qinglin and Li Changchun), thus reinforcing the Shanghai Gang's political influence (Fewsmith 2003; C. Li 2007; Szamosszegi and Kyle 2011). Additional evidence for personal factions can be obtained from Jiang Zemin's refusal to retire from the CMC chairmanship (Bo 2008, 337).

In the aftermath of the 16<sup>th</sup> Party Congress, however, various incidences of purges and dismissals contributed to a significant decline in power for Jiang Zemin and his allies. In 2003, Zhang Wenkang, health minister and supporter of Jiang Zemin, was dismissed due to his mismanagement of the SARS crisis (FAZ 2003; Bo 2008). Jiang Zemin's forced handover of the CMC chairmanship to Hu Jintao in 2004 was followed by the purge of Chen Liangyu for his involvement in corruption cases in 2006 (C. Li 2007, 2; Bo 2008, 338; Fewsmith 2021). In 2007, the Shanghai Gang's loss of power in the PBSC was further facilitated by the death of Huang Ju, the final dismissal of Chen as well as the retirement of Zeng Qinghong (Bo 2008, 338–39). After the 17<sup>th</sup> Party Congress in 2007, the only remaining member in the PBSC affiliated with the Shanghai Gang was Wu Bangguo. At the same time, the number of politicians with links to the Shanghai Gang represented in the Central Committee of the CCP decreased from 17 (2002) to nine (2007). The Shanghai Gang was therefore substantially weakened by the time the NBN deal was initiated (Bo 2008, 340).

Conversely, the CCYL managed to increase its presence in the Central Committee to 82 members (41 full, 41 alternate) at the 17<sup>th</sup> Party Congress, thus consolidating its power (Bo 2008; Miller 2011). Furthermore, two members of the PBSC (Hu Jintao, Le Keqiang) as well as six members of the Politburo had a history in the CCYL (Bo 2008, 340). Additionally, with Wen Jiabao, a third member of the PBSC could be assigned to Hu Jintao's camp (C. Li 2007, 5; Cho 2008, 159). In conclusion, while the Shanghai Gang experienced a significant decline in power as well as in group cohesion, the CCYL remained “the most powerful factional group by a large margin” (Bo 2008, 363). This observation is shared by Francois, Trebbi and Xiao (2016, 58), who found that the power base of Hu Jintao and the CCYL significantly increased after the 16<sup>th</sup> Party Congress and eventually peaked at 17<sup>th</sup> Party Congress in 2007. Accordingly, the peak of the CCYL's power corresponds with the timing of the NBN project.

Nevertheless, despite losing ground to the CCYL, the Shanghai Gang remained a relatively powerful political faction, forcing Hu Jintao to compromise with respect to the appointment of personnel within the political system (C. Li 2007). Accordingly, even after the 17<sup>th</sup> Party Congress, some critical positions were occupied by members of the Shanghai Gang, making further purges of Jiang Zemin protégés rather unlikely (Fewsmith 2021, 108). In fact, with the notable

exception of the Bo Xilai scandal, Hu Jintao did not go after other allies of Jiang Zemin (Fewsmith 2013, 2).

### Ideological Factions

Turning to the ideological factions, it can be concluded that Jiang Zemin's push for redefining the CCP's legitimacy has been effectively countered by Hu Jintao already in 2003 (Holbig 2009, 48). Since Hu Jintao managed to establish his own ideological and macro-economic preferences in the subsequent years, no further ideological factions relevant to the NBN case could be observed (Holbig 2009; Cohen 2012b).

### The State's Political Focus

With regard to diplomatic visits, which are leveraged as a proxy to evaluate the Chinese leadership's political focus, multiple events relevant to the NBN project could be observed (Norris 2016).

In June 2006, the "Philippines – China Economic Partnership Forum" was held in Manila. During the conference, the Chinese minister of commerce, Bo Xilai, signed a MoU with the Philippines, paving the way for the NBN project (Senate of the Philippines 2009, 15). Furthermore, Bo Xilai used this occasion to meet with President Arroyo to discuss bilateral cooperation prospects. The meeting was also attended by the Chinese ambassador to the Philippines, Li Jinjun, and the Philippine Speaker of the House, Jose de Venecia Junior (Chinese Embassy n.d.).

In January 2007, another official state visit to the Philippines took place in the person of Premier Wen Jiabao, an ally of Hu Jintao. Afterwards, the two nations issued a joint statement, "reaffirming the commitment of taking further steps to deepen the strategic and cooperative relationship" (Mendoza and Heydarian 2012, 60).

In the subsequent months, President Arroyo conducted multiple visits to China. During her first trip to the Bao Forum (April 2007), the NBN deal was finalised and signed. Further visits followed in June and October 2007, where she personally conveyed the cancellation of the NBN project to President Hu Jintao (Mendoza and Heydarian 2012, 60; Baviera 2016, 18). After the project was cancelled, Arroyo made three additional trips to China in 2008 (Mendoza and Heydarian 2012, 60).

## **Geographical Division**

To illuminate geographical divisions within the Chinese state, potential centre-local and rich-poor tensions are examined. To this aim, special attention is paid to the political dynamics between China's provinces (Norris 2016; A. Wong 2018).

In this regard, following the 16<sup>th</sup> Party Congress, the provincial representation in the Politburo increased from five to seven. This new composition indicates an “apparent bias towards the eastern seaboard” (Fewsmith 2003, 9), with five members serving as party secretaries of coastal provinces.<sup>41</sup> Moreover, 65% of the members of the 16<sup>th</sup> Politburo were affiliated to leadership positions in coastal regions at some point in their political career, whereas only 35% had served in inner regions (C. Li and White 2003, 574). This inequality is further enhanced by the presence of several members of the PBSC with a history in coastal provinces (Fewsmith 2003, 9–12). In the course of the 17<sup>th</sup> Party Congress in 2007, the ratio of the provincial representation in the Politburo remained unchanged, with five seats being covered by coastal and two by inner provinces (Fewsmith 2008; Miller 2011).<sup>42</sup>

However, despite the coastal-inland disparity, no further evidence suggesting major geographical divisions, particularly concerning the Chinese inducement efforts towards the Philippines, could be retrieved.

### **3.5 Summary Chapter 3**

Within Chapter 3, the empirical evidence for the NorthRail and the NBN project has been compiled. The collection of data followed the structure of the analytical framework introduced in Chapter 2. In a next step, the evidence is leveraged to determine each of the five IVs for both the NorthRail and the NBN project, which eventually leads to the coding of the DV in the respective inducement case. Chapter 4 maintains the general structure of Chapter 3, which means that the NorthRail project is analysed first, followed by the NBN case. Ultimately, a comprehensive conclusion of both inducement cases is provided in Chapter 5.

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<sup>41</sup> Beijing is considered as coastal region (C. Li and White 2003, 574).

<sup>42</sup> In 2008, Beijing's mayor Wang Qishan was appointed as vice premier, reducing the number of regional representatives to six (four coastal, two inner provinces) (Fewsmith 2008; Miller 2011).

## Chapter 4: Analysis

### 4.1 Structure of the Analytical Part

Chapter 4 is organised as follows: Based on the analytical framework, the findings of the empirical part (Chapter 3) are analysed. To this end, each indicator of the IVs is examined separately before an assessment of the IV as a whole is performed. After analysing the five IVs, the respective outcome of the DV “state control” for each inducement case is determined. The results obtained from the NorthRail and the NBN project are subsequently leveraged to draw an overall conclusion about the degree of Chinese state control during its economic inducement efforts towards the Philippines (Chapter 5).

### 4.2 Case Study #1: NorthRail Project

#### 4.2.1 Economic Actor Variable: Market Structure

##### **Findings**

##### Number of Firms

To evaluate the number of firms and therefore the IV “Market Structure”, the following criteria have been defined in the analytical framework:

- **Concentrated:** one to three non-competitive, monopolistic firms.
- **Oligopolistic:** more than two competing actors.

According to the ENR data, a total of 35 Chinese construction companies were among the “Top 225 International Contractors” in 2000 (Lan 2010). This number eventually increased to 49 in 2004, with CNMG ranking third. Overall, the ENR data for 2003 and 2004 suggest that at least 18 firms were eligible for performing overseas construction work (Reina and Tulacz 2005).

However, not all of the firms in the ranking were holding the legally required certificates to contract overseas railway projects. Based on the information retrieved from company websites as well as a careful review of government-funded railway projects involving Chinese contractors, the empirical evidence suggests that between 2002 and 2007, more than eight Chinese companies possessed the formal qualifications to compete for the NorthRail project. Among them, actors such as the China Railway Construction Corporation, the China Railway Engineering Corporation and the China Civil Engineering Construction Corporation could be found (Foster, Butterfield and Chen 2009; Dreher et al. 2017).

In addition, the railway construction industry in general can be considered highly competitive, as evidenced by fierce bidding wars between the firms for government-tendered ODA projects (Burke 2007; Hu 2014; Y. Sun 2014).

In accordance with the analytical framework, the number of more than two competing players in the Chinese railway construction industry – in this case at least eight – suggests a fairly **oligopolistic market** (Norris 2016).

### Market Share

To assess the market share and thus the IV “Market Structure”, the following criteria have been defined:

- **Concentrated:**  $\geq 50\%$  of the market share belongs to  $\leq$  six firms.
- **Fragmented:**  $\geq 50\%$  of the market share belongs to  $>$  six firms.

To compensate for the lack of sector-specific data, the market share of the companies represented in the 2005 ENR ranking was calculated, with the three largest companies claiming more than 50% of both domestic and international revenues (Reina and Tulacz 2005). However, as this market share does not necessarily represent the structure of the Chinese railway construction industry, drawing a clear assessment proves challenging.

Nevertheless, based on the information available to the author, the market share may best be categorised as **oligopolistic** (Norris 2016, 235–36).

### Pricing Power

To assess the pricing dynamics and thus the IV “Market Structure”, the following criteria have been defined:

- **Concentrated:** top one or two firms as price makers or reports and exhibits of cartel pricing.
- **Fragmented:** competitive pricing.

The collection of empirical evidence has put forth mixed results. On the one hand, scholars have highlighted the competitive character of the Chinese railway construction industry itself. This observation is reinforced by multiple cases of Chinese SOEs seeking to outcompete each other even when it comes to the execution of government-led ODA projects (Burke 2007; Hu 2014; Y. Sun 2014).

Conversely, in the particular case of the NorthRail project, there was no official public bidding process. Therefore, CNMEG was able to determine the scope and the price of the project according to its own preferences (Landingin 2010).

However, according to the analytical framework, this indicator is designed to describe the environment of a particular market space, not the circumstances of a single project (Norris 2016, 27–28). In absence of evidence pointing to one or two leading companies as price makers or widespread cartel pricing, and given the reports of strong price competition in the railway construction industry as a whole, this indicator is coded as **fragmented** (Norris 2016).

**Assessment**

Based on the findings presented above, the following assessment is drawn:

1. The number of competing firms clearly suggest an oligopolistic market structure.
2. The market concentration could not conclusively be determined, but the information available would suggest a concentrated market structure.
3. The third indicator suggests a competitive pricing behaviour in the railway construction industry in general, indicating a rather fragmented market structure.

Considering the lack of comprehensive data, especially with regard to the market share, the assessment of this IV proves challenging. However, based on the information available to the author, it can be concluded the number actively competing (e.g., competitive pricing) Chinese railway construction companies in a rather concentrated market space provided the Chinese state with a sufficient, but not too large, variety of alternative players for the implementation of the NorthRail project (Norris 2016, 292). Accordingly, the IV “Market Structure” is ultimately coded as **oligopolistic** (Norris 2016, 236) (see Table 12):

NorthRail Project	Market Structure		
	Concentrated	Oligopolistic	Fragmented
<b>Number of Firms</b>	-	<i>Oligopolistic</i>	
<b>Market Share</b>	<i>Evidence inconclusive, but available data suggest a concentrated market share.</i>		-
<b>Pricing Power</b>	-		<i>Competitive in general, concentrated on CNMEG in the NorthRail project.</i>
<b>Final Evaluation:</b>	<b>Oligopolistic</b>		

Table 12: Assessment IV “Market Structure” (NorthRail Project)  
 Source: Author’s design.

## 4.2.2 Relational Variables

### 4.2.2.1 Reporting Relationship

Unless stated otherwise, the figures and (company) information presented for the IV “Reporting Relationship” refer to the years from 2002 to 2012.

### **Findings**

#### Ownership Structure

To adequately capture this indicator, the focus was set on CNMEG’s formal ownership structure as well as the state’s potential controlling interest in the agent.

Starting with the former, CNMEG is entirely held by the Chinese state. Since 2003, CNMEG has been directly managed and controlled by SASAC, which in turn is subordinate to the State Council of the NPC (Mattlin 2007; Sinomach 2011).

Regarding the second criterion, the empirical evidence suggests that the Chinese state indeed has a relevant interest in controlling the agent. This is reflected, for example, in CNMEG’s status as a “key enterprise” as well as its classification as a so-called “pillar company”, which due to their strategic importance to the Chinese government are subject to significant state ownership and enhanced state influence (Mattlin 2007, 16).

Overall, it can be concluded that the Chinese state not only is the sole shareholder of CNMEG, but also has a relevant interest in controlling the agent, indicating a **direct reporting relationship**.

#### Management Structure

The criteria for evaluating CNMEG’s management structure cover the status of the firm’s employees, the company’s formal reporting structure, the state’s role in firm decision making and management appointment processes as well as the regulatory properties of the industry CNMEG is operating in (Norris 2016).

Based on the collected evidence, several aspects clearly point towards a direct reporting relationship.

First, the individuals working for CNMEG are state employees (Sinomach 2011; China Economic Review 2014). Second, the appointment of senior posts in the company is subject to the Chinese state, whereas from 2003 onwards the responsibility of management appointments shifted from the CCP to SASAC (L.-W. Lin and Milhaupt 2013, 736–38). Third, as a wholly state-owned enterprise, CNMEG directly reports to SASAC and therefore the Chinese party-

state (Szamosszegi and Kyle 2011, 5; L.-W. Lin and Milhaupt 2013, 711). Fourth, through the establishment of a mandatory Party Committee within CNMEG's organisational structure, the Chinese state maintains an explicit consultative role in the firm's decision-making processes (J. Wang 2014, 656; L.-W. Lin 2014, 754).

However, in the case of the final sub-indicator, namely CNMEG's regulatory environment, a clear assessment proves to be more difficult. To systematically approach this question, Pearson (2015) introduced a three-tier system, divided into top-tier, middle-tier and bottom-tier industries. According to this model, the intensity of the Chinese state's regulatory oversight is expected to decrease from top to down. Due to its high degree of diversification, the empirical evidence is not entirely conclusive in terms of assigning CNMEG to a specific tier-category (Mattlin 2007; Pearson 2015). However, considering that CNMEG was contracted to implement an international construction project, it can be concluded that the regulatory oversight by the Chinese government, at least in the particular case of the NorthRail project, was rather tight (Pearson 2015, 32–37).

In conclusion, four out of five sub-indicators conclusively point towards a fairly direct management structure and therefore direct reporting relationship. The only ambiguity remains the assessment of CNMEG's regulatory environment. Yet, the evidence from the NorthRail case suggests the strictest regulatory oversight according to the framework presented by Pearson (2015). Therefore, it is concluded that CNMEG's management structure indicates a **direct reporting relationship** between principal and agent.

