

**The London School of Economics and Political Science**

***Analysing the Enforcement Dimension of Regulatory Competition:  
A Cultural Institutionalist Approach***

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## **Abstract**

This thesis is aimed at solving this puzzle: If the rules are the same, how do regulatory authorities compete for business firms to come to their jurisdictions? I suggest that it is better to think of regulatory competition in terms of regulating and regulated sides finding a partner to form a marriage. I argue that an important dimension to regulatory competition is competition between different types of micro-level enforcement regimes for different types of firms. Assuming the rules stay the same, depending on the match or mismatch of regimes' and firms' preferences, enforcement regimes have differential results in business attraction, enforcement effect and regulatory advantage. This argument is elucidated by a so-called ER (enforcement regime) Framework that uses the cultural institutionalist approach – a fusion of historical institutionalism and Mary Douglas' grid-group typology. The framework is used to interpret the empirical findings about regulatory competition for foreign investment in China. The thesis adds to our knowledge about the dynamics both of regulatory competition and of enforcement regimes, and helps to fill the gap that exists between the literatures in these two areas.

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## **List of Abbreviation**

AQSIQ	Administration of Quality Supervision, Inspection and Quarantine
CADZ	China Association of Development Zones
CEO	chief executive officer
DG	director-general
ER	enforcement regime
ETDC	Economic and Trade Development Company
FD	factory director
FOE	foreign owned enterprise
GDP	gross domestic product
HRC	high regulated country
ICTI	International Council of Toy Industry
IPR	intellectual property right
ISO	International Organisation for Standardisation
LRC	low regulated country
MOHRSS	Ministry of Human Resource and Social Security
MOFCOM	Ministry of Commerce
MWS	minimum wage standard
NGO	non-governmental organisation
NIC	newly industrialised country
PRD	Pearl River Delta
R&D	research and development
RC	regulatory competition
RTB	race to the bottom
RTT	race to the top
SC	section chief
SCJ	sub-city jurisdiction
SIZ	special investment zone
SME	small and medium sized enterprise
TPR	Trade Policy Review
TRIP	trade-related intellectual property
TPP	three types of processing (processing with the raw material, according to the sample and by assembling the components provided by overseas client) and compensation trade
WTO	World Trade Organisation
YRD	Yangtze River Delta

## Introduction

The main driver in writing this thesis was to address the puzzle that I had faced for many years as a professional. I worked for ten years in the first free trade zone in China. Although the national government established 15 free trade zones for the same purpose of attracting overseas investment and their regulatory authorities implemented similar rules, they ended up with sharply contrasting achievements. Typically, while two other zones in the same city had only a few investors, our zone was fully occupied by hi-tech overseas manufacturers. We had to enlarge the area of the zone in order to satisfy the increasing demands of incumbent and interested overseas investors. Meanwhile, according to the former Special Economic Zones Office of the State Council, the free trade zones were generally under suspicion of smuggling and losing money, i.e. gaining US\$1 for spending US\$7, but our zone was free from such misconduct and was the only one earning foreign currency, i.e. gaining US\$7 for spending US\$1. The different achievements of the free trade zones had attracted wide interests from scholars and professionals. However no one could give a convincing explanation about the likely causes of the differences between the free trade zones.

In this thesis, I intend to solve this puzzle: *if the rules are the same, how do regulatory authorities compete for firms to come to their jurisdictions?* The thesis explores how regulators compete in such circumstances by using different approaches to implementing the rules, including enforcement practices. However, different firms prefer different styles of regulatory approach or enforcement regime. As a result, I suggest that it is better to understand regulatory competition for business in terms of finding a partner to form a marriage. I argue that an important dimension to regulatory competition is *competition between different types of micro-level enforcement regimes<sup>1</sup> for different types of firms. Assuming the rules stay the same, depending on the match or mismatch of regimes' and firms' preferences, enforcement regimes have differential results in attracting business, enforcement effect and regulatory advantage.* This central argument is elucidated in terms of a theoretical framework named as the Enforcement Regime (ER) Framework (Chapter III). The theoretical framework aims to draw together the literature on regulatory competition and enforcement styles, discussed in Chapters I and II, filling

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<sup>1</sup> In this thesis, the regime refers to micro-level regime unless specifically noted.

in the gaps between them, and is used to interpret the empirical findings discussed in Chapters IV to VIII.

## 1. Significant Findings of Empirical Fieldwork

In January, February and July of 2008, I conducted field research in the cities of Shenzhen and Suzhou - the two most successful cities in competing for overseas investment in south and east China. The findings of the empirical fieldwork not only confirmed my previous professional observations about sharply contrasting regulatory competition (RC) achievements among locations but also enriched my knowledge about the dramatically different enforcement practices and competing approaches of the frontline regulatory authorities. These findings clearly alerted me that enforcement practice at micro level was so significant to RC outcomes that an analysis of this dimension would provide a comprehensive and accurate account for the empirical phenomenon of RC. My main empirical findings can be disaggregated into three levels: macro, middle and micro.

*Macro level* At the macro level, the competitor is the national government, who was competing for foreign investment in a global context, competing against other nations. Here, regulatory competition operated through the regulatory rules. The national government decided the strategy of competing for quality foreign investment and set social regulatory goals such as product safety, environmental and labour protection. It not only made the rules but also monitored implementation of those rules at lower levels of government and even intervened at the micro-level into decisions as to how firms should be treated in particular instances. The engagement of national government in the lower-level implementation practice suggested that it recognised that the success of its strategy of competing for foreign investment through rule making at macro level would be fundamentally affected by implementation practices at the micro level. This implied that macro-level RC through rule-making was closely linked to micro-level RC through rule enforcement.

*Middle and micro levels* The middle level refers to the middle-level governments, where the competitors were provincial and municipal governments. They engaged in high profile, head-on competition for foreign investment between one another and actively claimed successes in winning quality overseas investment as desired by the national government. However, through a closer look at their achievements, I found that desirable businesses mostly clustered in only a handful

locations rather than settling evenly across a province or a city. These sub-city locations, i.e. special investment zones (SIZ), towns and villages, were regulated by authorities at the local or micro-level. This finding suggested that the successes of provincial and municipal governments were generally showcased by those of the few sub-city locations with business clusters. The lack of success of most other sub-city locations was kept quiet. Whilst the middle-level authorities also made provincial and municipal rules which applied across their regions, it appeared that ultimately their success in regulatory competition also depended on enforcement practices at the micro level.

*Micro level* At the micro-level are the frontline regulatory authorities based in specific sub-city locations such as SIZs, towns and villages. I found that their enforcement practices were dramatically different in spite of the fact they were implementing similar national, provincial and municipal rules. Some competed for quality foreign investment as desired by the national government. Some targeted exactly the type of overseas firms that were not, for varying reasons, desired by the national government. Some were disinterested in competition. Some were driving away overseas investors in order to make room for favoured domestic business. The relations and interactions between the authorities and firms based in their jurisdictions were sharply different from one location to another. The economic and social achievements of those locations were also very different. These findings suggested that micro-level enforcement of the rules made at macro and middle levels was highly varied and entailed both desirable and undesirable economic and social outcomes. I was convinced by the findings at this level that RC through rule making at macro level was fundamentally affected by enforcement of these rules at micro level.

After conducting the fieldwork, I further understood that none of the existing theories of regulatory competition could adequately explain my empirical findings<sup>2</sup>. Firstly, RC scholars appeared unaware that RC through rule-making at macro and middle levels was closely linked to rule enforcement at the micro level. Except for identifying the broad impacts of stringency versus laxity of enforcement, these scholars had overlooked the fact that micro-level enforcement practice was fundamentally significant to RC. Consequently, they could not fully explain how different sub-national regulatory authorities could compete for business when they were all charged with implementing the same rules. Secondly, when addressing RC

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<sup>2</sup> For details, see Chapter III.

at the middle level, most scholars seemed to have taken for granted that all sub-city locations were equally successful or unsuccessful in competing for business; and that self-made provincial or municipal rules were automatically and evenly well-enforced at the micro level. Consequently, they could not explain, when implementing the same rules, why some locations attracted more business than others. Finally, RC scholars had considered the competitor (the regulator) and the firm whose business was being competed for as quite separate from one another. Hence they paid no attention to the relations and interactions between regulators and firms and were thus unaware of the issue of whether there was a 'match' and 'mismatch' between their respective preferences and styles. Consequently, in a situation where the rules are the same, existing theories of regulatory competition could not explain why regimes were selective about businesses; why firms chose particular locations to conduct business; and why regimes were so different in their economic and social achievements. Therefore, an interrogation to the dynamics of micro-level enforcement was called for in order to give a more comprehensive and accurate account of the empirical phenomenon of RC that I had observed both as a professional and as a research student. However, most enforcement theories in socio-legal analyses focus on enforcement styles and businesses responses to regulation, and whilst they emphasise the need for a 'matching' of regulatory style to the firm's response to regulation, enforcement theories are not concerned with the question of how enforcement styles can be used to compete for business, as opposed to how they can be used to improve compliance with regulation. A question therefore arose: How to make sense of the empirical findings so as to develop a qualitative theory of RC?

## **2. Theoretical Framework**

To make sense of the findings of my empirical fieldwork I needed a suitable theoretical framework. I found two sets of theories to offer the most resonant insights: historical institutionalism and Mary Douglas' Culture Theory. I drew these together to develop a 'cultural institutionalist' framework which I then used to analyse my findings. The approach used was therefore iterative and inductive: I used the theories to interpret the empirical findings, and the empirical findings to review the theoretical framework that I developed.

## 2.1 Historical institutionalism

Historical institutionalism defines institutions as formal and informal norms, procedures, routines and conventions embedding the organisational structure of political economy (Thelen and Steinmo: 1992; Ikenberry: 1988; North: 1990; DiMaggio and Powell: 1991; and Hall and Taylor: 1996). It offers the opportunity to explore the reciprocal relationship of institutions, including regulatory rules, on regulatory players' behaviour, and assumes that micro-level regulatory authorities and firms are operating with some degree of rationality. It therefore enables an understanding of how both firms and micro-level regulatory authorities respond to the regulatory regime by drawing attention to the preferences of firms and local-level regulators, and how each seeks to achieve those preferences given the broader institutional context in which they are operating.

Notwithstanding their common interests in the reciprocal relationship of institutions and players, neo-institutionalists<sup>3</sup> interpret this relationship differently. A key difference in their interpretations is how players' preferences are formed. Economic institutionalists consider that players' preferences are formed exogenously. Institutions provide strategically useful information and an enforcement mechanism. Players are rationally driven by utility maximisation so that their behaviours are instrumental and strategic (Coase: 1937 and 1960; Williamson: 1975; North: 1990; and DiMaggio and Powell: 1991). North even regarded that institutionalisation of ideological consensus, contrasting to individualisation, was an efficient substitute for formal rules. Sociological institutionalists argue that players' preferences are formed endogenously. Institutions provide not only useful information but also moral and cognitive templates. Players are mindful of social appropriateness for their choices and behaviours (Meyer and Rowan: 1977; March and Olsen: 1984; Granovetter: 1985; Douglas: 1986; Jepperson: 1991; DiMaggio and Powell: 1991; and Zucker: 1991). Historical institutionalists see that players' preferences are formed partly exogenously and partly endogenously. While institutions shape and structure players' choice, players act and interact with bounded rationality (Simon: 1957). In a particular context, their choices and behaviours may cause unintended and inefficient outcomes (March and Olsen: 1984; Krasner: 1988; Goldstein: 1988; Weir: 1992; and Campbell: 1998).

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<sup>3</sup> In this thesis, institutionalism refers to neo-institutionalism only. For more details about the distinction between old and new institutionalisms, see DiMaggio and Powell (1991) and Black (1997).

Institutionalism has been broadly used in the regulation studies (Black: 1997; Morgan and Yeung: 2007; and Baldwin et al: 2013, pp53-65). However, strictly speaking their use is very limited in RC study and implicit in enforcement study. In the RC study, Bratton et al mentioned the involvement of economic and sociological lenses (1996, pp2-3). If we accept that these two lenses could be interpreted as the use of economic and sociological institutionalisms, then we can identify the following gaps in existing RC theories: While the economic lens focuses on the impact of rules and competitive measures to attracting business and gaining regulatory advantage, it ignores the restraints of institutional structure and regulatory process. While the sociological lens emphasises institutional constraints and operative forces, it is blind to competing for business<sup>4</sup>. Therefore, I am going to use historical institutionalist approach to fill the gaps in terms of paying attention both to institutional restraints upon regulators as well as impact of formal and informal structure upon firms, and to the regulator-firm interactions in enforcement process as well as their effects on competing for business and enforcing social regulation.

Contrasting to the RC study, the enforcement study is rich in institutionalist ingredients. Typically, the enforcer is of various types and is affected by contextual, hierarchical and regulatory factors. Also the regulated firm is of various types and is affected by intra-firm, inter-firm and extra-firm factors. Their bilateral relations and interactions have various characteristics. There are relevant enforcement effects. However, the scholars do not always seem to be aware of the involvement of institutionalism, as the above-mentioned facets are yet to be inter-related<sup>5</sup>. While borrowing a building block from the existing enforcement theories, I am going to use historical institutionalism to fill the identified gap in terms of systemising relevant facets of the enforcement dimension.

## **2.2 Mary Douglas' Culture Theory**

Notwithstanding explaining the reciprocal relationship between institutions and regulatory players, historical institutionalism does not really help to explain why some types of firms are attracted to some types of regulator and vice versa. To develop this explanation, I turned to Mary Douglas' Culture Theory, drawing on her

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<sup>4</sup> For details, see Chapter I.

<sup>5</sup> For details, see Chapter II.

grid-group typology to illustrate the various features of different regulatory authorities and firms and to analyse their bilateral relations and interactions.

The central tenet of the grid-group typology is that individuals in a society are subject to two types of social control over their choices and interactions. One is the group. The 'group' functions endogenously within the boundary of the society and is measured by the degree to which individuals cooperate. The other is the grid. The 'grid' is comprised of the rules imposed by the exogenous structure of the society. It is measured by the degree to which those rules are coercive or permissive. The scale of each control varies from low to high. At the high end is a clear definition of the social roles of individuals. At the low end social roles are ambiguous. Putting the two types of control together yields four archetypes of societies: Positional, Enclave, Individualist and Isolate (see Diagram 1<sup>6</sup>). Each society represents one type of cultural bias<sup>7</sup>. Positional, Individualist and Enclave respectively exemplify Max Weber's three types of rationality that are based on bureaucracy, market and religion community. The Positional is characteristic of strong grid and group. All constituents are assigned with respective roles. Their behaviours and interactions are governed by both endogenous and exogenous rules. All groups are contained by larger groups. The authority is exercised on the grounds of inequality of the constituents. The Individualist is characteristic of weak grid and group. All boundaries are provisional and negotiable. The interaction between constituents is characteristic of competition. The success is assessed according to the wealth and power an individual can achieve. The Enclave is typical of strong group but weak grid. Internal roles and relationships lack explicit definition and hence are open to negotiation. No individual is granted the authority to control another. Disagreements between the members tend to be kept underground. The members are likely to be dissidents of the main society. The Isolate is characteristic of strong grid but weak group. Its constituents are generally ignored. Their opinions are not invited or taken seriously. It is a society where one avoids responsibility and pressure<sup>8</sup>. The culture of each society is self-defined and competes with each other. The culture is

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<sup>6</sup> The version adapts from Douglas (2006a) pp2-6. This article is a comprehensive summary of the Culture Theory given by the author herself.

<sup>7</sup> For the original version, see Douglas (1982) pp183-254. For a summary of the theoretical development, see Douglas (2006a). More introduction to the theory, see also Douglas (2006b).

<sup>8</sup> Thompson et al (1990) proposed a fifth type, i.e. hermit, which is subject to zero grid and zero group (pp7). But Douglas (2006a) considered hermit as one version of the Isolate. The author agrees with Douglas's classification.

incorporated in the respective institutions and sustains as long as the institutions persist<sup>9</sup>.

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<sup>9</sup> For critiques of the Culture Theory, see Ostrander (1982), Douglas (1986), Thompson et al (1990), Rayner (1992) and (1993), Tansey and O'Riordan (1999)

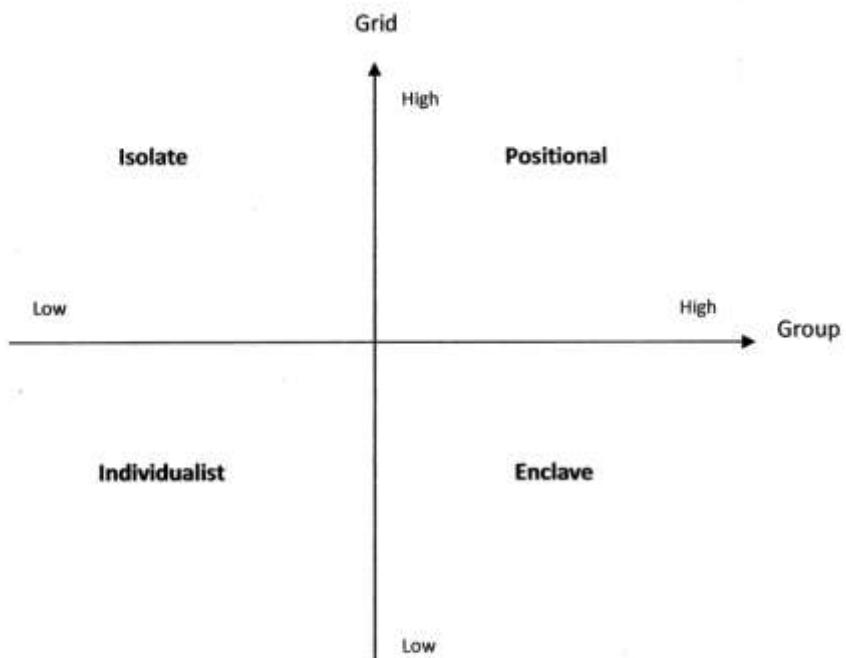


Diagram I      Mary Douglas' Grid-Group Typology

The typology is considered as an influential approach to explain regulation (Baldwin and Cave: 1999, pp31; Hood: 1998: pp7; and Baldwin, Cave and Lodge: 2013, pp50-51). Indeed Douglas commented culture as '*a general regulatory mechanism for human behaviour*' (1985, pp3). It has been applied to characterise regulatory styles in a number of contexts (1994; 1995 and 1998; Hood et al: 1999; Hood et al: 2001; Haines: 2003; Evans: 2008: and Lodge et al: 2008). However it has not yet been applied in the context either of RC or of enforcement. Based on this typology, it can be argued that regulatory authorities have different institutional features in terms of vertical oversight (grid) and horizontal inter-agency cooperation (group). I extend this application of grid-group theory of regulation to the context of RC, and argue that regulators have different interests and strategies of RC which yield different outcomes of RC. Meanwhile, different types of firms respond in different ways to formal and informal controls. The relevance of institutionalism is that when the regulating and regulated sides meet, their bilateral relations and interactions vary in different institutional contexts. It thus helps to address the gap between the literatures on RC and enforcement respectively, indicating how the effectiveness of different strategies of RC may vary depending on the 'fit' between the regulator and the firm.

### **3. Outline of Main Argument**

Drawing on historical institutionalism and the Culture Theory, and using the notion of a 'regime' outlined by Hood et al (2001), I develop the ER Framework. The details are set out in Chapter III, but the main elements are as follows.

First, an important dimension of RC is that regulators use various types of enforcement regimes to compete for various types of firms. Enforcement regimes have institutionally different characters, in that they enforce social rules and compete for business in different ways. Furthermore, firms have different responses to formal and informal rules, as we know from the literature on compliance. Taking into account the differences both in regulatory approaches and responses to regulation suggests that it is naive to expect that governments can rely simply on formal rules to ensure success in regulatory competition. Instead, how enforcement is practiced at the micro level fundamentally affects the outcome of strategies of regulatory competition that rely principally on rule-setting at the macro level.

Secondly, the varying outcomes of regulatory competition in situations where the rules are the same can be explained through the notion of the 'match' and 'mismatch' of enforcement regimes' and firms' preferences. For a regime, winning business is not a one-time deal but entails a long-term regulatory relationship and interactions between the regulator and regulated. Drawing on the empirical fieldwork, I argue that regulators' enforcement regimes are restrained by resources and cannot satisfy demands or ensure the compliance of all types of firms. Accordingly they target and compete for preferred type of business. The fieldwork also shows that firms vary in the type of enforcement regime that they prefer. To the extent that they can gain information about the different approaches of local regulators, they seek locations that mostly satisfy their demands and avoid those that do not. Regulatory competition is thus analogised to a marriage: each seeks out the type of partner they most want to be with. The result can either be a match or mismatch of preferences. Further, the indicative evidence is that the match or mismatch affects the outcomes of regulatory competition in terms of the types of businesses attracted to a regime and the effect of enforcement.

To summarise, this thesis presents a qualitative empirical research on the topic of regulatory competition in order to provide a key to the puzzle I have faced for many years. With significant findings from my fieldwork, I realised that existing theories were inadequate to account for the empirical phenomenon of RC which I observed. Therefore, I suggest that we should think of regulatory competition in terms of regulators and firms each finding a partner to form a marriage, and that critical in that matching process is the nature of the micro-level enforcement regime. Using Mary Douglas' Cultural Theory combined with historical institutionalism, which I term the 'cultural institutionalist' approach, I develop a theoretical framework, namely the ER Framework to analyse the fieldwork and arrive at this conclusion. The thesis adds to our knowledge about the dynamics both of regulatory competition and of enforcement regimes, and helps to fill the gap that exists between the literatures in these two areas. The insights from this thesis could also be used in further empirical studies on the impacts of micro-level enforcement regimes for regulatory competition to assess the significance of the match or mismatch between enforcement regimes' and firms' preferences in determining which regulatory regimes succeed in the competition for business and which fare less well.

## Chapter I     Theories of Regulatory Competition

This chapter is a systematic review of existing literature about regulatory competition (RC). The theories are scrutinised referring to the research question of this thesis: *If rules are the same, how do regulatory authorities compete for firms to come to their jurisdictions?* This literature review is to shed light on the inadequacy of existing theories of RC of which the enforcement dimension is still an uncharted area for interrogation.

Bearing in mind the ultimate purpose, this review is made selectively. The literature is chosen according to two main criteria: one criterion is the relevance of the subject matter. The subject matter must be the rule, public policy or institutions with regulatory purpose. Its goal is related to the attraction of business in a narrow sense, and to the economic interest in a broad sense. The other criterion is positive research only, no normative or prescriptive studies. The focus here is on the fundamental factors of RC such as the regulating and regulated sides as well as the measures used for competition and outcomes of RC. It is not whether RC is 'good' or 'bad', or finding solutions for problems incurred. The selected literature is to be reviewed with uneven weight, dependent on the relevance of their themes and methods.

The phenomenon of RC has been studied in diverse ways, most of which are contextually based. Some ways appear to be reconcilable, and some share limited commonality. The literature review is structured through juxtaposing six contrasting theories of RC, with relevant literature grouped into them. These theories are considered to roughly take two institutional lenses: economic and sociological. The first two theories use economic lens, while the last four use sociological lens. The review is carried out specifically for each theory, so as to reveal the respective focus and analytical approach. The review ends with a conclusion, which sheds light on the gaps and limitations of existing scholarly understandings about the empirical phenomenon of RC.

### 1.     A Driving Force to Satisfy Firm's Preferences

The theory of RC is widely acknowledged as originating from Tiebout's 'Pure Theory of Local Expenditure' (1956)<sup>1</sup>. This economic view was designed for the local governments of the USA to better satisfy the preferences of mobile consumer-taxpayers. *'The consumer voter may be viewed as picking that community which best satisfies his preference pattern for public goods. This is a major difference between central and local provision of public goods. ...The consumer-voter moves to that community whose local government best satisfies his set of preferences. ... The greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position.'* (pp418) Moreover, to introduce the market-like mechanism was to force the local governments to compete so as to improve their efficiency. *'On the production side it is assumed that communities are forced to keep production costs at a minimum either through the efficiency of city managers or through competition from other communities.'* (pp422) Given the government was assumed to be driven by maximising revenue, and the consumer-voter could 'vote by foot', the government was forced to compete through efficient responses to the consumer-payer's preferences. Tiebout's theory is contentious. A key question is: Does the government compete to satisfy the firm's preference? Why or why not?

### 1.1 'Yes'

For the 'yes' answers, the explanations are given from three points-of-view: the regulating side, the regulated side and the tripartite.

*Regulating Side* Morris summarised three motives for politicians and bureaucrats to attract business and to develop local economy (2010: pp105-112). The first was the public interest motive of increasing citizens' wealth. The second was the motive of producing public good. The third was the personal interest motive of enhancing personal well-being. This included both tangible benefits from taking bribes and psychic benefits of being in office to satisfy their policy preferences. This categorisation covers most varieties of governmental officials' interests in RC, including revenue maximisation (Tiebout: 1956; Cary: 1974; Romano: 1985; and Bratton et al: 1996), incentives for re-election (Harrison et al: 2006; Bradbury: 2006; Mertha: 2006; and Konisky: 2007) and rent-seeking (Bratton and McCahery: 1996, pp214).

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<sup>1</sup> Bernholz and Vaubel (2007) had a different opinion. See pp1.

*Regulated Side* Hirschman (1970) argued that the regulated side could exert influence upon the regulating side based on three types of measures - namely loyalty, voice and exit. Indeed, voice and exit have become basic concepts in describing the influence of the firm in RC contexts. Governments' competitive adjustments of regulations were arguably driven by the demands of home and foreign firms. If firms believed it in their interest to comply with low or high regulatory standards, they were likely to use exit to less green or greener jurisdictions as leverage to ensure governments would listen seriously to their voice (Porter: 1990; and Konisky: 2007). Murphy (2005) selected six American business cases to illustrate three general trajectories in the context of global RC for business. These trajectories were: firstly, production process standard became laxer, while market access standard stricter. Secondly, firms with monopoly and oligopoly status manoeuvred regulations to reflect their interests. They inclined to make domestic rules complicated in order to maintain their industrial advantage while deterring foreign competitors. Finally, firms with low asset-specificity drove regulation towards laxity, while multinationals pushed regulations of varied jurisdictions to converge. He bridged a gap in terms of establishing a correlation between regulatory trajectories and industrial interests and features. However, the link is weak as he did not elaborate on how the firms' preferences are transformed into the changed regulations and how the changes contribute to the advantage of particular regulatory regimes.

*Tripartite* Paul (1996) mapped a tripartite driving force behind RC in the EU packaging waste market. When the Netherlands and Germany adopted high packaging and recycling standards, unregulated France, the UK, Belgium and Italy reacted similarly, based on identical social, economic and political considerations. The environment-protecting groups were concerned about the possible reception of packaging waste from the regulated countries. The firms cared about potential loss of the packaging market to the Dutch and German environment-friendly competitors. Both groups lobbied their national governments to enact packaging regulations. All these governments responded positively and identically. They counted on the firms to formulate and implement the regulations. The firms were supportive because they could pass the additional cost on to the consumers, given that the regulations took effect not on production but on consumption.

Paul's description of the tripartite incentives behind RC in the packaging market of the EU is very similar to Vogel's account about the tripartite driving forces underpinning the raise of environmental standard of the State of California in the

context of domestic economic integration, which was dubbed as the 'California effect' (1995; and Vogel and Kagan: 2004). The major differences between the two are: Vogel emphasises that the impact of economic integration primarily depended upon the preferences of wealthy and powerful states or countries; and that the firms in wealthy and powerful jurisdictions used strict regulations as the pivot to their competitive advantages<sup>2</sup>.

In brief, the explanations for 'yes' answers are apparently premised upon the assumptions that all types of player - the government, the firm, the consumer, the public interest group and the jurisdiction - behave like the market player. Each has its specific interest to pursue, manifested as its behaviour rationally driven by its interest. When the government's incentive (incidentally) agrees with the firm's interest and at best, the public's, the government demonstrates active and efficient responses to the firm's preferences. Notwithstanding that some scholars identified a range of interests on the regulating side as well as the preferences on the regulated side, most research is one-sided and disconnected from each other.

## **1.2 'No'**

The opposing argument is that RC is not a driving force to satisfy firm's preferences. In Canada, whereas provincial governments were engaging in RC for developing local economy, attracting business only constituted a small part of their agendas (Kenyon and Kincaid: 1991; Brown: 2006; Olewiler: 2006; and Morriss: 2010, pp112). It was bundled with the goals of sustainable development involving environment protection, public health, education and fiscal policy. A balanced economic and social development was perceived as necessary to construct an overall local '*competitiveness*' – that is '*the ability to compete successfully*' (Brown: 2006 quoting Porter: 1990). Moreover, domestic political institutions mattered. Provincial governments responded primarily to local interests and secondarily to RC for business. The stronger support particular policies got from the voters, the less likely the governments changed them, even if they faced RC for attracting business (Harrison: 2006). Furthermore, governmental engagement to RC was not stable. As the ruling parties' ideologies changed, so would the governments' interests in RC. Along with shifts of political power, came changed ideologies and interests of provincial governments (Harrison: 2006).