### Financing Structure

As a final indicator, CNMEG's financing structure has been examined. If a firm receives most or a substantial part of its funds from the state, the reporting relationship is expected to be more direct. Vice versa, enterprises that are able to generate most of their funding through alternative channels, such as public markets or retained profits, tend to have a rather indirect reporting relationship with the state (Norris 2016; Reilly 2021).

As the collection of evidence did not conclusively disclose CNMEG's financing structure, other indicators had to be consulted. At a macro level, scholars found that from 2004 onwards, SOEs obtained most of their financing through self-raised funds, for instance from investors and from retained earnings (Allen, Qian and Qian 2005; K. J. Lin et al. 2020).

Although these figures arguably provide an indication of SOEs in general, they do not provide further insights into the specific financing structure of CNMEG. In line with the analytical



framework, the focus was therefore shifted to the potential sources of fundraising available to CNMEG, with particular attention being paid to equity markets and retained earnings (Norris 2016; Reilly 2021). With regard to the former, it needs to be outlined that CNMEG itself is not listed on any public market. Therefore, the only possible way to financially benefit from public offerings is through its listed subsidiaries (Mattlin 2007; Sinomach 2011; 2012). Yet, an examination of CNMEG's company structure revealed that its ability to raise funds through public markets was non-existent until 2004 (Sina 2004). Accordingly, at the time of the signing of the NorthRail project, CNMEG had no possibility to finance itself through stock markets. However, after the acquisition of Dingsheng Tiangong in 2004, CNMEG's access to public markets subsequently increased. The listing of ZYS in 2005 was followed by the IPO of Lamce (2005) as well as the transfer of YTO and China Foma (including Changlin and Linhai Power) to the company portfolio in 2008.<sup>43</sup> At the end of 2012, CNMEG had eight listed subsidiaries (Sinomach 2012). Therefore, it can be concluded that as access to public markets increased, so did CNMEG's ability to self-finance.

As for the retention of earnings, CNMEG was not only profitable throughout the period under review, but also significantly increased its profits from RMB 460 million in 2002 to more than RMB 8.6 billion in 2012 (Sinomach 2010; 2011; 2013).<sup>44</sup> Considering that CNMEG was able to retain its entire margin until 2007 – while from 2007 onwards only a small share had to be transferred to SASAC – it can be argued that the company's profits served as a substantial source of self-financing (Naughton 2008; Brødsgaard 2012; Kratz 2013; Milhaupt and Zheng 2015).

Overall, the aggregate figures on the financing structures of SOEs, the history of CNMEG's profits and the absence of meaningful dividend payments to SASAC suggest that the majority of the agent's financing was self-raised, indicating an **indirect reporting relationship**.

### **Assessment**

Based on the evidence presented above, the following assessment for the IV "Reporting Relationship" is drawn:

1. The evidence retrieved for the ownership and management structure clearly suggests a direct reporting relationship between principal and agent.

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<sup>43</sup> Sources: Pennington (2004); Sina (2004); Sinomach (2008; 2012); First Tractor Company Limited (n.d.); Shanghai Stock Exchange (n.d.); China Foma (n.d.); eWorldTrade.com (n.d.); China CAMC Engineering Co. Ltd (n.d.).

<sup>44</sup> Corresponding to approximately US \$55.5 million (2002) and US \$1.3 billion (2012) (National Bureau of Statistics of China 2015).

2. Regarding the company’s financing structure, the evidence is less conclusive. Ultimately, the development of CNMEG’s profits and the absence of meaningful dividends to be paid suggest the company’s ability to finance itself.

Considering the strong evidence collected for the company’s ownership and management structure, the IV “Reporting Relationship” is finally coded as **direct** (Norris 2016) (see Table 13):

NorthRail Project	Reporting Relationship	
	Direct	Indirect
<b>Ownership Structure</b>	<i>Direct</i>	-
<b>Management Structure</b>	<i>Direct</i>	-
<b>Financing Structure</b>	<i>Not conclusive; evidence suggests that CNMEG can finance itself by retaining profits.</i>	
<b>Final Evaluation:</b>	<b>Direct</b>	

Table 13: Assessment IV “Reporting Relationship” (NorthRail Project)  
Source: Author’s design.

#### 4.2.2.2 Intrinsic Goal Compatibility

##### **Findings**

##### **Goal Motives**

The purpose of this indicator was to explore the individual motives and incentives of principal and agent associated with the NorthRail project. If the empirical evidence points to a highly short-term incentivised commercial actor but to a rather politically and strategically oriented government, their respective “motives” ought to be classified as divergent (Norris 2016, 239).

As far as the Chinese government’s objectives are concerned, it can be concluded that the NorthRail project was funded in pursuit of political and strategic interests. By persuading the Philippines to sign the controversial JMSU as a “quid-pro-quo”, the Chinese state also sought to advance a structural interest transformation of the Philippines with regard to the South China Sea dispute (Goh 2011; De Guzman 2014; Yung and McNulty 2015; A. Wong 2019b).

Turning to the agent, the literature suggests that implementing ODA projects also yields certain benefits for the respective contractor, such as state-sponsored market access. This enables companies to rapidly expand their market share and gain significant strategic advantages over competitors, thus serving as a viable foundation for advantageous long-term engagement in the respective target country (Burke 2007; Kurlantzick 2007).

However, while it cannot be ruled out that CNMEG was driven by such long-term considerations as well, the empirical evidence indicates the firm's pursuit of short-term, profit-oriented motives and incentives. This was *inter alia* reflected in a highly overpriced contract in the first place, CNMEG's request for an additional US \$299 million from the Philippine government as well as the immense asymmetry in terms of project progress and payments received (Jimenez 2008; Landingin 2010; De Guzman 2014).

Based on the empirical evidence and the criteria discussed in the analytical framework, it is concluded that while the Chinese government pursued political and strategic interests, CNMEG was driven by short-term, profit-oriented considerations, thus pointing to **divergent** goal motives (Norris 2016).

### Goal Definition

For the assessment of the state's influence on CNMEG's goal definition process, two aspects are decisive. First, the power of the state to determine the political careers of high-ranking executives, thereby creating incentives to follow the party line, and second, its ability to alter the agent's commercial success through discretionary power (Norris 2016, 80–81).

As for the former, Ren Hongbin's political career and his close relationship with the state and the CCP points to a substantial influence of the Chinese government on CNMEG's goal definition process. Besides holding official political positions in the CCYL, the Central Committee of the CCP and the Standing Committee of the CPPCC, Ren Hongbin also publicly emphasised the responsibility of SOEs in pursuing governmental policies, thus underlining his adherence to state objectives (C. Zhu and Hornby 2012; Lam 2014). This finding is supported by the fact that CNMEG itself claims to formulate its corporate objectives in accordance with the CCP's respective "Five-Year-Plan", SASAC and the CCP Central Committee (Sinomach 2011, 3).

In addition to CNMEG's official commitment to party policies and the government's influence through Ren Hongbin, the Chinese state also has the regulatory means to substantially alter CNMEG's commercial success, most notably through SASAC (Naughton 2008; Pearson 2015). The more power the state has to determine the agent's commercial success, the greater the state's influence on the agent's goal setting process (Norris 2016, 80–81).

Overall, the evidence presented above suggests that the Chinese state would at least have been in a position to exercise considerable influence on the formulation of CNMEG's corporate goals. Thus, from this perspective, the respective goals of principal and agent are classified as **convergent**.

### Exclusivity of Goals

As emphasised by Norris (2016), short-term, profit-oriented goals of the agent and political and strategic objectives of the principal are not necessarily mutually exclusive. Nevertheless, a diverging priority setting of the two actors can lead to one objective being compromised by the other. Accordingly, both the exclusivity of the goals and the respective priorities of principal and agent have been examined.

As far as the general goal compatibility is concerned, the commercial motives of CNMEG and the political, strategic intentions of the Chinese state were – theoretically – not mutually exclusive (Baviera 2016; G. Lim 2017). The implementation of the NorthRail project, besides generating profits, also provided CNMEG with the opportunity to build a strong presence in the Philippines and thus to benefit from its engagement in the long term (Burke 2007; Kurlantzick 2007).

Turning to the second sub-indicator, CNMEG strongly prioritised its commercial, short-term objectives during the course of the project. This was inter alia evidenced by a highly overpriced contract, the company's request for additional funding, the unilateral suspension of work as well as the slow project progress (Jimenez 2008; Landingin 2010; De Guzman 2014; Cheung and Hong 2019). The agent's prioritisation thus strongly diverged from the state's political focus and strategic intentions behind the NorthRail project and its engagement in the Philippines (Goh 2011; De Guzman 2014; Yung and McNulty 2015; A. Wong 2019b).

Therefore, it can be concluded that while the individual goals of principal and agent themselves were not mutually exclusive, the different prioritisation caused the strategic objectives of the government to be compromised by CNMEG's short-term objectives and the associated externalities (Norris 2016, 84–85). Accordingly, the respective goals of principal and agent are to be considered **divergent** from this perspective.

### Assessment

Based on the findings presented above, the following assessment is drawn:

1. Out of three indicators, only the Chinese government's involvement in CNMEG's goal formulation process points to an intrinsic goal compatibility.
2. Conversely, the respective motives of principal and agent were inherently divergent, with the state pursuing political and strategic objectives and CNMEG being driven by short-term, commercial motives.

3. While CNMEG’s commercial motives and the strategic objectives of the Chinese state could theoretically both be attained, the firm’s strong focus on short-term goals eventually caused the government’s political considerations to be compromised, thus making them mutually exclusive.

Overall, based on the criteria presented in the analytical framework, the IV “Intrinsic Goal Compatibility” is coded as **divergent** (Norris 2016) (see Table 14):

NorthRail Project	Intrinsic Goal Compatibility	
	Convergent	Divergent
Goal Motives	-	<i>Divergent</i>
Goal Definition	<i>Convergent (state involved)</i>	-
Exclusivity of Goals	-	<i>Divergent due to mutually exclusive priorities.</i>
<b>Final Evaluation:</b>	<b>Divergent</b>	

Table 14: Assessment IV “Intrinsic Goal Compatibility” (NorthRail Project)  
Source: Author’s design.

#### 4.2.2.1 Relative Resources

##### Findings

##### Human Capital & Knowledge

To evaluate the distribution of human capital, three questions have been raised (Norris 2016). First, was the state experienced enough to regulate and oversee CNMEG in its specific field? Second, was the agent operating in a fast-developing industry that made it hard for outsiders to keep track with the current state-of-the-art technology? And third, did the agent possess any non-accessible technical know-how that would grant him an advantage over the principal?

As for the principal’s experience, it is crucial to note that the NorthRail project was intended to be a regular commuter railway (Landingin 2012). The construction of such commuter railways had already been well established, with the Chinese government playing a central role in its planning and development (Xue, Schmid and Smith 2002; Lixin and Fengli 2017). It can therefore be assumed that the Chinese state possessed the necessary experience to adequately regulate CNMEG in the NorthRail project (Norris 2016, 61).

Turning to the second question, the empirics show that the development of the Chinese railway construction industry considerably accelerated from 1991 onwards (Xue, Schmid and Smith 2002; World Bank 2009; Z. Sun 2015). In this context, it is crucial to note that the development

was initiated and directed almost exclusively by the Chinese government, which was therefore able to follow and comprehend relevant technological breakthroughs (Z. Sun 2015, 655).

Finally, although the empirical evidence suggests that CNMEG had project-specific knowledge from conducting the feasibility study, two aspects indicate that the firm most likely did not have exclusive technical know-how in general (Landingin 2010, 85; Supreme Court, Republic of the Philippines 2012). First, several other railway construction companies were conducting similar projects at that time. Second, the development of the railway construction industry was mainly led by the Chinese government itself, which was therefore well informed about the current state-of-the-art technology (Foster, Butterfield and Chen 2009; Z. Sun 2015; Norris 2016, 61).

In conclusion, while CNMEG possessed project-specific knowledge, it did not have any non-accessible technical know-how. Furthermore, the state was highly involved in the railway development and therefore is to be considered an insider. Since the commuter railway to be built was already well established, it can be assumed that the Chinese state had the necessary technical experience to monitor and regulate CNMEG's activities in the NorthRail project. Accordingly, the empirical evidence indicates a balance of relative resources **favouring the state** (Norris 2016).

#### Personnel Count

The main question guiding this indicator is whether or not the principal was physically able to sufficiently monitor the agent in order to enforce desired behaviour.

In terms of overall personnel count, CNMEG's roughly 40,000 employees outnumbered those of SASAC and the Department of Foreign Aid, which employed 800 and 100 people respectively (Bräutigam 2009; Sinomach 2011; L.-W. Lin and Milhaupt 2013).

With regard to permanent oversight and monitoring, the Chinese state's most important instruments were the so-called supervisory offices seconded by SASAC (Chen 2017). Based on the size of these offices (four to five officials) and the fact that each unit had to supervise four to five SOEs at all times, it can be concluded that the number of permanent officials physically dispatched to SOEs was presumably between one and five (Chen 2020). These figures suggest that the officials seconded by SASAC were likely to be in the minority compared to CNMEG's key decision-makers, which included not only the board of directors (between seven and eleven people) but also the firm's core management team, such as its chief financial officer or chief legal adviser (Sinomach 2011; 2012). Ultimately, this numerical inferiority made it difficult for

SASAC to adequately oversee CNMEG's internal processes and business operations (Liou 2010; Chen 2020).

Likewise, the Department of Foreign Aid did not maintain an overseas presence to monitor CNMEG in its activities. Instead, it relied on the Chinese Economic and Commercial Counselor's Office, which seconded one or two officials responsible for the entirety of China's foreign aid projects in a third country. Therefore also the staffing and permanent oversight of the Department of Foreign Aid can be considered highly inadequate and therefore inferior to CNMEG's personnel count (Bräutigam 2009; Lynch, Andersen and Zhu 2020).

Overall, considering that both SASAC's and the Department of Foreign Aid's personnel count were physically outnumbered by CNMEG's human resources, this indicator is clearly **favouring the agent**.

#### Budget Endowments<sup>45</sup>

As mentioned in Section 3.3.2.3, the lack of empirical data does not allow for a direct comparison between the financial endowment of CNMEG – measured by revenue and net profit – and SASAC.

However, considering that SASAC's budget in 2011 and 2012 (roughly RMB 3.9 billion) was almost doubled by CNMEG's net profits (RMB 6.7 billion and RMB 7.8 billion respectively), it can be argued that the agent's financial resources were superior compared to those of the principal (The Economic Observer 2011). This argument receives further weight when looking at CNMEG's net operating revenue, which increased from RMB 17.3 billion in 2002 to RMB 214 billion in 2012, with the company being consistently profitable (Sinomach 2010; 2011; 2013).<sup>46</sup>

In addition to SASAC, CNMEG's financial resources also exceeded the Department of Foreign Aid's budget, which ranged between RMB 105 million and RMB 122 million (Y. Sun 2019; Rudyak 2019; Lynch, Andersen and Zhu 2020).