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<sup>2</sup> More account can be found in the section of RC as 'One Form of Inter-Jurisdiction Interdependence'.

The landscape of China is somewhat similar. Zhang illustrated how the change in national government's strategies reshaped the inter-city relations in a region in China - the Yangtze River Delta (YRD) (2006). He compared the national governmental strategies before and after the year 2000 to demonstrate the difference. Before 2000, the YRD benefited from the privileged policies granted by the national government as an early mover of opening to foreign investment for economic development. The appointment and promotion of mayors was based primarily upon their achievements in advancing local gross domestic product (GDP). These policies engendered intense inter-city competition in the region. After 2000, the national government switched its emphasis towards narrowing down regional development disparity. The YRD no longer enjoyed privileged policies and faced increasing competition from other regions. The promotion of mayors was also changed and became based on their achievements in sustainable development. The municipal governments in the YRD decided to form regional alliances so as to maintain their established advantage as well as to compete as a whole against other regions.

A number of studies have also been done within the EU. The EU landscape is rather complex. Scholars identified factors that withheld the governments of the member countries from RC. Some factors were legal and institutional, typically those in company law. They included reincorporation costs, pattern of corporate regulation, complex normative landscape, path dependence and institutional structure. Others were political, such as protectionism and impact of interest groups; lack of innovative incentives due to insufficient rent seeking by bureaucrats; and worries about possible centralisation by the EC to remedy externalities caused by RC (Romano: 1996; Hertig: 2001; McCahery and Vermeulen: 2001; Kahan and Kamar: 2002; Heine and Kerber: 2002; and Riketts: 2004).

Though they are specific to particular regions, the explanations share one point: the government bears little resemblance to the market player. It needs to balance varied policy goals and is restrained by myriad forces embedded in domestic political and legal institutions. Moreover different governments have different ideologies and interests. These factors withhold the government from competing to satisfy the firm's preferences.

### **1.3 Summary**

The theory of RC as a driving force for the government to satisfy the taxpayer's including the firm's preferences derives from Tiebout's marketplace analogy.

However it is contentious that RC can be a driving force in this regard. The proponents share Tiebout's assumption of the government as identical to the market player, who is interpreted as driven by self-serving interests. Their arguments drawn from the three perspectives of the regulating and regulated sides and tripartite demonstrate the logic of a marketplace transaction - a deal is struck when the trading parties' interests match. Except from this logic, they do not seem to have adequate explanations. The opponents disagree that the government, like the market player, is an independent decision-maker. They emphasise the significance of institutional constraints upon the government and hint that varied institutions entail varied governments' choices and decisions. Comparatively, the opponents' explanations are more sufficient and hence more convincing than the proponents. Whereas the contentious camps denote the varieties of the government's responses and of the firm's preferences, there is no comprehensive framework to interpret them. This is a gap in this group of literature (Radaelli: 2004).

## **2. A Race in the Marketplace**

Deriving from Tiebout's marketplace analogy, RC is compared to a 'race'<sup>3</sup>. It assumes that governments compete like firms for attracting mobile business. The meaning of the term 'race' is never explicit. Nor are those for the pertinent labels used to denote the directions of the 'race', namely 'race to the bottom (RTB)' and 'race to the top (RTT)'. Radealli (2005), Braithwaite and Drahos (2000) and Murphy (2005) question the preciseness of the 'race' comparison as well as the pertinent terms of RTB and RTT. Yet these terms have been used in a taken-for-granted manner.

The RC aiming at attracting firms has been vulnerable to persistent normative scepticism. The scepticism follows the route of the government's over-value of business interest and economic development at the expense of social interest and sustainable development. Consequently, the central concerns are shaped and structured less about the race per se, but more about the directions of the race, or RTB and RTT. RTB and RTT can be either a measure or an outcome, namely a spill-over of business attraction. In either case, RTB appears to be equivalent to adjustments towards loose, low, weak regulatory standards and requirements, whereas RTT means the opposite. The literature on RTB particularly involves strong judgmental and prescriptive implications. Indeed, concentration on the directions of

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<sup>3</sup> Cary (1974) could be the first one to make the comparison. The usage of the term 'race' is not exclusive to the economic theory.

RC has left the marketplace analogy focused restrictively on lax rules at the expense of other methods for business attraction. This review omits normative and prescriptive debates and focuses on positive (parts of) literature. Positive studies cover both economic and social regulations. Since the review in the first group of theories has answered the 'why' question, this section is to answer the 'how' question. It discusses the measure and the outcome of RC for attracting business.

## 2.1 Competing Measures and Outcomes

The measures of RC for business attraction are generally instrumental. They include change and adjustment of rules and enforcement stringency, and deployment of land and other resources and incentives. The outcomes of RC, or the effect of these measures, in terms of business attractiveness and enforcement desirability, are in question.

*Adjustment of Rules* The adjustment of governmental rules is held as a fundamental measure, indicated by the concept of RC defined by numerous scholars. Sun and Pelkmans (1995) defined it as the '*alteration of national regulation in response to actual or expected impact of internationally mobile goods, services, or factors on national economic activities*'. Armour referring to Tiebout (1956) and Esty and Gerardin (2001) defined RC as '*national legislatures compete to attract firms to operate subject to their laws*'<sup>4</sup> (2005). Deakin (2006) defined it as '*a process whereby legal rules are selected and de-selected through competition between decentralized, rule-making entities, which could be nation states or other political units such as regions or localities*'. Baldwin and Cave' definition expanded the scope (1999), hence RC is '*the competitive adjustment of rules, processes, or enforcement regimes in order to secure an advantage*' (pp180). Woolcock took a step to clarify the terminology (1996): '*Competition among rules can be seen as a general term covering regulatory competition, institutional competition, regulatory arbitrage and regulatory emulation* (pp297) ... *Institutional competition is essentially the same as regulatory competition*' (pp298).

The adjustment of rules often involves the change in the stringency of rules. Lax rules are arguably effective for attracting business. Cary (1974), Bratton and McCahery (1996) attributed Delaware's success to its lax corporate law, and to legislative and administrative capture by managers at the expense of shareholders' interest. Among his opponents, Dodd and Leftwich (1980) argued that Delaware

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<sup>4</sup> Armour (2005), see definition on pp5 and referred Note 13 on pp37

was successful in attracting (re)incorporation because of its low operational and financial cost. Subramanian (2002) held that the effectiveness of lax rules to large industries disappeared over the long-term. Besides, over-protection of managers from takeover might discourage them to (re)incorporate in a state which was infamous for lax law. Writing in the EU context, Jackson and Pan (2008) also challenged the American corporate lawyers' view about the effectiveness of lax rules in inducing capital. Based on finding of the securities market, they argued that variation in regulatory stringency was not a factor for affecting capital raising practices. The capital practices responded to Pan-European requirements rather than to various rules of member states. In addition, increasing market integration might diminish further the need to consider the stringency of rules. Simmons pointed out that, given a more reliable financial regime and hence lower probability of risk, capital would flow into the countries with strict rules (2004).

*Adjustment of Enforcement Stringency* Empirical finding from different environmental sectors in the USA suggested that competing states interacted informatively and strategically through environmental enforcement in order to attract business. The finding from surface-mining regulation suggested that the stringency of state enforcement was systematically affected by that of its rivals. States lessened enforcement when their stringency was higher than their rivals. But they did not make adjustments when their stringency was lower than their rivals (Woods: 2006). In contrast, the finding from federal air, water and hazardous waste control regulations indicated that states responded to their rivals when the rivals' enforcement stringency put them either at a disadvantage or at an advantage (Konisky: 2007). The researches by Post (2004) and Knill, Tosun and Heichel (2008) highlighted the enforcement deficit in developing countries as a means to safeguard their regulatory advantages<sup>5</sup>. Nevertheless Coffee (2007) had an opposite opinion about enforcement stringency. He argued that, in the financial sector, stringent enforcement could enhance attractiveness to business by lowering the cost of information asymmetry. It did deter some firms, but these were the very types unwanted, given their primary purpose was profiting from speculation<sup>6</sup>.

*Land and Other Incentives* Land as a valuable resource is not mobile and stays in particular geographic locations. Apart from being a necessary factor for production in its own right, land is where mobile resources - capital, labour,

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<sup>5</sup> As these researches were done in the light of economic integration, more details will be given in the section of RC as 'A Form of Interdependence'.

<sup>6</sup> See more in the section about enforcement stringency versus regulatory attractiveness in Chapter II.

technology and equipment – can be placed (Dye: 1990, pp24). The World Bank regarded land as a regulatory indicator for foreign direct investment (FDI) (2010). Oman's research about the RC in the coastal cities in China exposed that concession in land lease, tax incentives and fast approval schemes were the principal instruments deployed by the governments (2000). Unlike tax incentives, the deployment of which was under the control of the national government, land was up to the entire discretion of municipal governments. Therefore, the outcomes of RC were: (1) there was neither noticeable drive-up in tax holidays nor drive-down in environmental or labour standards. Yet land was used up quickly for accommodating factories with overseas investment. At the same time, regional disparities between the coast and inland deepened. (2) The approval scheme for the projects with overseas investment turned out to be not always efficient because of the arbitrary behaviour of the agencies charged with approval authorities. (3) There were additional problems in administrative practice, typically rent-seeking, corruption, poor transparency and accountability.

In brief, the measures of RC suggested by the scholars are generally regulating-sided and instrumental. Among the instruments, both adjustments of restrictions and provisions of favourable conditions are deployed for business attraction. Lax rules and enforcement are arguably able to allure business but are likely to scare away capital and firms which will bring desired benefits. While favourable conditions are likely to be appealing to business, the agencies' behaviour and practice can be counter-productive. The above analysis suggests that a pure focus on competitive instruments may miss out other noteworthy issues. As noted by Baldwin and Cave (1999), both enforcement regime and process deserve attention for business attraction. However so far, there has been no scholarly attention identified.

## **2.2 Regulatory Advantage and Its Attributes**

When RC is compared to a race in the marketplace, the winner has regulatory advantage over his competitor in attracting business. This is typified in the American corporate law competition (especially Romano: 1985). Regulatory advantage is an additional outcome of RC for business attraction. However the terms such as 'regulatory advantage', 'regulatory attractiveness', 'competitive advantage' and 'comparative advantage' are used frequently by the scholars without differentiation. What do they mean exactly? How are they similar to and different from each other?

Baldwin and Cave suggested that regulatory advantage is equivalent to the provision of a more favourable business environment than competitors. It is not

necessarily based upon low compliance costs (1999, pp180). They did not differentiate types of regulatory advantage. If we refer to Porter (1990), there are two types of advantage: comparative and competitive. '*Comparative advantage ... rests on endowments of resources such as labour, natural resources, and financial capital. ... (F)actor resources themselves have become less and less valuable in an increasing global economy.*' Instead, competitive advantage '*depends on creating a business environment, along with supporting institutions, that enable the nation to productively use and upgrade its resources*' (pp xi-xii). Porter's definitions show that the concepts of comparative and competitive advantages are significantly different. Yet the concepts are not defined for a regulatory context. Although RC theorists are keen on distinguishing RTB and RTT, they generally use the term 'competitive advantage' on both occasions. This shows a lack of precision about the outcome of RC in existing theories. To define and differentiate the mentioned concepts requires additional work.

While admitting Delaware's advantage to be determined by its lax corporate law, Romano gave particular note to the arguable attributes of that advantage (1985): *Responsiveness* Governments' responsiveness to tax-paying entities is intrinsic to the marketplace analogy. Underpinned government's responsiveness is its interest of maximising revenue (Tiebout: 1956). The American corporate law competition typically exemplifies these features in attracting business (Cary: 1974; Romano: 1985; and Bratton et al: 1996). Yet the speed of responsiveness in terms of efficiently and continuously adapting corporate law to firms' needs underpinned Delaware's success (Romano: 1985; and Morriss: 2010, pp115). Delaware government was precisely responsive to corporate managers. Lax state legislations and low standards entitled managers' unilateral control of corporate conduct, thus freedom from the monitoring by shareholders, public opinion and judicial review. With such unrivalled favourable conditions to managers, Delaware was successful in attracting large numbers of firms (Romano: 1985; and Macey and Miller: 1987).

Nevertheless, the government responds not only to firms but also to citizens and public interest groups. The matters in this regard are typically social regulations such as environment, labour, health and safety. The government's responsiveness implies the adoption of high social standards and hence more regulatory cost to the firm (Baldwin and Cave: 1999: and Bratton et al: 1996). Yet complying with high social standards can be the firm's strategy for pursuing competitive advantage rather than a negative burden (Porter: 1990; Vogel: 1997; and Coffee: 2007).

Facing an increasingly globalised economy, national governments respond also towards the conditions and exigencies of the international market. Global mobility of business and competition in the international market is likely to make national governments assess or adjust regulatory standards, alter or withdraw restrictive rules, demolish or create regulatory regimes. National governments may also persuade or press the governments of foreign countries to adopt similar rules in order to protect the competitive advantage of domestic firms (Bratton et al: 1996; and Esty and Geradin: 2001).

*Innovation* Romano held that Delaware did enjoy the advantage of a first-mover in innovatively producing corporate law (1985). Given the first-mover advantage, it was difficult for late-moving states to grab the lion's share of Delaware in the corporate law market. Continuous enhancement further heightened Delaware's legal asset specificity. Hence it was hard for other states to replicate. Carney (1996) observed that the diffusion of the innovation of American corporate laws across the USA was driven by two interest groups: corporate lawyers and managers. Since the lawyers faced more collective problems than managers, changes in corporate laws were more manager-sponsored and entitled greater managerial flexibility. Ayres (1996) however argued that competing states might not respond or innovate efficiently. He used three models to demonstrate the hypothetical possibilities. The 'patent' model showed that states might lack incentive to innovate laws, as innovative states would not be rewarded by a return on their investment. Unlike intellectual property, legal innovations were not protected and easily copied by and dispersed among competitors. The 'yachting' model illustrated that a leading state might strategically emulate inefficient legal innovations in order to protect its first-mover advantage from being overtaken by a threatening rival. The 'bluebook' model demonstrated that the dominant state might promulgate sub-optimal codes so as to create more litigating business for lawyers as well as to make more difficulties for duplication by its competitors<sup>7</sup>.

*Certainty* Delaware was considered to be a first choice for potential (re)incorporating firms, because the access to its legal system meant a certainty of reducing transaction costs in doing business and winning potential litigations (Romano:1985). The state government was prudent in terms of maintaining the stability of standards and codes so as to avoid scaring away firms. Delaware had accumulated abundant case law and expert judges in the corporate law area. These

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<sup>7</sup> For further details about regulatory innovation, see the section of RC as 'One Form of Inter-Jurisdiction Interdependence'.

resources assured firms of big predictability of legal decisions. Indeed, certainty of a legal regime was an advantage for off-shore financial centres (Morris: 2010, pp112). Regulatory certainty was identified as more essential than flexibility in attracting foreign investment in the utilities sector (Levy and Spiller: 1994). It was a trait of supportive governmental institutions.

*Cooperation* Delaware enhanced its advantage by further cooperation on the regulating side. The opinions from the bars inside and out of the state about the reform of the corporate law were collected. The courts' hitherto unpublished viewpoints were circulated. Votes for revising standards and codes were invited (Romano: 1985).

### **2.3 Summary**

The theory of RC as a race in the marketplace generally draws the regulating side perspective. It addresses the types of measures for attracting business as well as the arguable attributes of the outcome of regulatory advantage. The concept of regulatory advantage seems to imply more tension among competing rivals than the term of business attraction. The definition of regulatory advantage lacks precision. Also its assumption that the government is competition-driven like the market player is vulnerable. In spite of the weakness, relevant positive literature makes a contribution to our understanding about RC by providing a straightforward structure about the nature, measure and outcome of RC.

## **3. An Intra-Government Contest<sup>8</sup>**

The theory of RC as an intra-governmental contest again evolves from Tiebout's theory (1956). It involves the competitions between both vertically and horizontally arrayed governments. Intra-governmental RC derives the tension from constitutional arrangement for authority allocation, structure and relations inside the federal system (Dye: 1990; Kenyon and Kincaid: 1991; Bratton et al: 1996; Esty and Geradin: 2001). Sometimes the tensions persist, mirrored by conflicts between the governmental institutions. At other times, the tensions are resolved through coordination or the intervention by the federal government (Scott: 1996, pp382). When RC happens in the rule making and implementing processes, it seems to be

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<sup>8</sup> These authors dub this sort of RC as 'intergovernmental'. Considering the RC are engaged by the governments within one national or federal system, I dub it 'intra-governmental', in order to highlight explicitly the 'active rivalry' (see Kenyon and Kincaid:1991, pp30 Note 1) between these governments and their agencies as well as the significant implications of governmental institutions to the RC.

more or less underpinned by the players' concerns about authoritative 'turf'. The empirical contexts are not necessarily federal. The emphases include how governmental institutions affect RC; and how varying authoritative structures of competitors engenders varying outcomes of policies and regulations.

In the rule-making arena, Scott (1996) considers that the distinctions in the telecommunications policies of the USA and the EU cannot be sufficiently explained without referring to their institutional structures and processes of liberalisation. The USA and the EU had distinctive constitutional structures (allocation of authorities), institutional arrangements (governmental relations and practices), and policy articulations (values and objectives). Hence in their process of liberalising telecommunications, the institutional participants in the RC were different. So were their institutional resources, instruments and strategies that could be deployed to push forward their positions. The functioning of these factors eventually led to distinctive regulatory outcomes.

In the rule-implementing arena, Bradbury contrasted the enforcement effectiveness of the state agencies with that of the federal agencies (2006). Looking at the regulatory sector of occupational health and safety, he found that the enforcement carried out by state agencies was associated with fewer workplace fatalities than that by federal agencies. He gave two explanations for the difference. One was that inter-agency competition gave state governments more incentives to undertake enforcement efficiently. Inefficient enforcement was likely to entail de-elections of politicians as well as the exit of citizens and industries. Another was that state agencies were better attuned to the local business environment than their federal counterparts. This led to lower monitoring cost and more efficiency. The result was regarded as consistent with Tiebout's federalism.

Mertha's research concerned how Chinese bureaucratic structure and implementing processes counter, distort or achieve legislative goals (2006). Wherever RC existed, it was likely to have increased enforcement action. Trade mark regulation was delegated to two separate governmental agencies. This overlapping and redundant arrangement triggered inter-agency competition. Both agencies actively engaged in enforcing activities, even inviting the foreign firms whose trademarks were abused to join their raids of violators. Due to endogenous competition as well as exogenous participation, trademark regulation was rewarded with efficient and effective compliance. In contrast, copyright and patent regulations were enforced by a single bureau. The enforcement was overridden by the agencies' economic interests. As a

consequence, both regulations ended in failing legislative goals. Mertha highlighted adequate consideration of bureaucratic institutions as indispensable to study China's law and policies. He credited Lieberthal and Oksenberg for lending the analytic approach of fragmented authoritarianism – a characterisation of China's bureaucratic institutions (1988) - to the scrutiny of RC and enforcement outcomes.

The implications of RC underpinned by incentives of authoritative 'turf' are that the constitutional and institutional arrangements are both the constraint and the resource for intra-governmental RC. The impact of these arrangements upon the players attracts disproportionately more attention than the other way around. Governmental organisations are assumed to be authority-seeking, which sets the tone for their relations and interactions. The interest and behaviour of the players in the same institutions appear to be homogeneous and vary only with the types of institutions to which the players belong. Mertha's RC reveals the existence of fragmentation inside the authoritarian institutions. Exploring the implications of fragmentation in the enforcement regime could be an alternative factor to explain the dynamics and effects of RC. The scrutiny of RC concentrates on the regulating side. RC is irrelevant to business attraction. The RC outcomes in both rule-making and rule-implementing are concerned about regulatory dynamics. Particularly, RC between enforcement agencies is related to enforcement effect.

#### **4. A Form of Jurisdictional Interdependence**

When RC is theorised as one form of regulatory interdependence between jurisdictions, the lens zooms out, and the contention between business attraction and social concern is brought to attention. This theory assumes that RC for business attraction is no more than an economic regulation goal, which is intertwined with the pursuit of social regulatory goal. Such an assumption enables this group of theories to capture the real world more authentically than those based purely on an assumption of economic rationality.

In the context of regulatory interdependence, the entities can be provinces of a federation or countries which are brought closely together by cross-border trade integration (or globalisation). Yet the governments of the interdependent jurisdictions are identified as the implicit competitors<sup>9</sup>. For the empirical studies on

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<sup>9</sup> See Kenyon and Kincaid (1991) pp30 Note 1. The author referred to U.S. Advisory Commission on Intergovernmental relations (1991) to classify the horizontal competition, namely interstate and interlocal competition, into 'active rivalry' and 'implicit competition'. The latter type is 'the manner in which the free

intra-country and inter-country interdependence, it is a common concern as to whether inter-location competition for economic development is destructive to the environment, healthcare and labour. Conclusions are made in terms of the direction of the race, downward, upward or sideways. Yet intra-country interdependence focuses more on the externality of competition for investment. Empirical research about inter-country interdependence usually involves a high regulating country (HRC) and a low regulating country (LRC). At the centre is the HRC's concern about a possible undercut of its competing advantage by LRC trading partners. A dimension is even developed to address the undue enforcement of high regulatory standards in LRC.

#### **4.1 Intra-Country Interdependence**

Harrison defined policy competition as one of the two forms of provincial interdependence in the Canadian federation (2006)<sup>10</sup>. One form is competition-driven, and the other is idea-driven. Competition-driven interdependence is mobility induced. It is observed when the provinces respond to the cross-border mobility of individuals, goods or investment. The involved issues are analogous to those incurred from the threat of Hirschman's 'exit' (1970). The dynamic is directions of the race: race to the bottom (RTB), to the top (RTT), or neither<sup>11</sup>.

The other form is idea-driven. When the provinces react to the cross-border transfer of information and norms, the interdependence takes the idea-driven form. The idea-driven dynamics are dubbed as emulation, learning and benchmarking, which are underpinned by the citizens' 'voice' (Hirschman: 1970). Policy innovation and diffusion appertain to the idea-driven category<sup>12</sup> (Harrison: 2006; Morriss: 2010, pp115). Walker (1969) defined an innovation as '*a program or policy which is new to the states adopting, no matter how old the program may be or how many other states may have adopted it*' (p881). He explained the diffusion of innovations among the states as determined by the perceptions and attitudes of key decision-makers of individual states as well as by the inter-state communications through the information networks comprising of professional associations, research centres and

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movement of goods, services, people, and capital constrains the actions of independent governments in a federal system.'

<sup>10</sup> Harrison, Kathryn (2006) pp1-23. The policies under scrutiny have apparent regulatory purposes and hence the competitions based on them are considered as RC.

<sup>11</sup> For empirical examples, see Theories 1 and 2.

<sup>12</sup> For details, see Harrison (2006) pp14-16. The author distinguishes the literatures on policy innovation, diffusion and yardstick competition. For yardstick competition considered by some as a voter-mobilised political competition, see also Bernholz and Vaubel (2007) and Elhost (2005); as measurer of efficiency, see Baldwin and Cave (1999) pp239-247. Since yardstick competition is not the subject matter of this thesis, this group of literatures is considered as not pertinent and hence omitted.

cosmopolitan cities. Alternative to inter-location communications, Breton suggested competition as a drive underlining such diffusion (1991, pp39). He argued that the potential threat of business' 'exit' from irresponsible locations to responsive ones made innovations diffuse among the American state and local governments. This position is shared by some regulation scholars. Black et al (2005) defined regulatory innovation as the use of new solutions to address old or new problems. It was from invention, diffusion and change. It had an impact upon the regulatory functions secondary to the institutional structure and organisational process. It should not be assumed to be always successful. The authors summarised the literature about the relationship between regulatory innovation and competition as twofold: regulatory innovation is often seen as essential to facilitate industrial innovation and economic competitiveness. It is also seen as improving regulatory effectiveness in terms of reducing compliance cost and providing flexibility for firms to make innovative and competitive strategies.

The interactions of Canadian provincial governments towards minimum wage standards (MWSs) are an example of idea-driven interdependence (Green and Harrison: 2006). In the absence of threatening mobility of goods, capitals or individuals, the governments used other provinces' MWSs as benchmarks to evaluate the reasonableness of their own. They ended up with adjusting their MWSs towards the national average level. Eventually MWSs of all provinces converged.

In brief, intra-country interdependence involves not only the regulating sides' RC for business attraction but also social concerns. This context involves diffusion of regulatory ideas, including regulatory innovation and good practice. Innovation is a form of interdependence, arguably alternative to competition. It is not an attribute of regulatory advantage. Competition-driven and idea-driven forms of interdependence can co-exist and co-function. Inferably, both the measure and outcome of RC are related to social concerns besides economic concern of attracting business<sup>13</sup>.

## 4.2 Inter-Country Interdependence

Using a hypothetical approach, Lazar dubbed three 'modes' of regulatory interdependence as competitive, coordinative and informational (2006). He demonstrated under each mode how an HRC and a LRC acted and reacted, and thus engendered distinctive outcomes in their investment attraction, wage and environment regulations. Under competitive mode, both countries adopted and

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<sup>13</sup> For more empirical findings, see the first part explaining the 'No' answers in Theory 1.

adjusted policies in their attempt to establish advantage over the other. Under coordinative mode, both countries tended to agree to adopt the same policy, which however engendered different distributional consequences. Under informational mode, one country's choice and experience generated cross-border externalities and gave the other country chances to assess, learn and emulate. Each of the three modes had its own internal strategic structures for trade-offs between the three regulations. Typically in competitive and coordinative modes, the structures were shaped through upgrading or downgrading specific standard(s) by the countries vis-à-vis each other. All three modes shared such similar consequences that the better-off of one goal was at the expense of the worse-off of other goals. Lazar noted that in reality, the three modes could be interwoven and there could be incentives for weak enforcement.

Lazar's three modes of regulatory interdependence are generally agreeable to Harrison et al's empirical accounts for competition-driven and idea-driven forms of interdependence (2006). Meanwhile its coordinative form is open to the refinement by the empirical studies of Vogel (1995) and Heritier et al about inter-country interdependence (1996). These scholars' studies show that when the examined countries adopt standards of distinctive strictness, the coordinative mode of interdependence may involve unilateral coercion. Vogel's 'California effect' features a predominance of the preferences of HRCs in the interplay of HRCs and LRCs. Wealthy and green HRCs are likely to impose a high environmental standard upon LRCs. The purpose is to 'level the playing field' so that HRCs can protect their competitive advantage from being undercut by LRCs. Heritier et al's study incorporates a vertical dimension into the description about coordinative mode of interdependence (1996). In the process of making European clean-air policy, HRCs like the UK, Germany and France competed to win over the EC to adopt their regulatory regimes, culture and practices. Thus they could minimise the cost of institutional and legal adjustment; maintain competitive conditions for domestic firms; and expand the market of environmental technology for domestic firms. LRCs were left only with the chance of adjusting their national standards according to European legislation. Indeed 'California effect' is prevailing universally with the increasing economic interdependence (Vogel and Kagan: 2004).

The concern about the enforcement of high regulatory standards in LRCs is an additional dimension of a coordinative form of interdependence. Post (2004) highlights the gap between the adoption of EU environmental law on paper and in practice by Poland, Hungary and the Czech Republic in the context of their

applications for the EU membership. The adoption of low environmental standards by these eastern and central European countries was considered as threatening to their industrial competitiveness by the EU producers and as deplorable by the EU environmentalists. Although the eastern and central European countries signed to comply with EU environmental law, they did not implement it duly. The main handicaps included inadequate enforcement capacity, weakness of domestic non-governmental organisations (NGOs), modest public interest in environmental issues, and a lack of technical and financial resources in many domestic industries.

Contrasting to Post's multi-variate examination, Knill, Tosun and Heichel focus on scrutinising the practice of the environmental enforcement (2008). The countries are Mexico and Hungary, with the background of the regional integration of the EU and the North American Free Trade Agreement. The findings are: when they were intended to compete against the HRCs in the same regions, the enforcement practice of both LRCs involved a strategic dimension. In Mexico, the national regulatory agency created a 'realistic' standard for enforcement practice. The enforcers applied differential monitoring approaches towards multinationals and small and middle sized enterprises (SMEs) – strict to the former and lax to the latter. Similarly, in Hungary, waste water regulation emulated the high German standard rather than the comparable low Portuguese and Greek specifications. The outcome was that there were persistent deficits in enforcement. The enforcers were also found to make an unofficial differentiation in implementing water and environmental regulations towards multinationals and domestic companies – strict to the former and loose to the latter. In both cases, the authors emphasise that the agencies' undue enforcement is underpinned by their mindfulness of maintaining 'competitive advantage' for attracting business; and that strict implementation upon multinationals is used to disguise their actual under-fulfilment of obligations to the regional agreements.