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<sup>45</sup> As the focus of this section is on a comparison between the financial budgets of the principal and agent, each expressed in RMB, the US dollar equivalent is not repeated. To obtain the detailed values, please refer to Section 3.3.2.3.

<sup>46</sup> No detailed breakdown of CNMEG's expenditures and budgets could be obtained.

In conclusion, CNMEG’s financial capabilities outnumbered those of SASAC and the Department of Foreign Aid, even if the two budgets were combined. As such, this indicator is considered as **favouring the agent**.

**Assessment**

Based on the findings presented above, the following assessment is drawn:

1. With respect to the distribution of human capital and knowledge, CNMEG has not gained an advantage through exclusive technical know-how. As the state has been an important driver for the development of the railway sector, this sub-indicator is regarded as fairly balanced. Following the dichotomous logic of the analytical framework, the balance of human capital and knowledge is therefore considered to be in favour of the principal.
2. Conversely, both the staff and the financial budget of CNMEG were larger than those of SASAC and the Department of Foreign Aid.

As a result of CNMEG’s superior financial endowment and personnel count, the IV “Relative Resources” is ultimately coded as **favouring the agent** (Norris 2016) (see Table 15):

NorthRail Project	Relative Resources	
	Favouring State	Favouring Agent
<b>Human Capital and Knowledge</b>	<i>Favouring state</i>	-
<b>Personnel Count</b>		<i>Favouring agent</i>
<b>Budget Endowements</b>		<i>Favouring agent</i>
<b>Final Evaluation:</b>	<b>Favouring Agent</b>	

Table 15: Assessment IV “Relative Resources” (NorthRail Project)  
Source: Author’s design.

4.2.3 State Actor Variable: Unity of the State

**Findings**

**Bureaucratic and Institutional Friction**

To capture the bureaucratic and institutional frictions within the Chinese party-state, the collection of data was directed towards possible bureaucratic reorganisations, contests over jurisdiction as well as organisational competition over budget and personnel (Norris 2016). In doing so, particular attention has been paid to the leadership transition from Jiang Zemin to Hu Jintao.

As for the former, while no significant changes in the way foreign and security policy was made could be identified, the establishment of SASAC in 2003 is considered an important case of



bureaucratic reorganisation (Cabestan 2009). Subsequently, SASAC did not only struggle to adapt to the Chinese bureaucracy, but its legitimacy was also subject to internal debate. In addition, the establishment of SASAC led to significant disputes between bureaucratic institutions over responsibilities, competences and privileges, such as the retention of profits or the appointment of senior posts in SOEs (Naughton 2006; 2008; Liou 2010).

Relevant bureaucratic friction and organisational competition could also be observed in the context of China's foreign aid programme. Here, the MFA, the MoF and the MofCom rivalled over the purpose and design of ODA activities, with each entity seeking to assert its individual interests (Gill and Reilly 2007; Corkin 2011).

Accordingly, from a bureaucratic and institutional perspective, the Chinese state is considered **fragmented**.

#### Personal and Ideological Factions

To evaluate the personal and ideological factions within the Chinese party state, relevant promotion patterns, purges, elite networks, known rivalries, corruption cases, ideological struggles and the political focus of China's top leadership were examined. To this end, special attention has been paid to the rivalry between Hu Jintao's CCYL and Jiang Zemin's Shanghai Gang (Norris 2016).

#### *Elite Networks and Personal Rivalries (Purges, Promotion Patterns, Corruption Cases, etc.)*

During the period under review, several incidences suggesting personal factions occurred. First, although Hu Jintao formally became secretary general of the CCP, Jiang Zemin and the Shanghai Gang remained relatively powerful. This was inter alia reflected by the fact that Jiang Zemin was able to place a total of six allies in the PBSC and initially refused to retire from his post as the chairman of the CMC (Bo 2008; Szamosszegi and Kyle 2011). Furthermore, with Hu Jintao seeking to foster his political power, a number of purges and dismissals could be observed. Particularly noteworthy here are the purges of Zhang Wenkang and Chen Liangyu, both of whom were close allies of Jiang Zemin (C. Li 2007; Bo 2008). Overall, the period between the 16<sup>th</sup> and 18<sup>th</sup> Party Congress was characterised by a strong personal rivalry between Hu Jintao and Jiang Zemin, with Hu Jintao's CCYL ultimately emerging as the politically most powerful faction. At the same time, Jiang Zemin and his Shanghai Gang experienced a considerable decline in power and group cohesion (Fewsmith 2003; 2013; C. Li 2007; Bo 2008; Szamosszegi and Kyle 2011; Francois, Trebbi and Xiao 2016).

### *Ideological Factions*

Apart from personal factions, ideological divisions within the party could be detected as well. After gaining power in 2002, Hu Jintao struggled to reverse Jiang Zemin's ideological legacy, which has been incorporated in the CCP's constitution at the 16<sup>th</sup> Party Congress. As Hu Jintao's campaign took until late 2003, it can be argued that the CCP leadership was ideologically divided, at least in the initial phase of the NorthRail project. Subsequently, however, Hu Jintao pushed for establishing his own ideological turns, which eventually were incorporated into the CCP's constitution in 2007, thus suggesting ideological unity among the party leadership (Holbig 2009, 48–56).

### *The State's Political Focus*

The final sub-indicator examined was the number and nature of official state visits between China and the Philippines. Among the high number of diplomatic visits, three events are particularly noteworthy (Clemente 2016).

While the talks on the NorthRail project were launched at a time when Jiang Zemin was still secretary general of the CCP, the first MoU was only concluded after Hu Jintao came to power (Philippine Embassy n.d.; He 2012). Furthermore, the signing was witnessed by Wu Bangguo, the party's number two and reportedly one of Jiang Zemin's closest allies (Bo 2008, 334–39). Finally, it was Hu Jintao himself who attended the signing of the agreement for the second phase of the project during his first state visit to the Philippines (Philippine Embassy n.d.).

As such, not only the frequency but also the timing of diplomatic visits suggests a certain political consensus among China's top leadership concerning the NorthRail project (Landingin 2010; Norris 2016).

Overall, a clear classification of this indicator proves challenging. On the one hand, the empirical evidence suggests substantial personal and ideological factions within the Chinese government. On the other hand, the timing and frequency of state visits to the Philippines indicate a common political focus among China's top leadership. Building on Norris (2016, 82), who argued that although "China is often beset by multiple forces that create a divided Principal, when the senior leadership focuses on a particular issue area, it is able to provide very effective state unity", this indicator is classified as **unified**.

### Geographical Division

Apart from the under-representation of the inner provinces in the Politburo and PBSC, no evidence suggesting centre-local or rich-poor tensions in relation to the NorthRail project could be observed.

Accordingly, from a geographical perspective, the Chinese state is classified as **unified**.

### Assessment

Based on the findings presented above, the following assessment is drawn:

1. From a bureaucratic and institutional perspective, the Chinese state is to be considered as fragmented. This is mainly due to the establishment of SASAC as well as the organisational contest between the MFA, MofCom and MoF.
2. From a geographical, personal and ideological perspective, the Chinese state is regarded as unified.

In line with Norris's (2016, 82) argument that if senior officials share a common political focus on a particular policy area – such as the NorthRail project – bureaucratic and institutional frictions as well as personal and ideological factions can be overcome and effective state unity can be provided, the IV “Unity of the State” is ultimately coded as **unified** (see Table 16).

NorthRail Project	Unity of the State	
	Unified	Fragmented
<b>Bureaucratic &amp; Institutional Friction</b>	-	<i>Fragmented</i>
<b>Personal &amp; Ideological Factions</b>	<i>Unified</i>	-
<b>Geographical Division</b>	<i>Unified</i>	-
<b>Final Evaluation:</b>	<b>Unified</b>	

Table 16: Assessment IV “Unity of the State” (NorthRail Project)  
Source: Author's design.

#### 4.2.4 Conclusion #1: The NorthRail Project

Based on the analytical framework presented in Chapter 2, the empirical evidence for the NorthRail case was collected. Thereafter, the gathered information has been leveraged to dichotomously determine each indicator, which subsequently provided the foundation for coding the five IVs. The final assessment of these IVs, including a Norris-based prediction for the outcome of the DV “state control”, can be obtained from Table 17:

Level	IV	IV Coding	Decisive Evidence	DV Outcome Prediction
<b>Economic Actor</b>	<b>Market Structure</b>	<i>Oligopolistic</i>	Despite the lack of comprehensive evidence, the number of actively competing firms (>2) in a rather concentrated market space in terms of market share suggests an oligopolistic market structure.	<b>Control likely</b>
<b>Relational</b>	<b>Reporting Relationship</b>	<i>Direct</i>	CNMEG is owned by and directly reporting to SASAC; CNMEG staff are state employees; explicit consultative role in the firm's decision-making processes for the Chinese state through the Party Committee; SASAC responsible for high-ranking management appointments; relevant controlling interest in the commercial actor by the Chinese state (CNMEG as part of a "strategic industry").	<b>Control likely</b>
	<b>Intrinsic Goal Compatibility</b>	<i>Divergent</i>	Despite the state's ability to alter CNMEG's commercial success and its influence through Ren Hongbin on the firms's goal formulation process, CNMEG's strong prioritisation of short-term objectives compromised the state's strategic considerations.	<b>Control unlikely</b>
	<b>Relative Resources</b>	<i>Favouring Agent</i>	While the human capital was in favour of the state (no exclusive know-how for CNMEG, while the state drove the development of the industry), CNMEG's personnel and budget far exceeded the capacities of SASAC and the Department of Foreign Aid.	<b>Control unlikely</b>
<b>State Actor</b>	<b>State Unity</b>	<i>Unified</i>	Despite bureaucratic and ideological frictions (e.g., establishment of SASAC, contest over China's foreign aid activities) as well as personal factions (e.g., Hu's CCYL and Jiang's Shanghai Gang), China's top leadership managed to demonstrate a coherent political focus towards the Philippines and the NorthRail project, thus demonstrating sufficient state unity; little evidence for centre-local or rich-poor tensions.	<b>Control likely</b>

Table 17: Final Assessment of the Five IVs for the NorthRail Project  
Source: Author's design.

In view of the number of actively competing firms as well as the available information on the market share, the IV "Market Structure" is coded as oligopolistic, thus providing ideal circumstances for state control. With regard to the relational dimension, two out of three IVs suggest state control to be difficult, namely the distribution of relative resources and the intrinsic goal compatibility. CNMEG's advantages in terms of resources stem from its superior personnel count and financial budget in comparison to SASAC and the Department of Foreign Aid. As for the intrinsic goal compatibility, the evidence of the NorthRail case shows that the company's strong prioritisation of short-term profit maximisation overrode the strategic interests of the

state, resulting in the objectives of principal and agent becoming mutually exclusive. The only relational variable suggesting state control is the direct reporting relationship between SASAC-owned CNMEG and the Chinese government, with especially CNMEG's ownership and management structure indicating strong governmental involvement in the firm.

Lastly, despite considerable bureaucratic frictions (e.g., SASAC, MFA, MoF and MofCom) and personal factions (e.g., Hu Jintao and the CCYL vs. Jiang Zemin and the Shanghai Gang), the Chinese state can be regarded as unified, especially with respect to the NorthRail project. This is evidenced by frequent state visits of the Chinese top leadership across all factions to the Philippines throughout the NorthRail project, with some trips even directly related to the construction of the railway. Such demonstrated "top-level guidance" helps in overcoming other divisions and therefore ensures effective state unity (Norris 2016, 82).

Having discussed the coding of the individual IVs and their isolated relationship to the DV, the question remains "how these IVs interact with each other and, ultimately, result in outcome values for the dependent variable of state control" (Norris 2016, 29). To answer this question, a "decision tree" introduced by Norris (2016) is leveraged. This decision tree functions as a structured questionnaire that queries the dichotomous values of the different IVs and highlights their interdependencies. By following the decision tree, which is also referred to as "sequencing", one is able to ultimately determine the value of the DV for each inducement case (Norris 2016, 29). The different steps of the decision tree are further explained below.

### **Step 1:**

According to Norris (2016), the first question to be asked along the decision tree is whether or not the state was unified. If the Chinese state is not able to act in a unified manner and fails to agree on basic strategic objectives, "it is nearly impossible for the state to exercise control over commercial actors" (Norris 2016, 31).

### **Step 2:**

If the prerequisite of a unified state is fulfilled, Norris (2016, 31) suggests consulting the IV "Goal Compatibility." It is argued that a combination of a unified state and intrinsically compatible goals most likely results in state control over the commercial actor, regardless of the values of the remaining three IVs. However, if the state is unified but the goals are divergent, classical "principal-agent" cases emerge. Here, the three remaining IVs – "Market Structure", "Reporting Relationship" and "Relative Resources" – become decisive factors for the outcome of the DV (see Figure 19):

		Goal compatibility	
		Low	High
State unity	High	<p><b>Principal-agent cases</b></p> <p>Outcome becomes a classic principal-agent challenge (need to look at: balance of relative resources, market structure, and reporting relationship)</p>	<p><b>Overdetermined cases of state control</b></p>
	Low	<p><b>Cases in which control is unlikely</b></p>	<p><b>Incidental cases</b></p> <p>Security externalities may be generated (but unlikely as a result of economic statecraft)</p>

Figure 19: Matrix of State Control  
Source: Norris (2016, 37).

### **Query Step 1 & 2: NorthRail Case**

Turning to the NorthRail project, it can be concluded that while the state acted in a unified manner, the intrinsic goals of principal and agent were divergent. In fact, the strong prioritisation of CNMEG’s short-term, profit-oriented goals compromised the state’s overarching policy considerations. Hence, the NorthRail project can be regarded as a classical “**principal-agent case**”, with the outcome of the DV being determined by the remaining three IVs (Norris 2016, 29–38).