In both intra-country and inter-country contexts, the first-order player is a jurisdiction, with second-order players as societal, namely the government, the market and the public. Whereas players are from diverse sides, the regulated side is generally sidelined. Regarding intra-country interdependence, idea-driven form intertwines competition-driven form, which means measures and outcomes of RC are complex. Regarding inter-country interdependence, the research highlights HRCs' competition to protect their regulatory advantage on the one hand. On the other hand, it draws attention to HRCs' possible coercion in converging cross-border regulatory - typically social - standards as well as to LRCs' deficit in enforcing these

imposed high social standards. This enforcement dimension is generally missing in the intra-country context. It is inferable that in the intra-country context, while the measure of RC involves social concerns and innovation, the outcome is sustainable economy. In the inter-country context, it lacks explicit information about the measure of business attraction. For the outcome of regulatory advantage, it is inferable that HRCs' resource is 'wealth and green', whereas LRCs' is undue enforcement of social regulation.

#### **4.3 Summary**

The theory of RC as a form of jurisdictional interdependence has wider zoom. The competing entity is of various sorts. The competed-for target is not given particular attention. RC is considered as intertwined with social concerns. Interdependent regulatory entities have different relations: competitive, coordinative and informational. This relational difference implies different measures and outcomes of RC. Both the measure and outcome of RC involve not only business attraction but also social effect typically environmental and labour protection. Unlike Theories 1 and 2, this Theory 3 is attentive to both economic and social regulations. It not only reveals the tension between economic and social regulations on the regulating side but also alerts to the significance of enforcement dimension of RC. Notwithstanding the alert to the enforcement dimension, the interrogation is limited to stringency versus laxity.

#### **5. A Contest of Home-Based Legal Institutions**

Scholars also understand RC as a contest between institutions based in different countries. Specifically, international arbitration lawyers are viewed to be the carriers of their home legal institutions. Their competition for international business is viewed as one between the home institutions. Such a theory of RC implies that the selling by competitors is not only 'law as a product' (Romano: 1985) but the whole institutions that are involved in the production.

Dezalay (1996) scrutinised the competition between the American and French lawyers for international arbitration business. He observed that such a competition involved not only the actors' professional expertise, strategic behaviour and rules, but also their social networks and practices, judicial and political systems, cultural forms and symbolic discourses. Eventually, it was a competitive interaction between two institutions of legal practice: the American Cravathian model of lawyering and the French *grands corps* model. The models bore the similarities of the lawyers'

positions. The American lawyers played a central part in the regulatory processes of the state, politics, business and academy arenas. In contrast, the French elite group, which rooted its professional bonding in training of *grandes écoles*, played an intermediary role between the state and the market. At the same time, the models were distinctive in the symbolic meanings of the lawyers. Whereas the American lawyers were viewed to represent the rule of law, the French represented the rule of the state. The RC between the two groups was asserted to engender the effect of destabilising government-centric governance and constructing transnational social structures.

Dezalay's research concentrates on regulatory intermediates as institutional players. While competing for business, they deploy the norms, cultures and practices of the home institutions. Although Dezalay touches upon the point that the players with different origins construct an additional social structure beyond their institutional endowment, he does not go further to explore the implications. This research concentrates on the regulating side and its measure. It ignores the regulated side and the outcome.

## **6. A Distinctive Feature of International Rule-Setting**

In the final theory, RC is observed as a distinctive feature of the governing institutions over international business and economics. The players are those with diverse and contesting interests: technocrats, NGOs, firms and nation-state governments. They manoeuvre various resources, instruments, mechanisms, networks and processes so as to win the upper hand in setting trans-national regulatory rules. The focus is to interpret the interplays of the involved diverse types of players, as well the functioning of various mechanism and social structures. An additional concern, if any, is the changing directions of international regulatory standards.

While RC is omnipresent in the global governing institutions, it co-exists with other interactive forms. Picciotto (1996) deems RC as symbiotic to regulatory coordination, both of which are socially constructing interactions and processes. He examined the change of international regulatory arrangements in sectors of industry property protection, patent, tax treaty, competition law, banking and financial markets. The conclusion was that competition in the forms of tensions, frictions, contradictions and battles between country-based interest groups and alliances posed the necessity of international coordination. Successful coordination

constructed new international arrangements, and in turn, opened playing fields for new rounds of competition. Such a symbiotic view about RC and coordination agrees with that concerning the co-existence of competitive, coordinative and informational modes in the context of jurisdictional interdependence. Braithwaite and Drahos created the term 'webs of influence' to describe the mixture of contests of players, principles (reciprocity, transparency, deregulation, ratchet up and race, etc.), and mechanisms (coercion, modeling, coordination and capacity-building) in setting international business regulations (2000). Govaere and Demaret (2001) used the World Trade Organisation (WTO) TRIPS Agreement to exemplify the exercise of regulatory coercion. They argued that the TRIPs granted protection to the private interests of the intellectual property right (IPR) holders in the developed world rather than to benefit signatory countries. To incorporate it in the world trade governing system resulted not from RC or coordination between governments but from coercive imposition of the governments of developed countries under the pressure of their domestic firms. Eventually the TRIPS regulated not the RC between governments but competition between firms. Morriss shared the same point by asserting that the RC fostered by the world trade rules suited the interests of the USA and the EU to win over the developing countries (2010, pp125-6). Heyvaert argued that contemporary environmental rule-making was of a transnational nature, where large regional regulator like the EU and private regulator had dramatically changed the RC scenario (2013). Consequently, environmental RC was less like to RTB or RTT. Instead it shifted towards the credibility of the regulatory regime and procedural quality, with attention paid to the design and mode of instrumentality and implementation.

These studies show that RC is rather complicated in the international business and economic scenario. According to Picciotto (1996), traditional diplomacy led by the governments of nation-states was replaced by regulatory interactions starred by regulatory intermediates, namely business lawyers, accountants, economists, and corporate managers. He used the concept 'networks' to describe the growth of the diverse, loosely connected and semi-legitimised international communities of technocrats. While these technocrats engage in competition and coordination, they generated norms and symbols that helped to structure markets, social consensus and eventually, institutions for international business regulation. The web Braithwaite and Drahos delineated for each of the thirteen chosen domains was contextually complex and paradoxical. They suggested that an understanding of the web required less of a law-like and more a clinical-diagnosis-style of thinking. Given the non-linear dynamics of the processes, some regulations ratcheted up, some

down, some in the middle of deregulation, and some limitedly globalised (2000). All studies show concerns about power asymmetry involved in the processes of the RC as well as the regulatory outcomes.

Generally, in the international rule-setting scenario, various societal groups deploy their resources to inject their interests into setting international economic and business rules. Due to power asymmetry, some interest groups are more likely to succeed to achieve their goals than others. Depending also on the context, the roles, relations and interactions between contesting parties, including the governments and the firms, can be complex and paradoxical. Contesting parties may coordinate and cooperate in order to win over common rivals and to get commonly desired regulatory results. Observing the RC context, each involves a distinctive community with its specific social constituent and structure, which has its own game to play and follows its own rule. The regulatory outcomes engendered from distinctive RC contexts are identified as distinctive. Overall, in this theory, demarcation between the regulating and regulated sides is blurred. All types of players seem to be on both sides. The scholarly major attention is in characterising the tension of the interacting players, which implies RC measure. While the RC outcome is mentioned, it is interpreted in terms of the direction of change of the standard.

## **7. Conclusion**

The six theories of RC draw upon two institutional lenses - economic and sociological. Based on the above literature review, it is recognised that these two lenses underpin different understandings about the empirical phenomenon of RC. Theories through economic lens emphasise players' impact upon RC outcomes but ignore institutional impact upon players. On the contrary, those through sociological lens emphasise institutional impact upon players but ignore players' impact upon RC outcomes. None emphasises the reciprocal impacts between institutions and players. Nor does any pay attention to enforcement dimension which involves the bilateral interactions and preferences between the regulating and regulated sides. Different understandings pay different attention to the regulating and regulated sides and demonstrate different understandings about the nature, measure and outcome of RC. Theories 1 to 4 share the same theoretical origin, namely Tiebout's theory of public economics (1956). This is likely to be an explanation as to why these understandings appear to be more agreeable to each other than they do to Theories 5 and 6. Nevertheless, while Theories 1 and 2 emphasise the regulating side's

influence in RC for business, Theory 3 and 4 pay attentions to institutional restraints on the regulating side, which are shared with Theory 5 and 6. Table 1.1 provides a glimpse of the six theories of RC. These theories can be summarised based on the fundamental factors of RC as follows:

*The nature of RC* Scholarly understandings in this regard are generally irreconcilable. In spite of sharing the same assumption of the regulating side as self-interest driven as well as the same interest in winning RC as the outcome, the first four theories have different concerns. Theories 1 and 2 are mostly interested in giving the competing instruments and attributes of regulatory advantage. In contrast, Theories 3 and 4 concentrate on the institutional endowment and restraint of RC. Theories 5 and 6 are distant from all first four. They are different from Theories 1 and 2 in that they do not perceive the regulating side as self-interest driven. Nor do they specify the winning of RC. Instead they pay attention to characterising the social networks and institutions involved in setting the trans-national rules of the game. They are also distinctive from Theories 3 and 4 in accounting for governmental institutions. All theories are contextual.

*The regulating side* Although most theories consider the government as the regulating side, competing entities vary according to RC contexts. Mentioned competing entities include governments at various levels in decentralised institutions, including the front-line enforcement agency, HRC and LRC. They also include professionals, technocrats and multinationals. There is no theory that systemises the characteristics of the competing entity. While the scholars argue for and against the competing entity as the marketplace player, they actually lack consistent knowledge as how differently regulatory authorities compete for business if rules stay the same. Indeed, the contextual specificity of the competing entity reflects the same characteristic of current RC theories.

*The regulated side* Most theories do not pay particular attention to the targets of RC. Theories 1 and 2 are the only ones that give explicit account for the competed-for target, namely the tax-payer or the firm. In contrast, although Theories 3 to 6 imply business attraction and economic development, they do not give serious account of the targeted business. Theories 3 and 4 are generally one-sided – concentrating on governmental institutions. While Theories 5 and 6 focus on social institutions that embed the involved players, the regulating and regulated sides are mixed. Notwithstanding their contrasting accounts, none of the theories systematically scrutinises the regulatory characteristics of the firm as the competed-

for target. It is noted that the 'race' analogy is not an exception. However, Murphy's argument about rule-changing directions is made based on firms' industrial rather than regulatory features (2005). This implies that while the scholars argue about RC for attracting business, neither those for nor those against show any knowledge about how the firms act and react in an RC context.

*RC measures* The RC measures implied in existing theories can be characterised as a recipe book. Some are instrumental, some are institutional; some emphasise understanding, some behaviour; some pay attention to standard-setting, some to enforcement stringency; some focus on economic regulation only, some alert to the relevance of social concerns; some refer to the government generally, some to a particular group or organisation, be it formal or informal; some focus on competitive mode only, some associate it with other regulatory modes, such as coordinative and informational. All theories are disconnected from each other. This characteristic reflects the patchy, disconnected and sometimes conflicting scholarly accounts for the empirical phenomenon of RC.

*RC outcomes* The scholarly accounts in this regard show that business attraction as an RC outcome is given secondary attention compared to others. Comparatively, more attentions are paid to local revenue increase; change of standards, typically RTB, RTT; regulatory advantage; authoritative superiority; enforcement effect; social welfare; policy diffusion and convergence; and supremacy in setting global business rules. This aspect implies that RC for attracting business involves more normative concern than positive analysis. It is an under-developed theme in existing RC study.

To conclude, this literature review shows that our knowledge about RC is neither comprehensive nor accurate. With no interrogation into enforcement dimension, we have no idea if rules stay the same, how different regulatory authorities compete for business to come to their jurisdictions; what commonly shared institutional factors underpins interests and strategies on the regulating side; why firms choose particular locations to conduct business; and why locations are so different in economic and social outcomes in the context RC. There is no theory that provides comprehensive and accurate account for the empirical phenomenon of RC. These theories are irreconcilable and disconnected with each other. The scholarly accounts about RC pay more attentions to contextual than to fundamental factors. Relevant debate about RC does not have a coherent and systematic framework.

The void of this framework makes current debate not only miss the point, hence our knowledge about RC is confusing, but also is poorly oriented for future research.

This thesis will fill the mentioned gap by proposing an enforcement regime (ER) framework. This framework will advance scholarly understandings about RC coherently and systematically. It will focus on fundamental rather than contextual factors of RC and consequently will be reconcilable and connected with existing theories. It will fill the gap by drawing attention to the dimension of micro-level enforcement regime in the context of RC. It emphasises the reciprocal impacts between institutions and players. It highlights the significance of match and mismatch of preferences of the regulating and regulated sides so as to unveil likely causes of contrasting economic and social effects. It aims at giving an adequate account to the empirical phenomenon of RC.

Suggested by its name, the ER Framework will focus on the enforcement dimension of RC, the significance of which has been identified by RC scholars but not yet interrogated. To account for RC based on interrogating enforcement dimension is an originality of the ER Framework. This dimension is missing in existing RC literature but available in the subject of regulatory enforcement. Therefore, it is necessary to refer to relevant regulatory enforcement literature to borrow a building block for the forthcoming theoretical framework.

Theory	Lens	Nature of RC	Types	Regulating Side	Regulated Side	Measure of RC	Outcome of RC	
1	Economic	A Driving Force to Satisfy Firm's Preferences	-	Local governments	Taxpayer incl. firm	Cost-efficient provision of public goods; Tax rules or enforcement; Response to taxpayer's exit & voice, arguably to firm's and interest group's voice	Attracting tax-payers, incl. firm; increased revenue	
2	Economic	A Race in the Marketplace	-	Decentralised governments at any level	Firm	Lax corporate law; adjustment of rules or enforcement stringency; land and other incentives; responsiveness; innovation; certainty; cooperation	Regulatory advantage in attracting business; RTB or RTT	
3	Sociological	An Intra-Governmental Contest	RC in rule-setting	Decentralised governments at any level	n/a	Constitutional / institutional arrangement & structure	Authoritative superiority in making and changing rule	
			RC in enforcement	Enforcement agencies	n/a	Structure of delegated authority for enforcement; politician's concern about election; agency's familiarity to local environment	Authoritative superiority; enforcement effect	
4	Sociological	A Form of Inter-jurisdiction interdependence	Intra-Country	Competition-Driven	Provincial governments	n/a	Response to voter's concern about the impact of business attraction to social welfare	No RTB; regulatory advantage typified as balanced pursuit of economic & social regulatory goals
				Idea-Driven		n/a	Learning, emulation, benchmarking	Convergence of rules
			Inter-Country	Competitive	HRC vs LRC	n/a	HRC: coercion of high standards; LRC: lax wage and environmental standards & enforcement	HRC's home industrial advantage; LRC's business attraction & entry to HRC market
				Coordinative		n/a	HRC: power & high green standard; LRC: lax enforcement	Economic integration; HRC's victory of levelling playfield by imposing high standard
				Informational		n/a	HRC: setting norm; LRC: learning	Regulatory diffusion
5	Sociological	A Contest of Home-Based Legal Institutions	-	Int'l arbitration law firms	n/a	Expertise and embedded institutions	Int'l arbitration business share	
6	Sociological	A Distinctive Feature of Int'l Rule-Setting	-	National govs, NGOs, firms & technocrats	n/a	Networks; coordination; 'Web of influence'	Supremacy in setting global business rules	

Table 1.1 Six Contrasting Theories of RC

## Chapter II Enforcement Dimension

The forthcoming framework will focus on the competition between different enforcement regimes (ERs) for different firms, which involves the enforcer and the regulated firm acting and interacting vis-a-vis each other, and which emphasises the reciprocal impacts of institutions and regulatory players' actions and interactions. However, as shown by the RC literature review, the RC scholars have ignored differences within the types of regimes and firms as well as their behaviours and interactions. They also emphasise either the institutional impact upon players or vice versa but not both. In contrast, the enforcement scholars pay attention to the different types of enforcers and regulated firms; their behaviours and interactions; and reciprocal impacts between institutions and players. Thus enforcement studies can lend a building block to the ER Framework. Specifically, the review of enforcement literature is to contribute to the forthcoming framework in two senses. In a narrow sense, it will suggest the relevant aspects to address the relation and interaction of the enforcer and the regulated in the enforcement process. In a broad sense, it will propose a comprehensive analysing structure ranging from the affecting factors to the entailed effect of the two players' types, behaviours, relations and interactions in enforcement context. Therefore, the review of enforcement literature will offer not only analytical structures to the ER Framework but also a descriptive structure for the empirical research.