### **Further Procedure in the Event of “Principal-agent Cases”**

In the event of a “principal-agent case”, Norris (2016) proceeds with examining the IV “Market Structure.” He argues that in the case of a diffuse or a highly concentrated market structure, state control – albeit not impossible – is rather unlikely (see Figure 20):

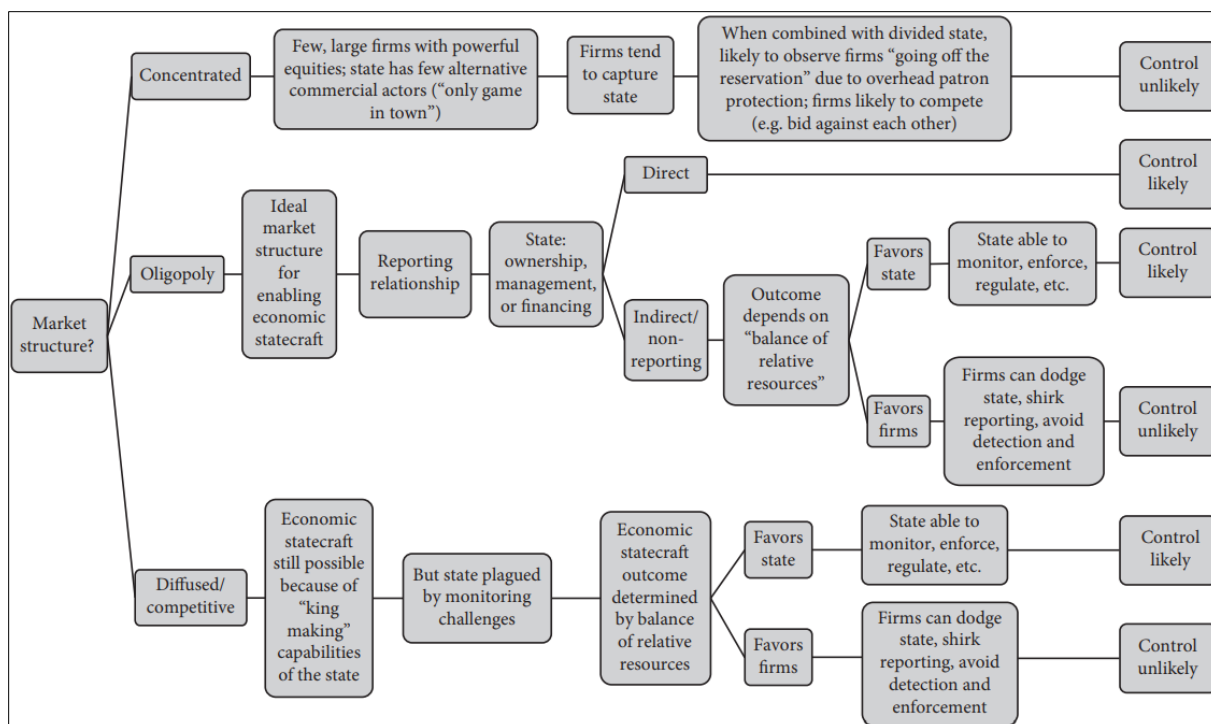


Figure 20: Decision Tree for “Principal-agent Cases”  
Source: Norris (2016, 34).

However, the most favourable empirical context for state control is an oligopolistic market structure. In such a case, the IV “Reporting Relationship” is to be examined next.

If the reporting relationship is direct, one can expect the combination of an oligopolistic market structure and a direct reporting relationship to result in state control, regardless of the distribution of relative resources. Conversely, in the event of an indirect reporting relationship, the IV “Relative Resources” becomes a decisive determinant (Norris 2016, 34).

### **Query of the Remaining Three IVs: NorthRail Case**

As for the NorthRail case, the empirical context was not only characterised by an oligopolistic market structure but also a fairly direct reporting relationship.

### **Conclusion**

As a result, the causal logic outlined above suggests that the Chinese government should have been in a position to exercise **state control** over CNMEG, regardless of the outcome of the final IV “Relative Resources” (Norris 2016, 34).<sup>47</sup>

<sup>47</sup> Nevertheless, a relative balance of resources favouring the agent may result in the state being unable to effectively monitor the commercial actor and enforce desired behaviour (Norris 2016, 34). To which degree CNMEG’s resource superiority may have affected the effectiveness of China’s economic inducements is further discussed in Chapter 5.

## 4.3 Case Study #2: The NBN Project

### 4.3.1 Economic Actor Variable: Market Structure

#### **Findings**

##### Number of Firms

To evaluate the number of firms and therefore the IV “Market Structure”, the following criteria have been defined:

- **Concentrated:** one to three non-competitive, monopolistic firms.
- **Oligopolistic:** more than two competitive actors.

Based on the empirical evidence, it can be concluded that between 2006 and 2007, at least three major Chinese telecom equipment manufacturers have actively been operating in the industry (Huawei, Datang and ZTE). With Julong Group, albeit struggling to assert its position in the industry, a possible fourth company may be taken into account as well. However, as it could not be determined whether Julong Group was still considered an option for contracting overseas projects, the number of firms is set at a minimum of three (Smith-Gillespie 2001; B. Low 2005; Harwit 2007; EU SME Centre 2011).

In terms of competitiveness, the empirical evidence suggests that the Chinese government was highly interested in maintaining a competitive and efficient telecom equipment industry, with especially Huawei and ZTE being fierce competitors in both national and international markets (Harwit 2007; Mthembu-Salter 2011; Hong, Bar and An 2012).

As a result of the findings presented above and the criteria defined by the analytical framework, the number of firms would suggest an **oligopolistic** market structure (Norris 2016).

##### Market Share

To assess the market share and thus the IV “Market Structure”, the following criteria have been defined:

- **Concentrated:**  $\geq 50\%$  of the market share belongs to  $\leq$  six firms.
- **Fragmented:**  $\geq 50\%$  of the market share belongs to  $>$  six firms.

In 2007, the year the NBN deal was signed, the Chinese telecom equipment market was highly concentrated. Ericson held 43% of the market share, while ZTE and Huawei accounted for a combined 13%. In 2008, Huawei and ZTE significantly increased their share of the 2G market to 22.5% and 15% respectively, jointly claiming 37.5% of the market. In terms of 3G, ZTE, Huawei and Datang accounted for more than 63% of the market share in 2008 (ZTE Corporation



2009b). One year later, more than 50% of the Chinese 3G market was in sum held by Huawei (28%) and ZTE (25%) (Hong, Bar and An 2012).

In absence of industry-specific data for 2006, the focus of the analysis is set on the year 2007. Although Ericson was not an option for contracting the NBN project, the 2007 data nevertheless suggest an extremely concentrated market environment in the Chinese telecom equipment industry. This circumstance is exacerbated by the fact that only three to four Chinese companies were operating in the respective market space. As the scope of this analysis has been limited to Chinese enterprises only, it can be concluded that at least half of the market share in the telecom equipment industry was held by one or two Chinese actors (Norris 2016).

Accordingly, the market share is classified as **concentrated**.

### Pricing Power

To assess the pricing dynamics and thus the IV “Market Structure”, the following criteria have been defined:

- **Concentrated:** top one or two firms as price makers or reports and exhibits of cartel pricing.
- **Fragmented:** competitive pricing.

Chinese telecom equipment manufacturers are described as highly competitive in fighting for government contracts and domestic market share. Furthermore, firms like ZTE and Huawei became increasingly fierce rivals in international markets and for overseas ODA projects, thus indicating a competitive pricing behaviour (Mthembu-Salter 2011; Stewart et al. 2011; Pawlicki 2017; Gagliardone 2019). At the same time, no evidence suggesting price collusion neither on the national nor international level could be retrieved.

Yet, in stark contrast to the abovementioned competitive pricing within the Chinese telecom equipment industry itself, the contract for the NBN project was awarded to ZTE bypassing an official public bidding process. Despite having economically and technically better offers at hand, the Philippine government designated ZTE as the project contractor (Pastrana 2008; Baviera 2016; Camba 2017; Batalla 2020).

However, as the assessment of the “pricing power” is intended to characterise the competitive nature of a specific market space – in this case the Chinese telecom equipment industry – rather than the circumstances of a single project, this indicator is classified as competitive and therefore **fragmented** (Norris 2016, 236).

**Assessment**

Based on the findings presented above, the following assessment is drawn:

1. While the number of firms suggests an oligopolistic market structure, the assessment of the market share implies a rather concentrated telecom equipment industry.
2. At the same time, the pricing behaviour in the telecom equipment industry can be described as highly competitive, thus indicating a fragmented market.

According to Norris (2016, 292), in a highly concentrated market with only a few dominant actors, one may expect these firms to “collude to resist the will of the state”, thus causing the respective IV to be coded as concentrated. However, the competitive nature (e.g., competitive pricing) of the telecom equipment industry, and thus the ability of the state to choose between a number of alternatives for its ODA projects, overrides “any freedom of action [for the commercial actor] that might be gained as a result of the concentrated market structure” (Norris 2010, 296).

As a result, the IV “Market Structure” is coded as **oligopolistic** (Norris 2010; 2016) (see Table 18):

NBN Project	Market Structure		
	Concentrated	Oligopolistic	Fragmented
<b>Number of Firms</b>	-	<i>Oligopolistic</i>	
<b>Market Share</b>	<i>Concentrated</i>		-
<b>Pricing Power</b>	-		<i>Competitive in general, concentrated on ZTE in the NBN project.</i>
<b>Final Evaluation:</b>	<b>Oligopolistic</b>		

Table 18: Assessment IV “Market Structure” (NBN Project)  
Source: Author’s design.

## 4.3.2 Relational Variables

### 4.3.2.1 Reporting Relationship

Unless stated otherwise, the figures and (company) information presented for the IV “Reporting Relationship” refer to the years 2006 and 2007.

#### **Findings**

##### **Ownership Structure**

To adequately capture this indicator, the focus was placed on the formal ownership structure of ZTE and the ZTE Holding as well as the state’s potential interest in controlling the agent.

Starting with the formal ownership structure, it is notable that ZTE is not directly owned by SASAC. Instead, it is listed on public markets with the largest single shareholder being the ZTE Holding (37.41% in 2006 and 2007). Thus, the ZTE Holding managed to retain full control over ZTE (ZTE Corporation 2007; R. Li and Cheong 2016, 258).

With regard to the Holding, the majority (51%) of the company’s shares is held by two wholly state-owned enterprises, namely Aerospace Guangyu and Xi’an Microelectronics. These two enterprises are in turn owned by central SOEs directly subordinate to SASAC (L.-W. Lin and Milhaupt 2013; R. Li and Cheong 2016; Kawase 2018). Accordingly, it is argued that through its majority ownership in ZTE Holding, the Chinese state succeeded in securing its controlling stake in ZTE (R. Li and Cheong 2016).

With regard to the Chinese state’s controlling interest in ZTE, three aspects are relevant. First, in 1996, the State Council defined ZTE as a key high-tech enterprise and one of the 300 most important state enterprises (R. Li and Cheong 2016, 262). Second, as a telecom equipment manufacturer, ZTE can be classified as a “pillar-enterprise”, thus indicating the state’s interest in retaining sufficient control (Mattlin 2007; Zenglein and Holzmann 2019). Finally, the two SOEs that topped ZTE’s ownership structure between 2005 and 2008 were not only owned by SASAC, but also ranked third and fourth on the central nomenklatura, placing them among the strategically most important enterprises for the Chinese state (Brødsgaard 2012, 635; R. Li and Cheong 2016, 257).

Therefore, although not directly owned by SASAC, ZTE’s ownership structure can be classified as **direct**, indicating a direct reporting relationship (Norris 2016).

### Management Structure

As outlined in the analytical framework, the empirical evidence for analysing ZTE's management structure covers the status of its employees, the company's formal reporting structure, the state's role in firm decision making and management appointments as well as the regulatory properties of the industry ZTE is operating in (Norris 2016).

The only aspect that clearly suggests an indirect management structure is the fact that ZTE staff are not considered state employees (Brødsgaard 2012, 634; R. Li and Cheong 2016, 257).

In the assessment of the remaining four sub-indicators, however, various ambiguities persist. This fact is mainly due to the divergence between the formal, observable reporting structure and the anecdotal evidence provided by academics researching ZTE. However, since the analytical framework relies on objective, observable evidence, the assessment of the sub-indicators is ultimately based solely on the formal empirical context (Norris 2016). Furthermore, the distinction between the Holding and ZTE is maintained in this assessment as well. That said, the focus here is on ZTE, which was responsible for the main operational activities (Milhaupt and Zheng 2016, 676).

Starting with the state's influence on managerial appointments, five out of the Holding's nine board members are seconded by the two state-owned shareholders and thus directly appointed by the Chinese state (R. Li and Cheong 2016, 258). At ZTE, staff appointments are made by the company itself, independent from the CCP's Organisation Department or any other governmental body (Hawes and Li 2017). Since the state has had no formal influence on personnel decisions at ZTE Corporation, this sub-indicator points to an indirect management structure.

As for the firm's reporting structure, although the Holding is majority-owned by and thus reporting to two SOEs, it was not directly reporting to SASAC, the State Council or any other official portion of the Chinese party-state. Likewise, as a publicly listed company, ZTE formally reports to its shareholders. Notwithstanding the fact that these shareholders included other SOEs, ZTE did not report directly to SASAC, the State Council or any other portion of the Chinese party-state (ZTE Corporation 2007; 2008; Hawes and Li 2017; R. Li and Cheong 2019). Therefore, this sub-indicator suggests an indirect management structure as well.

In terms of ZTE's regulatory environment, the company itself classifies as a "middle-tier" firm, with the state exercising moderate regulatory oversight compared to "top-tier" firms (Pearson 2015, 32–34). As such, ZTE's regulatory environment suggests an indirect management structure.

Conversely, one aspect that implies a direct management structure is the state's explicit role in the decision-making process of the firm, exemplified through the presence of a mandatory Party Committee (R. Li and Cheong 2016, 259–60).

Overall, out of five sub-indicators, only the state's explicit and formal role in the firm's decision-making process points towards a direct management and reporting structure.

Conversely, the remaining evidence, although subject to certain ambiguities, suggests a rather indirect management structure at the time of the NBN project:

1. ZTE staff were not considered state employees.
2. Neither ZTE nor the Holding have been directly reporting to SASAC, the State Council or any other portion of the Chinese party-state.
3. ZTE's management appointments on the corporate level were handled entirely by the company itself and thus formally independent from the Chinese state.
4. ZTE did not classified as a top-tier company in terms of regulatory oversight.

As a result of the arguments raised above, ZTE's management structure is classified as **indirect**.

### Financing Structure

To assess ZTE's financing structure, it was examined whether ZTE received most or a substantial part of its funding from the Chinese state or whether the agent was able to raise sufficient funds independently (Norris 2016).

As no comprehensive data concerning ZTE's financing structure could be retrieved, alternative funding sources at the agent's disposal were examined. As a constantly profitable company listed in both Hong Kong and Shenzhen, it can be concluded that while ZTE has received financial support and preferential treatment from the Chinese state, the bulk of its funding has been raised independently (R. Li and Cheong 2016, 262; Sinomach 2013).

Therefore, the coding of this indicator suggests an **indirect** reporting relationship.

### Assessment

Due to ZTE's "state-owned – privately managed" system, the evaluation of the IV "Reporting Relationship" was accompanied by certain ambiguities (Milhaupt and Zheng 2016). Nevertheless, based on the analytical framework and the empirical evidence, the following assessment for the IV "Reporting Relationship" is drawn:

1. Although ZTE is not directly owned by SASAC, the state nevertheless managed to retain the majority ownership through ZTE’s state-owned shareholders.
2. With regard to corporate governance, the assessment based on the formal criteria set out in the analytical framework suggests an indirect management structure.
3. Lastly, the evidence obtained for the financing structure illustrates that the majority of ZTE’s funding was raised independently from the state, thus indicating an indirect reporting relationship as well.

As a result of the findings presented above, the IV “Reporting Relationship” is coded as **indirect** (see Table 19):

NBN Project	Reporting Relationship	
	Direct	Indirect
<b>Ownership Structure</b>	<i>Direct</i>	-
<b>Management Structure</b>	-	<i>Indirect</i>
<b>Financing Structure</b>		<i>Indirect</i>
<b>Final Evaluation:</b>	<b>Indirect</b>	

Table 19: Assessment IV “Reporting Relationship” (NBN Project)  
Source: Author’s design.

#### 4.3.2.2 Intrinsic Goal Compatibility

##### **Findings**

##### **Goal Motives**

The purpose of this indicator was to explore the individual motives and incentives of principal and agent associated with the NBN project. If the empirical evidence points to a highly short-term incentivised commercial actor but to a rather politically and strategically oriented government, their respective “motives” ought to be classified as divergent (Norris 2016, 239).

To begin with the principal, by commencing the NBN project, the Chinese state sought to pursue its political and strategic objectives. The NBN deal was primarily intended to persuade the Philippines to renew the JMSU and thus reinforce China’s stance with regard to the South China Sea dispute (De Castro 2010; Baviera 2016; A. C. Wong 2019; A. Wong 2019b).

Turning to the agent, due to its listing at two stock exchanges, ZTE faced strong incentives to pursue short-term, profit oriented objectives (Liou 2010, 46). This aspect was further amplified by ZTE’s top management being part of an equity scheme that made them personally benefit from the company’s commercial success (R. Li and Cheong 2016, 255). Another indicator for

ZTE's pursuit of commercial motives is the fact that it was able to determine the specifics of the actual contract, eventually leading to a vastly overpriced but commercially lucrative deal (Conde 2007; Baviera 2016). Meanwhile, however, the implementation of state-led ODA projects also served the strategic interests of the company itself, especially in terms of market share and technological development (R. Li and Cheong 2019).

Accordingly, a successful implementation of the NBN deal would have been conducive not only to the state's strategic objectives related to the South China Sea but also to ZTE's long-term interests (e.g., market share) (De Castro 2010; Baviera 2016; R. Li and Cheong 2016; A. C. Wong 2019; Fuchs and Rudyak 2019)

Yet, considering ZTE's financial incentive structure, the evidence indicating the agent's pursuit of short-term interests as well as the state's political and strategic focus, the respective motives of principal and agent are to be regarded as **divergent** (Liou 2010; Norris 2016; Baviera 2016; A. C. Wong 2019).

### Goal Definition

To assess the government's influence on ZTE's goal definition process, two aspects have been examined. Firstly, the power of the state to determine the political careers of high-ranking ZTE executives, thereby creating incentives to follow the party line. Secondly, the state's ability to alter the agent's commercial success through discretionary power (Norris 2016, 80–81).

As for the first aspect, neither ZTE's CEO, Hou Weigui, nor the vast majority of the board members were associated with the CCP and thus did not pursue relevant political careers. Accordingly, no evidence could be found to suggest significant governmental influence on ZTE's goal-setting process through the management of executives' careers (R. Li and Cheong 2016, 260).

Nevertheless, the Chinese government did manage to gain influence on ZTE's goal definition process by becoming a crucial determinant for the agent's commercial success (R. Li and Cheong 2016). Although having no direct regulatory leverage through SASAC (Pearson 2015), the state's "king-making policy" was an integral part of ZTE's corporate development. Preferential treatment by the state included the company's participation in state-led technology projects, access to special funds, tax cuts, investment grants, cheap land, bureaucratic exemptions and the commissioning of major state-funded projects, among others (R. Li and Cheong 2016, 261–62; 2019). Considering that the state theoretically had the possibility to revoke these benefits in case of ZTE's non-compliance and thus significantly alter the firm's commercial

success, it can be argued that the government indeed had relevant leverage at its disposal (Norris 2016, 35–36).

Overall, it is concluded that through its ability to significantly alter ZTE's commercial success, the Chinese state was wielding considerable influence on the firm's goal formulation process. This circumstance ultimately indicates a certain **intrinsic goal compatibility** between principal and agent (Norris 2016, 239).

### Exclusivity of Goals

As emphasised by Norris (2016), short-term, profit-oriented goals of the agent and political and strategic objectives of the principal are not necessarily mutually exclusive (Norris 2016, 239). Nevertheless, a diverging priority setting of the two actors can lead to one objective being compromised by the other. Accordingly, both the exclusivity of the goals as well as the respective priorities of principal and agent have been examined.

As far as the general goal compatibility is concerned, the commercial motives of ZTE and the political, strategic intentions of the Chinese state were – theoretically – not mutually exclusive. While the NBN deal was crucial for the Chinese government to promote its policy preferences with regard to the JMSU and the South China Sea, a successful completion of the project would have also brought significant long-term benefits to ZTE's technological and financial development (R. Li and Cheong 2016; Baviera 2016; Fuchs and Rudyak 2019; A. C. Wong 2019; A. Wong 2019b).

Although the objectives of principal and agent could theoretically both be attained, ZTE's corporate incentive structure, namely its public listing and company equity scheme, was highly conducive to the pursuit of short-term, profit-oriented interests (Liou 2010). The firm's prioritisation of such short-term gains was eventually reflected in a highly overpriced but commercially lucrative NBN contract, which ZTE was able to design according to its own preferences (Conde 2007; Fabella and Dios 2007; Baviera 2016). The agent's prioritisation thus strongly diverged from the state's political focus and strategic intentions associated with the NBN project (De Castro 2010; Baviera 2016; A. C. Wong 2019).

Accordingly, it is concluded that while the respective goals of principal and agent themselves were not mutually exclusive, the different prioritisation caused the strategic objectives of the state to be compromised by the short-term objectives of ZTE and the related externalities. The state's political, strategic objectives and ZTE's short-term prioritisation are thus considered mutually exclusive, suggesting the IV to be coded as **divergent** (Norris 2016, 84–85).



## Assessment

Based on the findings presented above, the following assessment is drawn:

1. Only the state's involvement in ZTE's goal formulation process clearly points to an intrinsic goal compatibility between principal and agent.
2. Conversely, the examination of the respective goal motives suggests that the state's political, strategic objectives conflict with ZTE's short-term profit motivation, resulting in an intrinsic goal divergence.
3. ZTE's prioritisation of these short-term goals, evidenced by a highly overpriced contract, ultimately causes a deviation from the state's strategic considerations and therefore results in the respective objectives becoming mutually exclusive (Norris 2016, 85).

In conclusion, the IV "Intrinsic Goal Compatibility" is coded as **divergent** (see Table 20):

NBN Project	Intrinsic Goal Compatibility	
	Convergent	Divergent
<b>Goal Motives</b>		<i>Divergent</i>
<b>Goal Definition</b>	<i>Convergent (state involved)</i>	-
<b>Exclusivity of Goals</b>	-	<i>Divergent due to mutually exclusive priorities.</i>
<b>Final Evaluation:</b>	<b>Divergent</b>	

Table 20: Assessment IV "Intrinsic Goal Compatibility" (NBN Project)

Source: Author's design.

### 4.3.2.3 Relative Resources

## Findings

### Human Capital and Knowledge

To evaluate the distribution of human capital, three questions have been raised (Norris 2016). First, was the principal experienced enough to regulate and oversee ZTE in its specific field? Second, was the agent operating in a fast-developing industry that made it hard for outsiders to keep track with the current state-of-the-art technology? Third, did the agent possess any non-accessible technical know-how that would grant him an advantage over the principal?

In assessing the government's experience in monitoring and regulating ZTE, it is crucial to recognise that the development of the telecommunications equipment industry has been mainly guided by the Chinese state, rather than by the companies themselves (B. Low 2005; Harwit

2007). Accordingly, it is to be expected that the state was equipped with the necessary experience to oversee ZTE in its operations (Norris 2016).

Turning to the second sub-indicator, although the telecom equipment industry is regarded as highly dynamic and fast developing (H. Zhu and Pasadilla 2016, 314), this technological development has historically been driven by the Chinese state. Accordingly, it can be concluded that the Chinese state, due to its central role in the equipment industry, should have been capable of keeping up with recent industry developments (Stewart et al. 2011; Hong, Bar and An 2012).

Finally, the Chinese state was also considered an insider of ZTE and thus well informed about the current state of the company's technology. Accordingly, the agent did not possess any exclusive technical know-how (R. Li and Cheong 2016, 259; Norris 2016).

Overall, considering the state's insider role in both the industry as well as ZTE, this indicator is coded as being in **favour of the state**, regardless of the highly dynamic nature of the telecom equipment industry.

#### Personnel Count

The main question guiding this indicator is whether or not the principal was physically able to sufficiently monitor the agent in order to enforce the desired behaviour.

In absence of a direct governmental regulator, the empirical data collection was directed towards the Department of Foreign Aid and SASAC. While the Department of Foreign Aid was responsible of overseeing the company's activities in the Philippines, SASAC is considered to be ZTE's "ultimate controlling shareholder" (Milhaupt and Zheng 2015, 676; Corkin 2011).

Overall, the total workforce of ZTE (48,000 in 2007) significantly outnumbered not only the roughly 100 employees on the Department's payroll, but also the personnel seconded by the Counsellor's Office (one to two officials) (ZTE Corporation 2008; Bräutigam 2009; Lynch, Andersen and Zhu 2020).

Similar conclusions can be drawn in relation to SASAC. ZTE's total workforce would have outnumbered SASAC's overall staff, which amounted to roughly 800 people. Likewise, it would have been extremely difficult for the maximum of five permanent supervisors seconded by SASAC to adequately monitor ZTE's core management team (14 people in 2007) (ZTE Corporation 2008; L.-W. Lin and Milhaupt 2013; Chen 2020).

In view of the evidence presented above, it can be argued that ZTE's personnel count far exceeded that of SASAC and the Department of Foreign Aid. Accordingly, this indicator is considered as **favouring the agent**.

### Budget Endowments<sup>48</sup>

Comparing ZTE's budget endowment (revenue, net profit and expenditures) with the financial resources of the Chinese party-state proves challenging. This is mainly caused by the absence of a direct supervisor on the one hand and the inconsistency in empirical data, especially for SASAC and the Department of Foreign Aid, on the other.

Nevertheless, based on the available figures, it can be concluded that ZTE's financial resources as of 2006 and 2007, measured by its revenue (RMB 23.2 billion and RMB 34.8 billion respectively), net profit (RMB 767 million and RMB 1.25 billion respectively) and expenditures (RMB 7.2 billion and RMB 9.4 billion respectively), have been superior to the Department of Foreign Aid's overall budget of roughly RMB 105 million (ZTE Corporation 2008; Bräutigam 2009; Lynch, Andersen and Zhu 2020).

Similar tendencies can be observed in relation to SASAC. ZTE's revenue and expenditures in 2006 and 2007, for instance, exceeded SASAC's overall budget of roughly RMB 3.9 billion in 2010 and 2011. Moreover, in 2006 and 2007, the firm's net profit already accounted for a significant portion (about 20% and 30% respectively) of SASAC's total budget, suggesting ZTE's financial superiority (ZTE Corporation 2007; 2008; The Economic Observer 2011).

In conclusion, it is argued that ZTE's financial capabilities exceeded those of SASAC and Department of Foreign Aid, even if the two budgets were combined. Therefore, the budget endowment clearly **favours the agent**.

### Assessment

Based on the findings presented above, the following assessment is drawn:

1. As ZTE did not benefit from exclusive technical know-how and the Chinese state acted as a central driver for the technological development of the telecom equipment industry, the indicator "human capital and knowledge" is coded as favouring the state.

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<sup>48</sup> As the focus of this section is on a comparison between the financial budgets of the principal and agent, each expressed in RMB, the US dollar equivalent is not repeated. To obtain the detailed values, please refer to Section 3.4.2.3.

2. Conversely, ZTE’s financial and personnel resources vastly outnumbered the capacity of both SASAC and the Department of Foreign Aid, prompting the final two indicators to be classified as favouring the agent.

In conclusion, the available evidence points towards a distribution of relative resources in **favour of ZTE** (Norris 2016, 238) (see Table 21):

NBN Project	Relative Resources	
	Favouring State	Favouring Agent
<b>Human Capital and Knowledge</b>	<i>Favouring state</i>	-
<b>Personnel Count</b>		<i>Favouring agent</i>
<b>Budget Endowments</b>		<i>Favouring agent</i>
<b>Final Evaluation:</b>	<b>Favouring Agent</b>	

Table 21: Assessment IV “Relative Resources” (NBN Project)  
Source: Author’s design

#### 4.3.3 State Actor Variable: Unity of the State

##### **Findings**

##### **Bureaucratic and Institutional Friction**

To capture the bureaucratic and institutional frictions within the Chinese party-state, the collection of data was directed towards possible bureaucratic reorganisations, contests over jurisdiction as well as organisational competition over budget and personnel (Norris 2016). In doing so, strong emphasis was placed on the evidence concerning the years 2006 and 2007.

While no major reorganisations in the way foreign policy was made could be observed, the contest over the design of China’s foreign aid programme between the MofCom, the MFA and the MoF suggest considerable bureaucratic and institutional frictions within the Chinese party-state (Cabestan 2009; Corkin 2011). This assessment is further amplified by the fact that SASAC, after being established in 2003, struggled to strengthen its legitimacy towards rivalling bureaucratic entities (Naughton 2006; 2008; Liou 2010). Although SASAC managed to expand its authority over time, there was still considerable bureaucratic friction when the NBN deal was sealed. Such divisions eventually enable commercial actors to play competing bureaucratic entities against each other, reaping individual benefits (Naughton 2008). Since SASAC is ZTE’s “ultimate controlling shareholder”, these bureaucratic and institutional frictions are to be considered relevant to the NBN case (Milhaupt and Zheng 2015, 676).

Accordingly, due to the jurisdictional struggle between the MofCom, the MFA and the MoF over China's ODA programme as well as the bureaucratic contest between SASAC and other governmental agencies, this indicator is classified as **fragmented**.

### Personal and Ideological Factions

To evaluate the personal and ideological factions within the Chinese party-state, relevant promotion patterns, purges, elite networks, known rivalries, corruption cases, ideological struggles and the political focus of China's top leadership have been examined. In doing so, special attention has been paid to the rivalry between Hu Jintao's CCYL and Jiang Zemin's "Shanghai Gang" (Norris 2016).

#### *Elite Networks and Personal Rivalries (Purges, Promotion Patterns, Corruption Cases, etc.)*

With regard to personal rivalries, it can be concluded that at the time the NBN deal was signed, Hu Jintao and the CCYL already consolidated their power base (Francois, Trebbi and Xiao 2016). Vice versa, several incidences between 2002 and 2007, such as the purges of Zhang Wenkang and Chen Liangyu, both of whom were considered close allies of Jiang Zemin, contributed to a decline in power of the Shanghai Gang. Especially the purge and final dismissal of Chen Liangyu between 2006 and 2007 indicates that China's domestic political landscape was still characterised by significant personal factions at the time of the NBN project (C. Li 2007, 2; Bo 2008, 338).

#### *Ideological Factions*

Turning to ideological factions, the empirical evidence suggests that Hu Jintao's struggle to re-emphasise Jiang Zemin's notion of the "Three Represents" has successfully been accomplished by summer 2003. The subsequent incorporation of his own ideology into the party constitution in 2007 further suggests ideological unity (Holbig 2009).

#### *The State's Political Focus*

Finally, the number and nature of official state visits between China and the Philippines has been consulted as a proxy to depict the unity among China's top leadership. With respect to the NBN project, three aspects in particular stand out.