The literature under review is selective. Only those studies that are positive (interpretative and predictive)<sup>1</sup>, using the socio-legal approach and focusing on the enforcer-regulatee interaction in enforcement practice are taken as relevant. The literature review is organised as follows: It first reviews the behaviours, types and affecting factors for the enforcer and the regulatee respectively. Then it examines the issues involved in the bilateral relations and interaction of the two-sided players. It is followed by notes about the enforcement effects that are likely to be relevant to business attraction, which is related to RC. It ends by specifying the factors, weaknesses and gaps of relevant regulatory enforcement literature.

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<sup>1</sup> These studies roughly belong to private interest theories. See Yeung (2004) pp7.

## **1. Regulating Side: Enforcer's Behaviour, Type and Affecting Factor**

A general survey of the selected literature finds that the enforcer's behaviour mostly scrutinised by the scholars is the enforcer's exercise of discretion and choice of enforcement strategy. Concerning the enforcer's discretion, the scholarly attentions are the balance between sufficient delegation of authority to respond to potentially conflicting objectives and the control of abuses of authority (Bardach and Kagan: 1982; Silbey: 1984; and Hawkins and Thomas: 1984). Concerning the enforcer's strategy, the scholars note varied choices and use various terms to name them, such as approach, tactics, strategy and style. The scholars concentrate on addressing the combination, degree and balance of compliance/ cooperation and deterrence/ sanctioning for the purpose of achieving desirable corporate compliance (Grabosky and Braithwaite 1986; Vogel 1986; Hutter: 1988 and 1997; Aoki and Cioffi: 1999; May and Winter: 2000; and Kitaruma: 2000).

Braithwaite, Walker and Grabosky considered that enforcers' behaviour is too complex to be characterised through a single continuum of persuasion versus prosecution or compliance versus deterrence. They broadened the range of the continuum so that it had instead the extremities of cooperative fostering self-regulation and detached command and control. Accordingly they created a taxonomy of enforcers based on their enforcing strategies (1987). There were seven different types of enforcers. The Conciliator was not concerned about enforcing the law but emphasised achieving regulatory goal through conciliating conflicting parties. Benign Big Gun had enormous power but rarely used it. Diagnostic Inspectorate was a decentralised authority. It not only alerted the regulatee of a regulatory violation but also provided technical assistance to solve identified regulatory problem. Fostering the regulatee's self-regulation was part of its strategy. Detached Token Enforcer had the least stable interaction with the regulatee. It did not encourage the regulatee's self-regulation. Detached Modest Enforcer adopted an arms-length approach but was rulebook-orientated. It inclined to target repetitive offenders. Token Enforcer was a proactive prosecutor. Yet its prosecutions produced only token penalties. It was neither adversarial nor close to the regulatee. Modest Enforcer was punitive and deterring. Its style was the nearest to Bardach and Kagan's 'unreasonable regulation' (1982 and 2006).

While the above-mention researchers address the enforcer's behaviour and types, others pay attention to the factors affecting the enforcer's behaviour. These factors are identified as belonging to either the contextual category, the governmental system, or the regulatee's behaviour.

*Contextual factors* Regulatory context or environment is considered to be a determinant in the development of different styles of enforcement. Contextual factors include political, social and economic factors as well as their changes (for example Shover et al: 1984; Hutter; 1993; and Lo and Fryxell: 2003). They function at macro and/or micro level. When macro context is concerned, the main issue seems to be to what extent the enforcement outcome is in congruence with the legislative expectation. The effect is scrutinised by drawing a vertical perspective. For example, Hutter (1993) was concerned about the effect of the change in social and political environment for enforcing the law. Her focus was the difference between the contexts of law-making and of enforcement practice. The enforcing agencies were likely to respond to the change of regulatory environment. Hence the practice of enforcement would give a different effect from that expected by the legislature. When micro context is concerned, the main issue seems to be the difference in enforcement styles (Lange: 1999a). The perspective is local and sometimes comparative, with the issue and effect of particular micro contexts examined and even compared. Although the scholars have shown their awareness of both macro and micro contexts, most studies focus on one particular level.

*Governmental system* When governmental system is mentioned, three levels are identified in the analyses: institutional, organisational and individual. Institutionally, the entire governmental system is under scrutiny. Governmental institutions are taken as a determinant of bureaucratic discretion, and the impact of the discretion concerns the inducement of foreign investment to the utilities sectors (Levy and Spiller: 1999). Bureaucratic discretion is defined as an issue of credible commitment. With varied governmental institutions, countries demonstrated varied capacities in constraining bureaucratic discretion. Hence they generated varied effects for foreign investment.

Organisational factors are argued to affect the adoption of enforcement approaches. These factors include regulatory tasks such as inspection (Shover et al: 1984); role and procedural clarity, resource adequacy (Lo and Fryxell: 2003); standards and procedures tailored to local context; coordinative, technological and organisational support by the higher authority (Tang et al: 1998). Varied organisational factors engender adoption of varied enforcement approaches by the regulatory authorities in varied locations.

Individually, the inspector's experiences and perceptions about the regulatee and local regulatory programs determine his enforcement stance and strategy towards the regulatee (Shover et al: 1984). For example, if the inspector was suspicious of the regulatee and perceived a high probability of deliberate non-compliance, he tended to choose vigorous means to enforce regulation. An individual inspector's belief and perception was subject to the influence of the collective stance and history of his organisation.

The demarcation of institutional and organisational factors tends to be blurred. For example, bureaucratic commitment is considered as an institutional issue by some scholars but an organisational issue by others (Levy and Spiller: 1999; and Tang et al: 1998). When Black (1998a) discussed the significance of the regulator's conversations with the regulatee in interpreting and implementing rules, she held the construction of an effective conversational relationship relied on both organisational and institutional factors such as commitment, access, authority, trust and accountability. Indeed, the mentioned issues can be both institutional and organisational, depending on the specific context of the research. Overall, the scholars take either a focused perspective to address governmental institutions or a general perspective by mentioning multiple dimensions.

*Regulatee-related factors* Some factors are identified as related to the regulatee and have an effect upon the enforcer's behaviour, namely the choice of enforcement approach. For example, Black (2001) summarised the scholarly viewpoints about the correlations between the characteristics of regulated firms and enforcers' choice of enforcement approaches. The more frequent contact between the enforcing officers and the regulated firms, the higher homogeneity of the regulated industries, the more likely enforcers were to adopt conciliatory approaches.

The regulated firm's size is identified as a typical factor that the enforcer takes into consideration when choosing enforcement approaches. The enforcer is more likely to use a sanctioning approach towards small firms than big firms, even in a compliance-oriented regulatory environment. The main reasons are that firstly, enforcing officers are likely to have more contact with big firms than small firms. Since big firms tend to last longer than small firms, they have more chances than small firms to make long-term and repetitive contact with enforcing officers. Secondly, big firms tend to be more concerned about their reputation than small firms. Thirdly, big firms have more sufficient capacities and resources than small firms to afford compliance costs. Finally, big firms are more capable of challenging

enforcing officers' decisions, either through contacting senior level officials or mobilising political process (Black: 2001 quoting the literature including Black: 1976; Reiss: 1984; Shover et al: 1984; Hawkins and Thomas: 1984b; Grabovsky and Braithwaite: 1986; Gunningham: 1991; and Hutter: 1997).

To summarise, the enforcer's behaviour is related to his exercise of discretion and his choice of enforcement strategy. Accordingly, enforcers are perceived to be varied in types. The factors that affect the enforcer's behaviour appertain to regulatory context, governmental institutions, and the regulatee's industrial and corporate features. The contextual factors are identified to emphasise the normative values such as democratic access and public interest in enforcement practice. The less normative concern such as economic development seems to be of limited interest to the scholars. When governmental system is concerned, institutions, organisation and individual are the three dimensions considered to shape the enforcer's behaviour. Varied institutions, organisations and individuals are likely to engender varied enforcers' behaviour. It is prudent to claim bureaucratic system as a significant determinant of the enforcer's behaviour, typically enforcement approach or discretionary exercise. However, contextual and governmental factors are not clearly related. It is not clear whether contextual factors are exogenous or endogenous of governmental institutions. The regulatee-related factors are linked to the enforcer's choice of strategy. They imply the main purpose and goal of regulatory enforcement. The positive study of correlation between the firm's size and the enforcer's behaviour is restricted in the explanation of the rationale. So far other implications are not explored. For example, does the enforcer have preference towards the firm? If so, do all enforcers prefer big firms to small ones and well-complying ones to ill-complying ones? Why or why not? Although positive study about the affecting factors of the enforcer's behaviour is one theme of regulatory enforcement theory, it is not the mainstream. In particular, institutional and organisational analyses are limited. Overall, there is no comprehensive framework to systemise the enforcer's behaviour, the type and the identified affecting factors.

## **2. Regulated's Side: Firm's Behaviour, Type and Affecting Factor**

The regulatee's behaviour in the enforcement context is represented by his compliance, which shows his awareness, motivation and sense towards regulatory enforcement. The scholars demonstrate notable interests in classifying regulatees based on their varied behavioural characteristics in the enforcement context. Their primary purpose is to prescribe effective strategies to enhance the compliance of

the varied regulatees. There have been at least three sets of taxonomies of regulatees. Kagan and Scholz's (1984) classified regulatees in terms of amoral calculators, political citizens and incompetent organisation. Baldwin and Cave (1999) distinguished them in four groups: well-intentioned and well-informed, well-intentioned and ill-informed, ill-intentioned and ill-informed and ill-intentioned and well-informed. Vickers et al (2005) classified small-sized firms into four types - avoiders/outsiders, reactive minimalists, positive respondents, and proactive learners. In spite of using different criteria, the classifications of the regulatees through these typologies are roughly agreeable. However, how they are agreeable is not articulated.

The enforcement faced by the regulatee is identified as falling into three categories: intra-firm, inter-firm, and extra-firm. The factors affecting the regulatee' behaviour has been scrutinised from these three perspectives.

*Intra-firm* In the intra-firm perspective category, the main affecting factors include the regulatee's understanding, industrial feature and size. The regulatee's understanding towards regulation affects his behaviour. Winter and May found that Danish farmers' awareness of rules were critical to their compliance with agro-environmental regulations (2001). Their social and calculus motivations were equally influential to compliance. Inspectors' formalism was helpful to some extent, but coercion would cause backfire. Similarly, when Australian taxpayers perceived the provision of public goods as fair and legitimate, they were willing to honestly declare income. If they were allowed to think morally rather than feel oppressed or controlled in auditing process, then taxation would achieve the most desirable effect (Braithwaite et al: 2007; and Feld and Frey: 2007).

The firm's industrial feature appears to be correlated to its stance of self-regulation and regulation. Genn (1993) interviewed the managers of 40 industrial and agricultural sites in England and found that self-regulation was effective only in the largest and most hazardous companies, regardless of the intensity of the inspectors' efforts. Other companies had limited knowledge and comprehension about regulations and standards. Besides, most of them adopted temporary compliance when the inspectors visited. Genn's conclusion is not entirely agreeable with the finding by Gray and Shadbegian (2005). The latter scholars tested the compliance and sensitivities to enforcing inspections of the plants and firms in the paper industry in the USA. The finding was that older and larger plants were less likely to comply with environment regulation. Compared with plants owned by smaller firms, plants

owned by larger firms were less sensitive to inspections but more sensitive to other enforcing actions.

The firm's size seems to be the most noteworthy affecting factor. The scholars tend to agree generally that the firm's size corresponds to its complying behaviour. In spite of some disagreement about big firms' behaviour (Haines: 1997; and Black: 2001), the scholars generally share a poor impression of small firms' -- reactive, opportunistic and organisationally incompetent (Kagan and Scholz: 1984). For example, the research by Fairman and Yapp (2005) showcased that the SMEs asked the inspectors to explain what exactly they should do and then did what they had agreed with the inspectors. This demonstrated that the SMEs were heavily reactive. Vickers et al were more optimistic (2005). They investigated the responses of the small and micro enterprises in the food and clothing manufacturers of the UK to the statutory health and safety requirements. The findings were specifically: about 63% of enterprises were not aware of the legislation; 64% found the enforced requirements burdensome; more than 90% did not consider compliance as difficult and a majority welcomed consultant-like inspectors; and 60% agreed that investment in health and safety would benefit the business financially. The authors argued that well designed and implemented regulation could yield their desirable compliance. The provision of information and advice was as necessary as inspections and punitive means.

Although the scholars have identified multiple intra-firm factors to explain the regulatee's behaviour, they hardly do it systematically. Remained myths include: how to systematically characterise the regulatee's reaction to enforcement based on its understanding, industrial and corporate features?

*Inter-firm* Inter-firm perspective examines the affecting factors based on industrial and trade relationships. These factors not only determine the behaviour of particular groups of firms but also are related to private enforcement. In the former case, Haines introduced the perspective of contracting hierarchy to investigate the inter-firm mechanism (1997). Using corporate response to death at worksites in Australia, she indicated that the position a company held in contracting hierarchy, which corresponded to the size of a company, bore a strong correlation to its behaviour and compliance with occupational health and safety regulation. Large companies were high in the hierarchy and tended to comply well. Small ones were low and lacked compliance. However she iterated that the possession of power in the hierarchy could not guarantee either improving compliance or evading social

responsibility. For firms of all sizes, the first things under consideration were market-related factors such as intra-industry competition, contract price and changes in demand.

Some scholars have alerted to the significance of the inter-firm factors to effective enforcement (Ayres and Braithwaite: 1992). Relevantly, private enforcement through industry-wide informal mechanisms and networks is suggested by the scholars to enhance corporate compliance. The main issues in debate are the strength of private enforcement versus public enforcement and enforcement stringency versus regulatory attractiveness. Gunningham (1991) examined and compared the effect of private ordering in the commodities and futures markets of Sydney, Hong Kong and Chicago. Through interviewing the main players in the field, the author concluded that informal mechanisms were far more important in maintaining market order and sorting out trade disputes than rules issued by the government. Informal mechanisms include peer group pressure, fear of exclusion, leverage of large institutional clients, and transparency of particular dealings and opportunity of pay-back for repetitive players. He highlighted the point that the functioning of governmental regulation filtered through formal and informal enforcement networks and structures. The ultimate regulatory effect relied on how the mentioned structures and mechanisms received, transformed and implemented the regulation.

There are opponents arguing against the superiority of private enforcement. For example, Jackson and Roe (2008) held that public enforcement was at least as important as private enforcement in regulating the financial market. They justified the standpoint based on measuring the used resources by public agencies against the outcome of financial regulation. The finding was that the real resources of public agencies - staffing and budget levels - were significantly correlated to the robust development of the stock exchange market.

It is noted that most empirical findings about private enforcement come from the financial sector. Strictly speaking, the above mentioned private enforcement is but a combined version of public and private enforcement. Whereas the literature highlights the role of private enforcement, public regulation stands at the backdrop. This reminds us that, when observing private enforcement, one should look at a broader context and structure that private enforcement situates. Some questions arise such as: how do public and private enforcement interplay? Does private enforcement affect all regulatees alike?

*Extra-firm* Extra-firm affecting factors are mainly related to the regulatee's reaction towards formal and informal enforcement. In the governmental enforcement context, scholarly concern seems to be related to the contingency occurred in the process of enforcement. One example is the note about the regulatee's creative compliance. In this regard, the regulatee circumvents the scope of the law, which, while not breaching the letter, does dishonour the spirit (McBarnet and Whelan: 1991). Another example is the finding of the negotiation basis in the firm's compliance. The research by Fairman and Yapp (2005) showcased that the SMEs in the food industry in the UK complied not with law but through negotiations with the inspectors. The contingency in the enforcement process will be further addressed in the following enforcer-regulatee bilateral perspective.

The informal enforcement is related to social activism faced by the firm in a context of global economic integration (Vogel: 2008)<sup>2</sup>. The scholars are particularly concerned about multinational companies' compliance with social and environmental regulations in developing countries which have limited regulatory capacity (Braithwaite: 2005; and Graham and Woods: 2006). Meanwhile, they acknowledge that corporate self-regulation, market-based mechanisms, industrial association's code of conduct and informal rules are likely to function for enforcing these regulations (Potoski and Prakash: 2005; Auld, Bernstein and Cashore: 2008). Firms may voluntarily comply with social norms so as to avoid additional regulation, to protect their reputations and brands or to reduce problems with trading partners such as information asymmetry or opportunism (King, Lenox and Terlaak: 2005; Vogel: 2008). It is inferred that the trans-national informal regulation is likely to complement the weak regulatory capacity of the host developing countries (O'Rourke: 2003). It also invokes us to consider the possible functioning of plural legal norms. These norms are playing an active role in regulating trans-national industrial production and supply chains (Snyder: 1999). Relevant questions include: How to characterise the firm's reaction towards informal enforcement?

### **3. Two Sides Together: Relation and Interaction**

Like their behaviour, the relationship and interaction of the enforcer and the regulatee are affected by the previously mentioned factors. At the same time, they have particular characteristics and implications for enforcement practice.

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<sup>2</sup> Considering the relevance, the social regulation enforced by the third party in domestic context is omitted.

### 3.1 Bilateral Relation

The enforcer-regulatee relationship suggests two implications upon enforcement practice. One implication is that the relational distance premises the formality of the enforcer's choice of enforcing approach. Another implication is that the relational characteristics determine the familiarity and predictability of enforcement practice to both players.

*Relational distance between regulator and regulatee* Black (1976 and 1980) invented the concept of relational distance. It was '*measured by the scope, frequency and duration of interaction between people, and by the nature and number of links between them in a social network*' (1980, pp4). He predicted that the use of law varied in line with the relational distance of the involving players. Law was more likely to be introduced to deal with the dispute between the players with a bigger relational distance. In contrast, non-legal means were likely to be used on similar occasions if the players were relationally closer. This view was tested by the enforcing styles of the police. The finding was that the police tended to adopt more conciliatory rather than penal styles when they were familiar with the people involved.

Black's theory was tested by Grabosky and Braithwaite (1986) in studying the probability of using prosecutions by Australian regulatory agencies. They hypothesised that (1) an agency with a high percentage of staff coming from the regulated industries would prosecute less than those whose staff were recruited from elsewhere; (2) agencies which regulated a relatively few number of firms would prosecute less than those that regulated a higher number; (3) agencies which regulated a single industry sector would prosecute less than those that regulated multiple sectors; (4) agencies whose inspectors had frequent contact with the same firms would use less formal sanctions than those with less personal contact. Their research findings supported strongly Hypotheses (2), (3) and (4), but there was comparatively weaker support for Hypothesis (1). Even so their findings about an agency with a high percentage of staff coming from the regulated industry could be considered as industrial capture of the regulatory agency. The findings imply a correlation between the regulator-regulatee relational distance and the frequency of use of formal sanctions. Hence they further strengthen Black's theory of relational distance.

*Characteristics of enforcer-regulatee relationship* Hawkins and Thomas (1984b), drawing on an organisational perspective, defined enforcement as a developing and

implementing process, with interactions between regulatory agency officers and the regulated, legislators and professionals. They used two concepts to explain the characteristics of the process of enforcement: bargaining and social construction. Bargaining was fundamental to the enforcement process. This was because both the regulatory agency and the regulated were concerned about conserving resources and minimising interference with established routines. Bargaining in the form of negotiation could shape a process where both parties could benefit from compliance. It also influenced the choice of compliance and deterrence strategies by the regulatory agency. Social construction was about the interpretation of reality by the members of bureaucracy. It helped to explain why and how enforced rules were modified by the inspectors' interpretations, taking into account their relationships with the regulated. Both the processes of bargaining and social construction could lead to institutionalisation of the shared values. In turn, these values shaped and structured enforcement practice as well as the players' behaviours. These scholars' theory was generally agreeable with Lange's field study on the enforcement of waste regulation (1999b). Her findings were that regularised enforcement process built a social life of the enforcer and the regulatee. Through informal negotiation and social construction, the two players shared working group norms, customary norms and agreements. It became difficult to distinguish clearly between compliance and non-compliance. Indeed, the enforcer-regulatee social life at the lowest hierarchical level was perceived as 'an enforcement system' that localised law (Lange: 1996)

Hawkins and Hutter (1993; and Hutter: 1997) argued that the relationship between the regulatory agency and the regulatee was of reflexive, serial, incremental and long-term characteristics. The interactive process was about negotiation, with the degree and scope contested by both players. The relationship and interaction had specific settings, which were jointly shaped by both sides. On one side, the enforcing officials' competence and stance towards regulation mattered. They constructed working definitions of compliance, which were derived mostly from legal and regulatory definitions and reflected the regulatory environment surrounding regulatory activities. On the other side, the myriad of behaviour and actions taken by the regulated had diverse impacts upon the relationship and interaction. Accordingly, the inspector formed judgments about the regulatee's compliance at a particular site and time. Established relationships and interactive processes were likely to generate an effect that was familiar and predictable to both players. However, a change of individuals on either side could entail changes in that established relationship and interaction.

The end of the study on the enforcer-regulatee relationship is enforcement and compliance. In this regard, the scholars tend to assume that the two parties are of equal and reciprocal standing. It is arguable that this assumption is applicable to all contexts. Although relational distance is a topic of enforcement theory, the relevant literature is limited in number. Apart from relating to the enforcer's style, relational distance is not related to other aspects of enforcement or regulatory activity. Are there other implications for the enforcer-regulatee relationship in enforcement context? Additionally, if the working definition of compliance is based on the agreement between the enforcer and the regulatee, what does it imply for their status in the bilateral relationship? How much certainty can such working definition engender? How to characterise the enforcer-regulatee social life in different contexts?

### **3.2 Bilateral Interaction**

The scrutiny of bilateral interaction of the two players is based on enforcement arrangements, enforcement practice and variation in legal implements.

*Enforcement arrangements* The scholars use a comparative method to address the influence of enforcement arrangement and approach upon the regulatee's motivation, behaviour and interaction. May (2005) showed how different enforcement arrangements, together with social considerations, shaped and structured different compliance motivations of the regulatees. Compliance motivations were typically deterrent fear and civic duty. The former was associated with a sense of being caught for regulatory violations and the latter saw compliance as an obligation. From the examples of the agro-environmental regulation in Denmark and the USA, the author discovered that Danish farmers had a high sense of civic duty and a low sense of deterrent fear. American marine firms had exactly the opposite senses. American homebuilders shared more similar motivations with Danish farmers than with American marine firms. He held that a high sense of civic duty reflected an accommodative enforcement arrangement, whereas a high sense of deterrent fear corresponded to a legalistic one. The author defined regulatory interaction in terms of societal contract and social contract. The Danish one was a societal contract and the American, a social contract. At the heart of a societal contract was a set of shared norms about acceptable behaviour between the regulator and the regulatee, and rules formulated and negotiated through the involvement of the farmer union. Each party was bound by the contract to exercise his respective obligations according to the norms and rules, and each was aware

that the other did the same. Societal contract was applied to the whole sector. Inspection served as a forum and reminder of the norms and inspectors only visited farms occasionally. In contrast, social contract was based on shared terms about what to do. The shared terms regarded specifically how provisions and codes applied to particular situations. They emerged from repetitive interaction and negotiation between the regulator and the regulatee. Social contract was underpinned by a give-and-take reciprocity. In the USA, homebuilders did what was agreed by the negotiations in order to acquire the certificate of occupancy; so did the inspectors, but their actions were for the purpose of avoiding the paperwork burden and any possible regulatee's complaint to their superiors. Social contract applied to individual firms. Unlike homebuilders, the marine firms faced a typical situation of American legalism. The relationship was coercive. The regulator dictated the terms of permits and the regulatees self-reported their data. Violations found were publicised and the violators fined. Since the regulator and regulatee had limited interaction, there was no way for the two parties to negotiate norms or terms. The research implies that the regulatee's motivations are highly shaped by the enforcement arrangement. They are also conditional upon the specific social settings within which both players are embedded.

*Enforcement practice* Larson examined how distinctive enforcement practice institutionalised legality distinctively and in turn shaped distinctive legal consciousness and behaviour of the participants (2004). He assumed regulation as a social process through which the market player was embedded in the social structure. The author examined securities regulation in Fiji and Ghana. The two countries had identical laws but different implementation practices. The regulatees' behaviour demonstrated distinctive characteristics. Specifically, in Fiji, securities regulation concerned the transaction process of the stock exchange. The enforcing agency had a more visible presence in the daily exchange operation. In Ghana, regulation was carried out by means of auditing the outcomes of the exchange. The enforcing agency was more detached from the daily operation. The operation and competition behaviour of the brokers in these two countries was different. Those in Fiji were more formal rules oriented, whereas those in Ghana developed stronger norms functioning on the trading floor.

The above empirical studies demonstrate that enforcement arrangement and practice are likely to shape and structure the regulatee's motivation, action and legal consciousness towards regulation and law. Such effect of enforcement arrangement and practice seems to function in a specific 'field of action' (Larson: 2004, pp737).

The 'field of action' comprises of the particular industrial sector; the interactive process of the enforcer and the regulatee; and the relevant rule. The two players' behavioural and interactive modes as well as the norm and code are institutionalised in the field of action.

*Variation in legal implementation* Heimer's research pinpointed institutional and organisational factors in explaining why hospitals varied in implementing medical law (1995). The author assumed legal and medical institutions as represented by their respective professionals. If the medical professional was involved in the law-making process and was successful in injecting their interest in the law, the legitimacy and autonomy of specific medical practice was ensured. Medical law was likely to be welcomed by the medical sector. Meanwhile, if hospitals had the convention of including legal workers in the routine of processing organisational issues, the legitimacy of the medical practice was further ensured. Hence the organisation was in the right position to request resources. With the preconditions at both legislative (macro) and operational (micro) dimensions satisfied, medical law was able to be implemented by hospitals. If the two conditions were not satisfied simultaneously, the outcome would be under-implementation of law. This study exemplifies how the implementation of law is determined by inter-institution competition in the rule-making process and by inter-institution cooperation in the rule-implementing practice.

In Heimer's research, the regulatee has multiple entities. He is the individual (professional), the organisation (hospital) and the institutions (medical). The choice of the regulatee is examined through the role of the individuals (medical and legal professionals), which is shaped by the interest and concern of their respective institutions and affects the institutional and organisational decision-making. Unlike other literature, Heimer defined the regulating and regulated systems as separate institutions. The involved individuals do not share the same institutions, but interact on behalf of their respective institutions at the macro and micro levels. Her perspective can be accurately described as inter-institutional (regulating and regulated) and intra-institutional (organisational). This perspective captures the tensions between law making and implementation as well as the competition for legitimacy and autonomy between legal and non-legal systems. This dual-level analysis broadens the vision for observing organisational decision-making. It interconnects the decision-makings at two levels through the common concerns of legitimacy and autonomy and hence the effect of legal implementation.

#### 4. Enforcement Effects

The enforcement effect that has concerned scholars the most is corporate compliance. The effect of business attraction is very limitedly explored by current positive enforcement studies. Bearing in mind the theme of the forthcoming framework, particular attention is paid here to the effects that are identified as (potentially) correlated to business attraction. Accordingly, the following effects and their related causal factors are identified.

*Bureaucratic discretion vs certainty and flexibility* Discretion is arguably inevitable for regulatory enforcement, but it is necessary for effective enforcement (Hawkins and Thomas: 1984b; and Black: 2001). This was because the enforcement agency faced various regulatory goals, and the practice to achieve them demanded a balance between certainty and flexibility. Such balance required discretion. The effect of discretion is one focus for the scholars. Hawkins and Hutter (1993) iterated that the street-level inspectors for the occupational health and safety and environmental regulations in England and Wales were highly discretionary. Enforcement practice was of '*individualised, fragmented and ad hoc*' characteristics. Similarly Lovat (2004) alerted that the inspectors of the environmental regulatory agency in Scotland exercised diverse discretion. Consequently enforcement practice was not standardised and lacked certainty. He considered the problem was caused by lack of clarity in legislations.