First, the initial MoU for the project was signed by Bo Xilai, who due to his patron-client relations with Jiang Zemin is regarded as part of the Shanghai Gang and thus a political opponent of Hu Jintao and Wen Jiabao (Bo 2008; Cohen 2012a; C. Li 2012). Second, despite the political rivalry, Premier Wen Jiabao visited the Philippines only a few months after Bo signed the MoU in order to reaffirm the previously made commitments (Mendoza and Heydarian 2012). Finally,

the exceptional high number of bilateral deals sealed between 2006 and 2007 suggests a certain political consensus of China’s leadership towards the Philippines (Clemente 2016).

Overall, while the personal factions between Jiang Zemin (Shanghai Gang) and Hu Jintao (CCYL) indicate a certain fragmentation within the Chinese party-state, the frequency of state visits point to a fairly unified state, particularly with regard to the Philippines and the NBN project (Norris 2016, 82). Following the arguments raised by Norris (2016, 82), according to which personal and institutional divisions can be overcome if the senior leadership shares a common political focus, this indicator is classified as **unified**.

Geographical Division

Despite the strong representation of coastal provinces in the Politburo and PBSC, no specific evidence suggesting centre-local or rich-poor tensions with regard to the NBN project could be retrieved. Therefore, from a geographical perspective, the Chinese state is classified as **unified** (Norris 2016).

Assessment

Based on the findings presented in the previous chapter, the following assessment is drawn:

1. Besides bureaucratic and institutional frictions caused by the establishment of SASAC and the dispute between the MofCom, MoF and MFA over the design of China’s foreign aid programme, the two remaining indicators have been coded as unified.

Ultimately, following the dichotomous approach of this thesis, the IV “Unity of the State” is classified as unified. This evaluation is based on the notions of Norris (2016, 82), who argued that if senior officials share a common political focus on a certain policy area, such as the NBN project in the Philippines, bureaucratic frictions as well as personal factions can be overcome and effective state unity can be provided (see Table 22):

NBN Project	Unity of the State	
	Unified	Fragmented
<b>Bureaucratic &amp; Institutional Friction</b>	-	<i>Fragmented</i>
<b>Personal &amp; Ideological Factions</b>	<i>Unified</i>	-
<b>Geographical Division</b>	<i>Unified</i>	-
<b>Final Evaluation:</b>	<b>Unified</b>	

Table 22: Assessment IV “Unity of the State” (NBN Project)  
Source: Author’s design.

#### 4.3.4 Conclusion #2: NBN Project

Deriving from the analytical framework, the empirical evidence for the NBN case was collected. Thereafter, the gathered information has been leveraged to dichotomously assess each indicator, which provided the foundation for the coding of the five IVs. The final assessment of these IVs, including a Norris-based prediction for the outcome of the DV “state control”, can be obtained from Table 23:

Level	IV	IV Coding	Decisive Evidence	DV Outcome Prediction
<b>Economic Actor</b>	<b>Market Structure</b>	<i>Oligopolistic</i>	The number of at least three highly competitive firms (ZTE, Huawei, Datang) in a concentrated market space provided the Chinese state with viable alternatives for the execution of its economic inducement efforts. Accordingly, this IV is coded as oligopolistic.	<b>Control likely</b>
<b>Relational</b>	<b>Reporting Relationship</b>	<i>Indirect</i>	Although ZTE is majority-owned by the state, its management structure can be described as fairly indirect: ZTE was not directly reporting to SASAC or the State Council; the state’s regulatory oversight was moderate; ZTE staff were not state employees; high-ranking management appointments - as for ZTE - were made by the firm and independent from the state. State financing, albeit existent, was overwhelmed by self-raised funds.	<b>Control unlikely</b>
	<b>Intrinsic Goal Compatibility</b>	<i>Divergent</i>	Despite the state’s involvement in the firm’s goal formulation process, ZTE’s strong prioritisation of its short-term goals and profits compromised the state’s strategic considerations behind the NBN project.	<b>Control unlikely</b>
	<b>Relative Resources</b>	<i>Favouring Agent</i>	While the human capital was in favour of the state (no exclusive know-how for ZTE, while the state steered the industry development), the budget and personell of ZTE largely outnumbered those of SASAC and the Department of Foreign Aid.	<b>Control unlikely</b>
<b>State Actor</b>	<b>State Unity</b>	<i>Unified</i>	Despite bureaucratic frictions (e.g., establishment of SASAC, contest over China’s foreign aid activities) as well as personal factions (e.g., Hu’s CCYL vs. Jiang’s Shanghai Gang), China’s top leadership demonstrated a coherent political focus towards the Philippines and the NBN project, thus providing sufficient state unity; little evidence for centre-local or rich-poor tensions.	<b>Control likely</b>

Table 23: Final Assessment of the Five IVs for the NBN Project  
Source: Author’s design.

Despite a rather concentrated market of Chinese telecom equipment providers, the number of firms (three to four) as well as a highly competitive pricing behaviour within the industry cause the IV “Market Structure” to be coded as oligopolistic, thus providing an environment that is conducive to state control (Norris 2016).

Turning to the relational dimension, all three IVs exhibit an empirical context that is considered unfavourable to state control. First, the two actors’ intrinsic goals diverge with regard to the attainment of the state’s strategic objectives. This discrepancy, despite the state’s potential influence on ZTE’s goal formulation process, is caused by the strong prioritisation of profit maximising activities by ZTE, thus displacing the state’s political and strategic intentions behind the NBN deal.

Second, state control over ZTE is hampered by the distribution of relative resources between principal and agent. Although the state was well acquainted with developments in the telecom equipment industry and ZTE’s technology, thus dominating the “human capital and knowledge” sphere, the firm’s large personnel count and budget trumped the state’s respective resources. This discrepancy can ultimately be leveraged by the commercial actor to evade the state’s oversight and regulation.

Lastly, although ZTE classifies as a state-holding enterprise, its management structure vis-à-vis the Chinese state can be described as indirect. Additionally, while incidences of state financing could be observed, the majority of ZTE’s funds were self-raised. Therefore, the IV “Reporting Relationship” is coded as indirect, making state control over the agent more difficult.

Concerning the final IV, despite bureaucratic frictions, jurisdictional contests as well as personal factions as embodied by the rivalry between Hu Jintao and Jiang Zemin, the Chinese state is considered unified, at least with regard to the Philippines. This is particularly evidenced by the high number of bilateral agreements and frequent state visits of China’s top leadership across all factions in the preface of the NBN project. Ultimately, such “top-level guidance” helps in overcoming other frictions and thus ensures effective state unity (Norris 2016, 82).

However, after coding the respective IVs and examining their isolated relationship with the DV, the question remains “how these IVs interact with each other and, ultimately, result in outcome values for the dependent variable of state control” (Norris 2016, 29). To this aim, the “decision tree” introduced by Norris is leveraged. This “decision tree” functions as a structured questionnaire that queries the dichotomous values of the different IVs and highlights their interdependencies. By following the “decision tree”, also referred to as “sequencing”, one is able to



ultimately determine the value of the DV (Norris 2016, 29). To provide for a better understanding, the different steps of the decision tree are reiterated below:

### **Step 1:**

The origin of the “decision tree” and thus a decisive prerequisite for state control is the IV “Unity of the State.” It is argued that if the Chinese state is not able to act in a unified way and fails to agree on basic strategic objectives, “it is nearly impossible for the state to exercise control over commercial actors” (Norris 2016, 31).

### **Step 2:**

If the empirical context fulfils this prerequisite, it is suggested to proceed by examining the principal’s and agent’s goal compatibility. A combination of a unified state and intrinsic goal compatibility most likely results in state control over the commercial actor – regardless of the values of the remaining three IVs (Norris 2016, 31). However, if the state is unified but the goals are divergent, classical “principal-agent” cases emerge (see Figure 19). Here, the three remaining IVs – “Market Structure”, “Reporting Relationship” and “Relative Resources” – become decisive factors for the outcome of the DV (Norris 2016; 37).

### **Query Step 1 & 2: NBN Case**

Turning to the NBN case, it can be concluded that while the state acted in a unified manner, the IV “Intrinsic Goal Compatibility” is classified as divergent, thus hampering effective state control. This assessment is mainly driven by ZTE’s strong prioritisation of short-term, profit-oriented interests (Norris 2016, 85). Hence, the achievement of the state’s strategic interests is regarded as a typical “principal-agent case”, making the remaining three IVs crucial determinants for the outcome of the DV “state control” (Norris 2016, 37).

### **Further Procedure in the Event of “Principal-agent Cases”**

In order to systematically approach such principal-agent cases, Norris (2016) suggests to start with examining the IV “Market Structure” (see Figure 20). In the case of a highly fragmented or highly concentrated market environment, state control ought to be extremely difficult, either because the state lacks alternative agents for carrying out its economic statecraft or because the market is too diffuse to monitor the different entities and assert the desired behaviour (Norris 2016, 35). Conversely, an oligopolistic market structure is considered particularly conducive to state control, as there are “not so many economic actors that the state cannot monitor all of them, yet there are also not so few that the state has no opportunity to play one off the other to advance the state’s own interests” (Norris 2016, 36).

However, an oligopolistic market alone does not provide for state control, making it essential to also query the values of the IVs “Reporting Relationship” and “Relative Resources.” In the case of a direct reporting relationship in an oligopolistic market, one would expect state control to be likely. Vice versa, in the case of an oligopolistic market but an indirect reporting relationship, the balance of the relative resources becomes crucial (Norris 2016, 34).

If the distribution of relative resources favours the principal, the Chinese state should be able to overcome the obstacles of an indirect reporting relationship and sufficiently regulate the agent. Conversely, relative resources favouring the agent contribute to the agent’s ability to evade oversight and capture parts of the state for its own agenda, thus making effective state control unlikely (Norris 2016, 34–35).

### **Query of the Remaining Three IVs: NBN Case**

As for the NBN project, it can be concluded that the empirical context exhibits an oligopolistic market structure where the state could theoretically choose between three to four competing telecom equipment manufacturers. Accordingly, the outcome of the DV eventually relies on the nature of the IVs “Reporting Relationship” and “Relative Resources” (Norris 2016, 34).

As for the former, the collected data indicate an indirect reporting relationship between ZTE and the Chinese state, mainly due to ZTE’s independent management structure and financial autonomy. Consequently, whether the state was able to control ZTE ultimately depends on the distribution of relative resources. In this respect, the evidence collected for the NBN project suggests a balance of resources that favours ZTE, especially when comparing the company’s financial budget and number of employees with the state’s respective capacities.

### **Conclusion**

In conclusion, the evidence analysed through the prism of the analytical framework suggests that in the NBN case, the outcome of the DV is **no state control**.

## **4.4 Overview Chapter 4**

Within Chapter 4, the empirical evidence gathered in Chapter 3 was evaluated. Based on the respective indicators and observable evidence, the five IVs for the NorthRail project and the NBN case have been determined. Thereafter, using the sequencing provided by Norris (2016), the results of the five IVs formed the foundation for the final coding of the DV in both inducement cases. Finally, Chapter 5 combines the findings from the two inducement cases to comprehensively answer the initially stated research question.

# Chapter 5: Conclusion

## 5.1 The Level of Chinese State Control Over Commercial Actors

Overall, this thesis focused on two particular cases of Chinese economic inducements in the Philippines. The purpose of this research was to identify the degree of state control within each project, thus answering the first part of the RQ.

To this aim, the analytical framework presented by Chapter 2 has been applied to the respective empirical context, with a total of five IVs being investigated. The final assessment of these IVs for each project may be obtained from Figure 21:

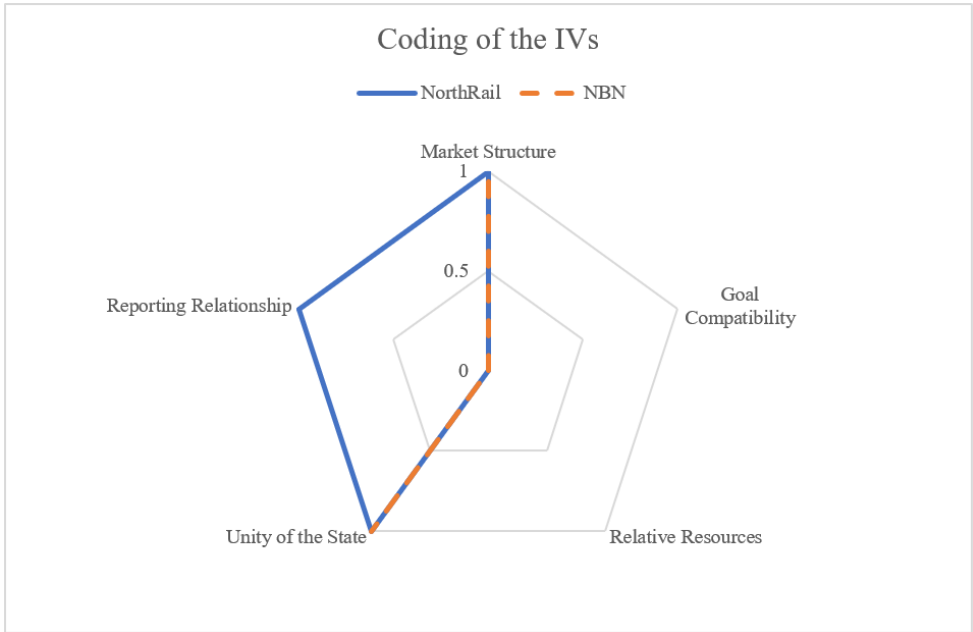


Figure 21: Final Assessment  
Source: Author’s design.

The codification of the diagram continues the dichotomous approach pursued throughout this thesis. A value of “1” is considered conducive to effective state control, whereas a value of “0” is deemed obstructive.

In the case of the NorthRail project, three out of five IVs, namely the “Market Structure”, the “Reporting Relationship” and the “Unity of the State”, were conducive to Chinese state control. With regard to the NBN case, only the “Market Structure” and the “Unity of the State” would suggest the Chinese state’s ability to effectively mobilise and direct ZTE’s activities.

The detailed assessment of the parameters determining state control reveals certain parallels between the two cases and therefore provides nuanced insights on the level of Chinese state control over its commercial actors.

First, the Chinese state's political strategic objectives were not adequately matched by either CNMEG or ZTE. While executing an ODA project arguably entails certain benefits, such as gaining market share in the region, these incentives do not seem to have prevented the two commercial actors from prioritising their short-term, profit-oriented motives.

Second, the Chinese state was inferior to both CNMEG and ZTE in terms of budget and personnel, allowing the commercial actors to dominate the IV "Relative Resources." The repercussions of the agents' dominance in this regard are further discussed in chapter 5.3.

In a final step, however, the focus was shifted to examine the interdependencies between the IVs and their ultimate impact on the outcome of the DV "state control" in each inducement case. To this end, the decision tree ("sequencing") provided by Norris (2016) has been leveraged.

Based on the value of each IV, it can be concluded that in the case of the NorthRail project, the Chinese state should have been able to exercise effective state control over CNMEG. Conversely, the values of the IVs in the NBN project, their interdependencies and ultimately their impact on the DV indicate that the Chinese state was not able to exercise sufficient state control over ZTE.

In conclusion, the assessment of the empirical evidence through the prism of the analytical framework allows to formulate two hypotheses:

**H1: In the NorthRail case, the Chinese state should have been able to sufficiently exercise control over the commercial actor (CNMEG).**

**H2: In the NBN case, the Chinese state was not able to sufficiently exercise control over the commercial actor (ZTE).**

Therefore, the **level of Chinese state control** during its economic inducement strategy towards the Philippines can be described as **mixed**.

After having answered first part of the research question, it is asked whether or not we can observe an impact of the level of state control on the effectiveness of Chinese economic inducements towards the Philippines. Thus, the second part of the research question is answered.

## 5.2 The Impact of State Control on the Effectiveness of Economic Inducements

### 5.2.1 The Short- and Long-term Effectiveness of Chinese Economic Inducements

To answer the second part of the research question, the theoretical assessment generated through the application of the analytical framework is contrasted against the effectiveness of the Chinese economic inducement strategy towards the Philippines. Therefore, it is necessary to elaborate whether the Chinese economic inducements vis-à-vis the Philippines are to be considered effective or not. In doing so, a distinction between “short-term” (tactical) and “long-term” (structural) effectiveness is made (Mastanduno 1999; Kahler and Kastner 2006).

#### **Short-term Effectiveness**

Starting with the short-term effectiveness, the Chinese inducement efforts towards the Philippines may be described as partially successful (Yung and McNulty 2015, 5). By signing the JMSU agreement, Manila made breath-taking concessions to China in terms of geographical sovereignty, as it allowed the Chinese side to conduct operations within the 200-nautical-mile radius of the exclusive economic zone claimed by the Philippines (Wain 2008, 47; Camba 2017, 7). Hence, the “JMSU initially seemed to be a coup for Chinese diplomats” (Bower 2010).

Yet, despite the initial success, the Philippines refrained from renewing the JMSU. Baviera (2016, 115) therefore concludes that the Chinese economic inducements have been unsuccessful “in terms of bringing about favourable outcomes on the JMSU issue.”

As a result, while the initial signing of the JMSU is regarded as a short-term success, Beijing’s inability to convince the Philippines to extend the contract is considered a case of ineffective tactical economic inducement.

#### **Long-term Effectiveness**

Turning to the long-term effectiveness of Chinese economic inducements, A. Wong (2019b, 18) argues that the Chinese infrastructure projects were ineffective in translating into long-lasting political influence on the Philippines. Following the halt of the JMSU, the Chinese-Philippine relations further deteriorated, eventually leading to the election of Benigno Aquino III, who pushed for a more critical stance towards China and sought closer coordination with the United States instead (Corr and Tacujan 2013; A. Wong 2021). In view of Beijing’s strategic and structural interests associated with its economic inducement strategy, A. Wong (2021) further notes that “At the end of the day, the country’s [Philippines’] policy on the issue China cares about most, the South China Sea, has remained fundamentally unchanged: the Philippines

has stuck to its own territorial claims.” Accordingly, the Chinese economic inducements analysed within this thesis have proven not to be effective on a structural (long-term) level.

### 5.2.2 The Impact of State Control on the Short- and Long-term Effectiveness

In a next step, the impact of the level of Chinese state control on the short- and long-term effectiveness of its economic inducements is examined (Norris 2016).

As emphasised in the previous section, it must be considered that the partial short-term, tactical success of the Chinese economic inducements is mainly attributed to the initial signing of the JMSU, which in turn is closely connected to the conclusion of the NorthRail project (Bower 2010; De Guzman 2014; Yung and McNulty 2015). As a result, when elaborating on the impact of state control on the short-term success, the focus is shifted to the NorthRail case.

When analysing the impact of state control on the ineffectiveness of China’s tactical inducements, the focus is set on the NBN case. Being agreed on in 2006 and cancelled in 2007, the NBN project is situated at a crucial point ahead of the JMSU fade out in June 2008. Therefore, scholars argue that the Chinese state sought to convince the Philippine government to extend the JMSU by initiating the NBN deal. Despite the efforts, the Philippines decided to not continue with the JMSU (De Castro 2010; Baviera 2016; A. C. Wong 2019).

However, besides serving tactical purposes, both the NorthRail project and the NBN project have been integral to China’s structural inducement strategy towards the Philippines (Landingin 2010; Baviera 2016; Gong 2017; A. Wong 2019b; A. C. Wong 2019). Accordingly, the findings of both cases are consulted when examining the impact of state control on the long-term effectiveness of Chinese economic inducements.

#### **Impact on Short-term (In)Effectiveness**

##### **Short-term Effectiveness: NorthRail Project**

First, the impact of the degree of state control on the short-term effectiveness associated with the signing of the JMSU is examined. To this end, the projected outcome of the DV in the NorthRail case is leveraged. The theory suggests that the Chinese state was able to exercise a sufficient level of control over CNMEG. Hence, it can be concluded that the degree of Chinese state control in the NorthRail project had a positive impact on the initial short-term effectiveness of the Chinese economic inducements vis-à-vis the Philippines. The outcome of the DV and the empirical reality thus provide supporting evidence for Norris’s (2016) hypothesis, according to which state control is a decisive aspect for the execution of effective economic inducements.

### Short-term Ineffectiveness: NBN Project

However, the second element of China's tactical inducements covers the attempted extension of the JMSU, which is closely linked to the NBN project (De Castro 2010; Baviera 2016; A. C. Wong 2019). As the Chinese inducements did not persuade the Philippines to prolong the JMSU, it is concluded that the short-term ineffectiveness of the Chinese inducements corresponds with the outcome of the DV in the NBN case (no state control) (Norris 2016, 26). Accordingly, the impact of the degree of state control on the short-term ineffectiveness is considered high, thus reaffirming the theoretical predictions (Norris 2016).

### Impact on Long-term Effectiveness

Assessing the impact of state control on the long-term effectiveness of China's economic inducements proves challenging, as two cases with a different outcome of the DV need to be considered. While in the NorthRail case, the Chinese state was likely to exercise sufficient control over CNMEG (DV = state control), the empirical evidence of the NBN project implies state control over ZTE to be unlikely (DV = no state control). Consequently, the extent of Chinese state control during its economic inducement strategy vis-à-vis the Philippines has been classified as mixed. However, to maintain theoretical simplicity, both inducement cases are contrasted separately with the long-term effectiveness of Chinese economic inducements. Nevertheless, the ambiguities arising from analysing two inducement cases as part of one overarching strategy are further addressed in Section 5.4.

To begin with the NBN case, it can be concluded that the outcome of the DV (no state control) and the ineffectiveness of China's structural inducement strategy are in line with the theoretical predictions raised by Norris (2016). Accordingly, it is concluded that the low degree of state control over ZTE ultimately had a negative impact on the long-term effectiveness of China's economic inducements towards the Philippines.

Turning to the NorthRail case, in which the Chinese state should have been able to exercise sufficient control over CNMEG, it needs to be constituted that the coding of the DV and the empirical reality do not correspond with the theoretical predictions (Norris 2016, 26). Despite theoretical state control over CNMEG, the Chinese economic inducement efforts have not been effective in the long-term.

### Summary

The impact of state control on the short- and long-term effectiveness of the Chinese economic inducements towards the Philippines is summarised in Table 24:

Level	Cases	DV Outcome	Effectiveness	Impact of State Control on the Effectiveness	Confirming Theory?
Short-term (tactical)	NorthRail	<i>State control</i>	<b>Effective</b> Signing of JMSU.	High	Yes
	NBN	<i>No state control</i>	<b>Ineffective</b> No extension of JMSU.	High	Yes
Long-term (structural)	NorthRail	<i>State control</i>	<b>Ineffective</b> No substantial policy change in the Philippines' South China Sea stance.	Low	No
	NBN	<i>No state control</i>		High	Yes

Table 24: Impact of State Control on the Effectiveness of Chinese Economic Inducements  
Source: Author's design.

As illustrated above, in three out of four cases, the outcome of the DV corresponds with the expected effectiveness of Chinese economic inducements, thus reaffirming the arguments raised by Norris (2016, 26). Particularly the impact of state control on the short-term (in)effectiveness can be considered well documented. The signing of the JMSU in the first place was mainly driven by the conclusion of the NorthRail project, which according to the outcome of the DV was subject to a high degree of state control. Likewise, the failure to convince the Philippines to extend the JMSU – and thus the ineffectiveness of Chinese economic inducements – is closely associated with the NBN project, which represents a case in which the Chinese state did not exercise control over the commercial actor.

In terms of long-term effectiveness, the degree of Chinese state control has been described as mixed, with the DV of the NorthRail case suggesting state control and the DV of the NBN case suggesting no state control. This mixed degree of state control therefore does not allow for a clear explanation of the impact each case outcome (DV) had on the effectiveness of the economic inducement strategy. Nevertheless, it can be concluded that this **mixed degree of state control** was **not sufficient** to provide for an effective long-term economic inducement strategy.

According to the theory, however, the ineffectiveness the Chinese economic inducement strategy in the long-term would imply a low degree of state control (Norris 2016). Yet, this research found the Chinese level of state control to be mixed, leaving room for alternative explanations.

1. The formulated hypotheses concerning the DVs in each inducement case are incorrect. Such a wrong assessment of the DVs can be caused by:
  - a. An incorrect sequencing of the IVs determining the DV.
  - b. An incorrect coding of the IVs in the first place.



2. The impact of the NBN case (no state control) overwhelmed the impact of the NorthRail case (state control).
3. The degree of state control only played a subordinate role among other explanatory variables for the long-term effectiveness of Chinese economic inducements.

The alternative explanations are further examined in the remaining sections. While Section 5.3 is exclusively dedicated to test the formulated hypotheses, Section 5.4 comprises a thorough discussion of the issues raised above. As a result, valuable implications for this case study, future research projects as well as policymakers can be drawn.

## 5.3 Hypotheses Testing

### 5.3.1 Testing the Theory of State Control

The answer to the second part of the research question shows that the effectiveness of Chinese economic inducements could not always be explained by the level of state control as determined by the analytical framework. Therefore, it is necessary to thoroughly test the hypotheses derived from the framework:

**H1: In the NorthRail case, the Chinese state should have been able to sufficiently exercise control over the commercial actor (CNMEG).**

**H2: In the NBN case, the Chinese state was not able to sufficiently exercise control over the commercial actor (ZTE).**

To this end, the level of state control within each inducement case is reviewed using a diverging approach. The results derived from this alternative assessment are thereafter contrasted with the results produced by the analytical framework. To provide for such an alternative assessment, the three-level test introduced by Reilly (2021) is leveraged. The test consists of three questions that allow for an easy ex-post assessment whether or not a government was in control of a commercial actor in a given empirical context:

1. Did the state manage to direct the commercial actor to “engage in economic activities in the direction that Beijing desired” (Reilly 2021, 14), for example by executing a government-funded project in a certain country?
2. Did the firm act in a way “likely to advance (or undermine) the state’s foreign policy objectives” (Reilly 2021, 14), for instance through fiscally irresponsible behaviour or enterprise malfeasance (e.g., corruption, poor quality, etc.) (A. Wong 2019a; Reilly 2021)?

3. Was the Chinese state capable of detecting incidences of irresponsible corporate behaviour and subsequently managed to redirect the course of the commercial actors (Reilly 2021, 16)?

This ex-post questionnaire serves as a useful tool to refine and challenge the ex-ante assessment produced by the analytical framework applied in this thesis.

### **NorthRail Project**

Starting with the NorthRail case, the first question can be answered in the affirmative. The Chinese government managed to direct CNMEG's commercial activities to the Philippines, executing a railway project the Japanese government and its related actors refrained from (Trinidad 2016; A. Wong 2019b).

Likewise, the externalities implied by the second question also apply to the NorthRail case. Besides being vastly overpriced, the NorthRail project was accompanied by corruption charges (A. Wong 2019b, 24). Additionally, the project progressed rather slow, leading to a significant delay by 2008 (Diaz 2008; Landingin 2010). After ongoing struggles with the NLRC, CNMEG unilaterally suspended the work in February 2008, asking for an additional US \$299 million in compensation from the Philippines. In response, outraged "by CNMEG's demands, Northrail [NLRC] considered terminating the contract [...]" (Landingin 2010, 89).

Answering the final question proves to be more ambiguous. In support of state control, it can be noted that the incidences of bribery were allegedly known to the Chinese state (Diaz 2008). Further, to bring the project back on track, "top leaders of both countries interceded and helped Northrail [NLRC] and CNMEG to come up with a revised agreement that amended the design and scope of the project and raised the cost by US \$99 million towards the end of 2008" (Landingin 2010, 90). Thereafter, the construction works reportedly began to run more smoothly (Landingin 2010, 90). It can therefore be argued that the Chinese state, at least to a certain extent, was able to "redirect the course of the commercial actor" (Reilly 2021, 16). Nevertheless, the project was cancelled in 2012. In the aftermath, a special report suggested that the Philippines paid CNMEG a total of US \$210 million for accomplished work worth only US \$80.5 million. The report also claimed that several duties that should have been executed by CNMEG, such as obtaining relevant permits, were delegated to their Philippine counterparts (Rappler 2013). In this sense, it can be argued that although the Chinese state was able to control and re-direct the commercial actor in 2008, it did not manage to assert a behaviour that would

guarantee a successful project implementation, thus suggesting a lack of sufficient state control (Landingin 2010; 2012; Reilly 2021).

**NBN Project**

Turning to the NBN case, the first question can be answered in the affirmative. ZTE was willing to implement the NBN project in the Philippines, thus engaging in a direction that was deemed conducive to Beijing’s foreign policy goals (Reilly 2021).

Similar to the NorthRail case, also the NBN project exhibits signs of enterprise malfeasance, prompting the second question to be answered in the affirmative as well. Besides bypassing official procurement rules and being vastly overpriced, ZTE officials also engaged in high-level corruption in the Philippines (Storey 2008; Baviera 2016; A. Wong 2019b).

With regard to the final question, when the scandal was unveiled, both ZTE and the Chinese state quickly distanced themselves from the accusations (Baviera 2016). It remains unknown whether the Chinese state was informed about ZTE’s corporate behaviour. However, based on the fact that the project was suspended, it may be argued that the Chinese state was not able to “re-direct” the actions of the commercial actor, thus suggesting an insufficient level of state control.<sup>49</sup>

Overall, the three-stage test provided a useful foundation for the testing of the beforehand formulated hypotheses.

While the ex-ante assessment of the NBN deal seems to confirm H2, the failure of the NorthRail project and therefore the inability of the Chinese state to sufficiently control CNMEG and enforce desired behaviour in the long-term appears to be contesting H1 (see Table 25):

	Cases	DV Outcome	“Reilly Test”	Confirming Hypothesis?
<b>Hypotheses Testing</b>	NorthRail	H1: State control	State not able to sustainably control the commercial actor.	No
	NBN	H2: No state control	State not able to sustainably control the commercial actor.	Yes

Table 25: Results of the Hypotheses Testing  
Source: Author’s design.

The repercussion of this discrepancy on the future design of the analytical framework is discussed in the following section.

<sup>49</sup> However, the project cycle of the NBN deal was relatively short. It could therefore be argued that a high degree of Chinese state control did not have time to thoroughly unfold after the project was put on hold.

### 5.3.2 Implications for the Analytical Framework and the Design of State Control

Contrasting the formulated hypotheses (DVs) against the results of the “Reilly test” offers the opportunity to calibrate the analytical framework in a more nuanced way. Likewise, the findings are highly valuable for Chinese policymakers, as they reveal insufficiencies in state control that ought to be overcome for future economic inducement efforts. At this point, however, it is crucial to mention that errors in the coding of the DVs and therefore the formulation of the hypotheses can result either from the sequencing process itself or from an incorrect coding of the IVs in the first place. This section focuses on the sequencing, whereas criticism concerning the coding of the IVs is left to the final section of this thesis.

In this respect, the hypotheses testing reaffirms the first two steps in the sequencing process presented by Norris (2016). The “Reilly test” for the NorthRail and the NBN case suggests that while the Chinese state – enhanced by a unified top leadership – was able to initially direct the commercial actors in the desired direction, exhibits of enterprise malfeasance eventually occurred (Reilly 2021, 14). Reilly (2021, 14–15) explains this phenomenon with principal-agent challenges in the respective empirical context and different interests of the state compared to its actors. Those findings therefore seem to support the logic provided by Norris (2016, 37), who argued that diverging goal priorities contribute to relevant frictions between the state and its commercial actors, turning economic inducement incidences into “classical principal-agent cases.” The consistency of the “Reilly test” with the empirics for the IVs “Unity of the State” and “Goal Compatibility” allows for a fruitful analysis of the remaining three IVs, which are deemed crucial in the context of such “classical principal-agent cases” (Norris 2016, 37).

#### **Implications from the NorthRail Case**

Starting with the NorthRail project, the theory based on Norris (2016) suggests state control to be likely, as the Chinese state can draw from an oligopolistic market and a fairly direct reporting relationship with CNMEG. In stark contrast, the “Reilly test” implies that the Chinese state failed to assert behaviour that would be conducive to its foreign policy objectives.

To explain this contradiction, one may turn to the remaining IV “Relative Resources”, which was clearly favouring CNMEG. While Norris (2016, 223) advocates disregarding the distribution of relative resources in the case of an oligopolistic market structure and a direct reporting relationship, he also notes that this assessment may “very well prove to be anomalous” to his particular case studies.

The outcome of the NorthRail project may therefore be considered a case in which the distribution of relative resources ultimately acted as a decisive factor for state control. Despite an oligopolistic market structure and a direct reporting relationship, the Chinese state failed to sustainably direct and monitor CNMEG's activities and control the associated externalities. The inability of the Chinese state of doing so could therefore be rooted in CNMEG's overwhelming financial budget and personnel count, which allowed the commercial actor to evade oversight and "dodge" the state (Norris 2016, 30). This observation comes along with two concrete implications.

First, the IV "Relative Resources" should not be dropped as an explanatory variable of state control in future models, as suggested by Norris (2016). Instead, scholars should be encouraged to further elaborate on the effects of the distribution of relative resources on the level of state control. To this end, further cases that show variations across this particular IV should be identified and investigated.

Second, the Chinese state should step up its efforts in designing an effective oversight and control mechanism for ODA projects. While the state is rather unlikely to match the financial resources and the personnel of large multinational enterprises (Norris 2016), the regulatory resources both in China (e.g., through SASAC) but especially overseas must be improved. The 2018 establishment of the CIDCA may be a first step into that direction and suggests that the Chinese state has begun to realise the need for a well-defined (in terms of responsibilities) and well-equipped (financially and in terms of personnel) agent oversight mechanism.

### **Implications from the NBN Case**

Similar to the NorthRail project, also the NBN case exhibits a classical principal-agent challenge. Moreover, both the theory put forward by Norris (2016) and the "Reilly test" are consistent in terms of their respective outcome, according to which the Chinese state did not exercise sufficient control over ZTE (Norris 2016; Reilly 2021). Although the NBN project cycle was significantly shorter than the one of the NorthRail case, meaningful implications for both the analytical framework and the Chinese state can be drawn.

Most crucially, the development of the NBN deal highlights the effect of externalities caused by enterprise malfeasance on the attainment of governmental objectives. The NBN project can therefore be considered a prime example of what happens when the agent's short-term, profit-oriented objectives collide with the strategic considerations of the principal (Norris 2016). The corruption ZTE engaged in eventually caused the project to derail. Thus, the IV "Goal

Compatibility” can be expected to have played a decisive role for the outcome of this case. Accordingly, the Chinese state should be wary to reconcile the objectives of its commercial actors with its own strategic considerations, especially if the project takes place in a sensitive environment where the externalities associated with the actor’s behaviour might not be mitigated in time (A. Wong 2019b).

Additionally, the empirical evidence suggests that ZTE’s malfeasance may have been amplified by the rather indirect reporting relationship and a balance of relative resources vastly favouring the agent, enabling ZTE to avoid effective oversight and state control (Norris 2016).

### **General Implications from the Cases**

However, after scrutinising each case individually, a step back is taken to review and illuminate the parallels between the two inducement projects, thus drawing valuable lessons with regard to the degree of Chinese state control in general. As highlighted in Section 5.1, both inducement projects were characterised by a diverging intrinsic goal compatibility. Hence, if the Chinese state is to increase its degree of control in future economic inducement efforts, the incentive structure for the executing agents should be reshaped. This can be done either by increasing the value of compliance with the state’s strategic objectives or by decreasing the benefits from pursuing short-term, profit-oriented motives.

Likewise, both inducement cases took place in a context, in which the distribution of relative resources was strongly in favour of the agents. The fact that both the NorthRail and the NBN case suffered this weakness reiterates the imperative for the Chinese government to effectively increase its agent oversight, particularly overseas.

In conclusion, this section provided a nuanced assessment of the degree of Chinese state control over the two commercial actors responsible for executing the NBN and the NorthRail project. Thus, valuable insights on the design of the analytical framework and concrete lessons for Chinese policymakers concerning the determinants of effective state control could be gained.

### **5.4 Critical Assessment and Practical Implications**

As emphasised in the previous section, the outcome of the DVs and therefore the degree of Chinese state control does not necessarily correspond with the expected effectiveness of China’s structural economic inducements. Accordingly, it is crucial to critically reflect on the work conducted throughout this thesis. Hence, the range of alternative explanations presented at the end of Section 5.2 as well as general criticism is brought up and thoroughly discussed. Thus, valuable implications for future research on the characteristics of the sender state, the

factor “state control” and its impact on the effectiveness of economic inducements can be drawn.

First of all, although the coding of the DV was already subject to intense scrutiny in Section 5.3, it must be emphasised that the outcome of the DV is ultimately determined by the evaluation of the five IVs and their respective indicators. Those variables and indicators rely on a dichotomous assessment (Norris 2016). While this approach contributes to a cleaner assessment, it is also susceptible to coding errors, especially in cases with ambiguous or fragmented empirical evidence. The IV “Market Structure” in the NorthRail case, for example, lacks comprehensive data to assess the market share within the Chinese railway construction industry. This could ultimately lead to an erroneous coding of the IV and by extension the DV.

That said, a second point of criticism concerns the quality of the collected data itself. For several indicators, such as the financing structure or the market share, no consistent data could be retrieved, thus posing another relevant limitation to this study.

Third, the approach pursued in this thesis neglects potential developments over time, which in turn affects the coding of the individual indicators and IVs. This becomes even more relevant when considering that the period under examination lasted up to ten years. CNMEG’s ability for self-financing, for instance, has been improved over the years through several IPOs. In view of the large time period in question, it is almost impossible to pinpoint a specific moment to adequately determine the value for each IV. While doing so is certainly a difficult task that goes beyond the scope of this thesis, it nevertheless remains a crucial limitation that needs to be taken into account when analysing and discussing the results of this research project.

Fourth, the final coding of the DV eventually relies on a sequencing process (“decision tree”). The sequencing establishes a ranking among the IVs, with the “Unity of the State” being the most important and the balance of “Relative Resources” being the least significant. Yet, Norris (2016, 223) argues that “the research design never intended to rigorously identify the relative importance across the five IVs.” Accordingly, the sequencing applied throughout this thesis is to be questioned in general. In fact, the hypotheses testing (see Section 5.3) for the NorthRail case provides initial evidence that the IV “Relative Resources”, which was deemed less important, may have been a decisive factor for the final case outcome. Accordingly, the relative importance of the single IVs is certainly an aspect to be further elaborated on, thus illuminating their relationship, interdependencies and impact on the outcome of the DV.

Fifth, the fact that two inducement cases have been considered as determinants for the long-term effectiveness of the Chinese economic inducement strategy constitutes another point of criticism. The framework provided by Norris (2016) does not explain the relationship between two inducement cases and does not provide a sound mechanism to evaluate the impact of potential interdependencies on the actual effectiveness of the strategy as a whole. In an effort to fill this knowledge gap, further research on economic inducement strategies including two or more inducement cases needs to be conducted. In this regard, this study may be a vital starting point, delivering initial evidence on how two inducement cases interact and influence the outcome of an overarching strategy in the long-term.

Finally, as already outlined in the literature review, the effectiveness of economic inducements is a highly complex issue, involving multiple aspects and dimensions. As emphasised by Blanchard and Ripsman (2008, 372), there does not exist a “monocausal theory” that conclusively explains the causal linkage between one determinant and the effectiveness of an economic inducement strategy or case.

Accordingly, it may be argued that in the case of the Chinese economic inducement efforts towards the Philippines, the determinant “state control” only played a subordinate role. Instead, other aspects, such as variables anchored in the target state, could have been a decisive factor for the effectiveness of the inducement strategy (Crumm 1995; Foran and Spector 1997; Mastanduno 2003). A. Wong (2019b), for instance, analysing the same cases of Chinese economic inducements, argues that the ineffectiveness was mainly caused by a high public accountability in the Philippines. Consequently, it is imperative to keep in mind that “state control” is not the only potential explanatory variable for the success or failure of economic inducements. However, the fact that there may be multiple determinants does not mean that they are necessarily mutually exclusive. On the contrary, the findings generated through this study combined with the work conducted by A. Wong (2019b, 2) provide initial evidence suggesting that effective state control and preventing negative externalities becomes even more important in target states exhibiting a high public accountability and “robust societal institutions, such as the media, civil society, and public opinion.” This example illustrates the importance to comprehensively understand the mechanisms of effective economic inducements and therefore serves as a proof of relevance for in-depth studies of single determinants.

This research project started with the ambitious aim of contributing additional knowledge to the question under which circumstances economic inducements may translate into the desired policy outcome. By examining the characteristics of the sender state and its degree of control



over commercial actors, this aim can be considered accomplished. The analysis of the empirical evidence delivered nuanced insights concerning the impact of state control on the effectiveness of economic inducements, laying the foundation for a better understanding of this discipline in general.

In conclusion, based on the findings of this study, its limitations and remaining knowledge gaps, the author suggests the following steps to be taken:

Scholars may:

1. Further elaborate on the relationship among and the sequencing of the different IVs, thus seeking to better understand the outcome of the DV and the dynamics of state control. This could be done through careful case selection seeking to identify the impact of single IVs on the coding of the DV.
2. Develop a coding mechanism that pays adequate attention to the time variable.
3. Conduct further research on the interdependencies of two inducement cases within one economic inducement strategy and their impact on the effectiveness of this strategy.
4. Also consider alternative explanations for the effectiveness of economic inducements, within the sender state, the target state as well as beyond, covering for instance the specific inducement type offered within a strategy.

At the same time, the analysis of the Chinese economic inducements towards the Philippines also produced valuable implications for policymakers. This is particularly true for those of the sender state, which are concerned with designing economic inducement strategies in an effective way. Thus, the following findings should be considered when crafting future inducement strategies:

1. To be effective, the goals of the commercial actors need to be intrinsically reconciled with the state's strategic objectives. The Chinese state should thus strive to either increase the value of adhering to its strategic goals or reduce the incentives to pursue short-term, profit-seeking motives. In both cases, the key may lie in the selection of the (financial) metrics used to evaluate the performance of companies and their top management.
2. The distribution of relative resources could be more important than expected. Therefore, it is crucial for the Chinese state to provide an effective mechanism for agent oversight, especially overseas.

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## Annexes

### **Abstract**

When and under what conditions do economic inducements effectively translate into the desired policy outcome? This thesis adds knowledge to this question by analysing the Chinese economic inducement efforts directed towards the Philippines between 2002 and 2012. To this end, particular attention has been paid to the ability of the Chinese state (principal) to control its commercial actors (agents), which are responsible for implementing the inducements. More specifically, this research raises two questions: First, what was the degree of Chinese state control during its economic inducement strategy vis-à-vis the Philippines? Second, did the degree of state control impact the effectiveness of the strategy in achieving the desired foreign policy objectives? To answer these questions, this thesis builds on a broad body of literature on the effectiveness of economic inducements, the role of the sender state and its relationship with commercial actors. Drawing on a comprehensive framework for “state control”, two specific cases of Chinese economic inducements – namely the construction of the North Luzon Commuter Railway and the National Broadband Network – are analysed and evaluated.

Ultimately, the findings suggest that the extent of Chinese state control can be described as *mixed*, mainly due to diverging intrinsic goals between principal and agent, as well as insufficient agent oversight on part of the state. This thesis furthermore highlights the importance of sufficient state control for the execution of effective economic inducement strategies and provides concrete recommendations for policymakers and researchers alike.

## **Zusammenfassung**

Wann und unter welchen Bedingungen führen wirtschaftliche Anreize („economic inducements“) tatsächlich zu den gewünschten politischen Ergebnissen? Die vorliegende Arbeit trägt zur Klärung dieser Frage bei, indem sie Chinas wirtschaftliche Anreize für die Philippinen zwischen 2002 und 2012 untersucht. Der Fokus der Analyse liegt hierbei insbesondere auf der Fähigkeit des chinesischen Staates, seine kommerziellen Akteure, welche für die Umsetzung der Anreize verantwortlich sind, zu kontrollieren. Konkret werden zwei Fragen aufgeworfen. Erstens: Wie hoch war Chinas Kontrolle über die kommerziellen Akteure während seiner Anreizstrategie gegenüber den Philippinen? Zweitens: Hatte der Grad der Kontrolle Auswirkungen auf die Wirksamkeit der Strategie bei der Erreichung der gewünschten außenpolitischen Ziele? Um diese Fragen zu beantworten, stützt sich diese Arbeit auf eine breite Literatur über die Wirksamkeit wirtschaftlicher Anreize, die Rolle des Absenderstaates und seine Beziehung zu kommerziellen Akteuren. Auf der Grundlage eines umfassenden analytischen Rahmens werden zwei konkrete Fälle chinesischer wirtschaftlicher Anreize in den Philippinen analysiert und bewertet.

Letztlich deuten die Ergebnisse darauf hin, dass der Grad der chinesischen staatlichen Kontrolle als gemischt bezeichnet werden kann, was vor allem auf divergierende intrinsische Ziele zwischen Staat und kommerziellen Akteuren sowie auf eine unzureichende Beaufsichtigung der Akteure durch den Staat zurückzuführen ist. Diese Arbeit unterstreicht darüber hinaus die Bedeutung von adäquater staatlicher Kontrolle über kommerzielle Akteure für die Durchführung effektiver Anreizstrategien und liefert konkrete Empfehlungen für politische Entscheidungsträger und Forscher.