Levy and Spiller (1999) argued that bureaucratic discretion was associated with both regulatory certainty and flexibility, and a balance of the two was helpful to promote foreign investment in the utilities sector of a country. Hence whether and to what extent the balance was likely to be struck was premised upon the control of bureaucratic discretion. Discretion, as well as its restraint, was derived from the governmental institutions of a host country, which Levy and Spiller named as institutional endowment. If a country's institutions could not restrain discretion appropriately, they could not simultaneously create regulatory certainty and flexibility. In this case, regulatory certainty should be given the priority. This study adopts an institutionalist approach to characterise bureaucratic discretion constraint. It does not address the issue of discretion in an enforcement context. Nevertheless, it is relevant in terms of relating the constraint of bureaucratic discretion to the attraction of foreign investment in the utilities sector.

*Responsiveness vs easiness-seeking and differentiation*

The scholars pay attention to the effect exerted not only by congruent interests but also contrasting demands and requirements upon the enforcer's choice of enforcement approaches. Silbey (1984) and Cranston (1986) noted an easiness-seeking characteristic in the complaint handling by the consumer protection agencies in the USA and the UK. Specifically, when the agencies faced conflicting requests from the relevant parties, they tended to choose the easiest way to sort out the disputes. The easiest way, usually in the form of economic compensation, cost the agencies limited resources and required low expertise and a short time to handle and complete a case. Also the cost was low for consumers and businesses, since they could avoid legal proceedings. The empirical studies highlight that when faced by diverse demands the enforcer may be driven to respond in a tactical rather than regulation-binding fashion.

Scholz and Wei elaborated the characteristics of the enforcer's responsiveness in a broader context (1986). They made a comparison between the responding structures of the federal and state agencies in enforcing the Occupational Health and Safety Act regulation in the USA. They found that the federal and state agencies shared similarities such as (1) responding significantly to state-level political signals (e.g. national policy, congressman's and interest groups' concern) and task signals (e.g. budget, duty, goal and routine); (2) consistently responding to the demands of interest groups (labour complaint) with daily enforcement contacts; (3) responding instrumentally (through serious citations and penalties) to task changes (workplace accident and unemployment rates) and symbolically (through inspections and non-serious citations) to political changes (ideologies of parties and elected officials). Meanwhile, state agencies were more responsive than federal agencies to political and task signals and changes. The general implications of the characteristics of bureaucratic responsiveness are that: (1) different enforcing agencies do not make the same responses, even though they face the same regulatory environment; (2) the enforcing agency inclines to respond more attentively to the local issues rather than federal issues.

Generally speaking, the enforcer's responsiveness in the above positive research has a theme distinctive from responsive enforcement in prescriptive studies. The positive researchers concentrate on the diversity and complexity of demands and requests faced by the enforcer. Their interest lies primarily in describing the characteristics and showing concerns about the implications of the responsiveness. In contrast, prescriptive researchers focus on the variety of the regulatee's attitudes

and accordingly propose the strategy and tactics for the purpose of bringing about desirable corporate compliance (for example Ayres and Braithwaite: 1992; Braithwaite: 2006; and Baldwin and Black: 2008). Comparatively the positive research is less developed than the prescriptive research about regulatory responsiveness. Indeed, the prescriptive research seems to represent current mainstream theory of regulatory enforcement, given the primary concern of compliance and deterrence. So far, we understand limited implication of the enforcer's responsiveness other than enforcement effect. Since a positive study of regulatory responsiveness demonstrates the potential of capturing broad-ranged and diversified factors and contexts, it deserves consideration for a topic that addresses other than compliance and deterrence.

*Enforcement stringency vs regulatory attractiveness* Dowell et al (2003) inquired the correlation between the adoption of stringent environmental standard by a firm and its market value. Based on analysis of the American multinationals in developing countries, they found that the firms who adopted stringent environmental standards had much higher market values and were more competitive than those which did not. Thus they suggested developing countries should avoid using lax environmental enforcement when attracting foreign investment. Otherwise they would end up attracting poor-quality investment and uncompetitive firms. Coffee (2007) examined and compared the effect of high-intensity enforcement in the financial markets of the common-law countries. The enforcement exercised by the American public and private agencies was outstanding in terms of its stringency enforcement. At first glance the enforcement appeared to deter foreign investors. A closer look suggested that the deterred firms were mostly those aiming to speculate. At the same time, the strong enforcement reduced the cost of information asymmetry and equity capital. Thus high-intensity enforcement of the financial market of the USA filtered out the undesired types of firms and attracted the well-behaved firms.

## 5. Conclusion

This literature review shows that regulatory enforcement theories have formed comprehensive knowledge about the enforcer's and the regulatee's types, behaviours and interactions as well as the affecting factors and enforcement effect. This knowledge about the reciprocal impacts between institutions and players has the following factors, weaknesses and gap.

*Analytical framework* Existing enforcement studies are comprehensive. The scholars emphasise both the impact of institutions upon players and vice versa. They also pay sufficient attention to the dimension of the relation and interaction of the regulating and regulated sides. Notwithstanding that, there is potentially a connection and correlation between affecting factors, enforcement process and enforcement effect, this connection or correlation is not yet established. This implies that in spite of being a potential building block, relevant enforcement theories are yet to form a coherent analytical framework.

*Formal versus informal enforcement structures* Two enforcement structures can be identified from the literature: formal and informal. Formal enforcement structure is represented by the governmental system. It contains three dimensions: the institutions, the organisation (enforcing agency) and the individual (inspector). Informal enforcement structure is represented by intra-firm, inter-firm and informal control mechanisms. Formal and informal structures affect the outcome of enforcement and compliance. In spite of existing elaboration of both structures, the linkage between the dimensions inside each structure as well as that between the two structures is weak. Whether an informal enforcement structure complements or distracts a formal one is unclear.

*The regulating side* The enforcer is typified according to his behaviour. Yet the typification is so descriptive that its criterion is confusing and its range is unknown. The affecting factors to the enforcer's behaviours are identified to belong to various sorts - contextual, institutional, organisational and individual. However, the connection is weak between different types. The enforcer's response is mostly related to his enforcement strategy. There is limited scrutiny of the correlation between his response and interest. Also, it is arguable that enforcers' response is homogeneous: most significantly and consistently to his task, and variously to the regulatee's behaviour. Meanwhile, in spite of identifying the regulatee as one affecting factor, there is no exploration of what characteristics the enforcer prefers the regulatee to possess. Generally speaking, although the enforcer's behaviour, type and affecting factors are addressed comprehensively, the analyses are not systemised.

*The regulated's side* The scholars show interest in creating typologies of the regulatee's behaviour in the enforcement context. Although these typologies are generally not in conflict, how they agree is unclear. Additionally, the scholars address the affecting factors of the regulatee's behaviour from multiple

perspectives. Yet they do not systemise the regulatee's reactions towards intra-firm, inter-firm and extra-firm enforcement. Nor do they explore how public and private enforcement structures interplay, or how various types of firms react variedly towards private and informal enforcement.

*Bilateral relation and interaction* The enforcer-regulatee relational distance is solely relevant to the enforcement strategy. A process of bargaining and social construction between the enforcer and the firm is a prerequisite for institutionalising shared values so as to provide a familiar and predictable process. Nevertheless, the implication of this bilateral relation, other than to the enforcer's style, is limitedly explored. It is questionable that a change of individual on either side always engenders a change in the bilateral relationship - for instance, in a highly institutionalised setting. The literatures addressing the bilateral interaction demonstrate rich institutional ingredients. These are typically enforcement arrangements, institutionalising shared values, and the players interacting vis-a-vis each other on behalf of their respective institutions. Yet the relevance of institutionalism is not articulated. It is vague as to which player determines the enforcer-regulatee bilateral relation and interaction.

*Enforcement effects* Most scholarly concern about enforcement effect is regarding the regulatee's compliance. A few theories suggest a correlation between enforcement and business attraction. Some causal factors of enforcement effect have similar meanings as those mentioned for the RC outcome in the RC literature. These include certainty, flexibility (similar to efficiency), and responsiveness. The identified similarity is yet to bridge the gap between the two themes of regulatory enforcement and RC.

To conclude, although existing theories about the enforcer's and regulatee's types, behaviours and interactions are comprehensive, their weaknesses need to be dealt with, gaps to be filled and analyses to be systemised. The two-sided perspective and players' behavioural and interactive dimension complement what is missing in the RC literature. So do the emphases of the differences in enforcers and firms as well as the reciprocal impacts between institutions and players. These will contribute a building block not only to substantiating and structuring the forthcoming ER Framework but also to structuring the descriptive analysis in the empirical research. Notwithstanding the enforcement literature review's contribution, like the RC literature, it lacks a coherent analytical framework to inter-relate all factors. Consequently, neither RC nor enforcement subject can contribute such a framework

to the ER Framework. To develop the framework, it needs to develop an analytical framework to address the dual themes of RC and enforcement.

### Chapter III    Analysing Micro-Level Enforcement Regime of Regulatory Competition

In this chapter, I introduce my theory of regulatory competition (RC). Focusing on micro-level enforcement dimension, I suggest that a better way of understanding RC is to think of regulating and regulated sides as finding a partner to form a marriage. It is necessary to take into consideration the varieties of regulatory authorities and of regulated business firms; their likely relations and interactions after winning business; as well as the match and mismatch of their preferences. In this way, we can better understand why, while rules stay the same, locations have such varying regulatory results. I argue that an important dimension to RC is *the competition between different types of micro-level enforcement regimes for different types of firms. Assuming rules stay the same, depending match or mismatch of regimes' and firms' preferences, enforcement regimes have differential results of business attraction, enforcement effect and regulatory advantage.*

I present my theory through the so-called ER (enforcement regime<sup>33</sup>) Framework. The ER framework comprises four parts. The first part is about the regulating side, or the competing entity, represented by the regime and its agency. The framework suggests that regimes are different institutionally – displaying different combinations of vertical oversight and horizontal inter-agency cooperation. It is those institutional differences that determine the different interests and performances of regimes and their agencies in the context of RC. The second part draws attention to the regulated side, or the competed-for target, the firm. It illuminates that firms have various cognitions about the controls from formal and informal enforcement structures and behave accordingly. The third part introduces an original idea - 'match and mismatch of preferences'. It suggests to think of RC in terms of the regime and the firm finding a partner to form a marriage and then to be aware of the match and mismatch of their preferences. Winning business is never a one-time game but entails a long-term regulatory relationship. Both regime and firm have preferences and are selective for its partner and marriage. Match or mismatch of their preferences affects their long-term relation and interaction. The last part further analyses the match and mismatch of preferences by examining its three effects:

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<sup>33</sup> Hereinafter simplified as 'the regime'. 'The regime' in this thesis refers to micro-level enforcement regime unless otherwise specified.

business attraction, enforcement effect and regulatory advantage. With match and mismatch of preferences, (1) regimes and firms either or not mutually choose each other. Hence regimes either succeed or fail in business attraction; (2) Formal and informal structures either complement each other or not. Hence regimes have different enforcement effects; (3) regimes achieve various regulatory advantages, exemplified as different economic and social achievements. These three effects are also the outcomes of RC.

## 1. Regulating Side: Different Regimes and Agencies

The regime is the RC entity. Borrowing from the definition of regulatory regime by Hood et al (2001), the regime is defined as '*the complex of institutional geography, rules, practice, and animating ideas that are associated with particular regulation-implementing activities in the RC context*'. The institutional geography of the regime is on a micro scale, with fragmented front-line enforcement agencies<sup>4</sup> executing specific task and general purpose vis-à-vis the regulated firm. Its incentive structure, formal and informal rules of the game affect the RC measure, enforcement process and outcome. Its practice and animating idea concerns the rigour, strategy and characteristics of implementing rules. The definition implies that on the one hand, the regime, with its representative player - the agency, is influenced by institutions; on the other hand, the action and interaction of the regime with its agency and the firm have impact upon institutions which is embodied as RC outcome.

Regulatory institutions can be understood in vertical and horizontal forms, which correspond to the grid and the group. The grid means the oversight by the governmental authority at superior levels of the hierarchy<sup>5</sup>. The superior authority delegates varied tasks for the regime to implement. This vertical top-down control can be both monitoring and mediating<sup>6</sup>. It both constrains agencies' discretion and provides agencies resources to fulfill contesting regulatory goals (Levy and Spiller: 1994). It is regarded as exogenous to the regime. The regime is accountable to the superior authority for its achievements related to the regulatory goals. The group

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<sup>4</sup> Hereinafter simplified as 'the agency'

<sup>5</sup> The oversight is not restricted to governmental oversight and can involve all sorts. Yet this framework simplifies the types of oversight by focusing on the mentioned type only.

<sup>6</sup> Hereinafter simplified as 'the oversight'

means the cooperation between agencies. It is considered as endogenous to the regime.

Agencies are classified into two groups according to their duties. One group inclines to be restrictive, the other facilitative (Baldwin and Cave: 1999). Those which enforce social regulations such as labour, environmental protection and product safety belong to the restrictive group. Those who promote business and economy, such as granting favourable conditions, licenses and permits, appertain to the facilitative group. The relations between the two groups of agencies are likely to be in opposition, considering their converse duties. However, their relations can also be cooperative, depending on the particular institutional context. It is noted that this way of classifying agencies is based on simplified assumptions. An agency can be delegated with both restrictive and facilitative tasks. The agencies which enforce social regulations are not necessarily restrictive, and those which grant permits and favourable conditions are not necessarily facilitative. Also the agencies in the same restrictive or facilitative group do not necessarily have less tension than those belonging to these two groups. To adopt these simplified assumptions is necessary to develop a narrowly focused analysis.

Regimes have different institutional features. This is because their vertical oversight and horizontal inter-agency cooperation are different, so are vertical and horizontal combinations. With different vertical and horizontal combinations, we can find four archetypes of regimes: Positional, Isolate, Individual and Enclave. Each type has its distinctive feature. For a Positional (high-grid-high-group)<sup>7</sup> regime, both vertical oversight and horizontal inter-agency<sup>8</sup> cooperation are strong. For an Isolate (high-low) regime, the oversight is strong but the inter-agency cooperation is weak. This status is exactly opposite to that of an Enclave (low-high) regime. In an Individualist regime, both the oversight and the inter-agency cooperation are weak (low-low) (see Diagram III).

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<sup>7</sup> Hereinafter simplified by omitting the words 'grid' and 'group'

<sup>8</sup> The term 'inter-agency' narrowly refers to 'between the two types of agencies'.

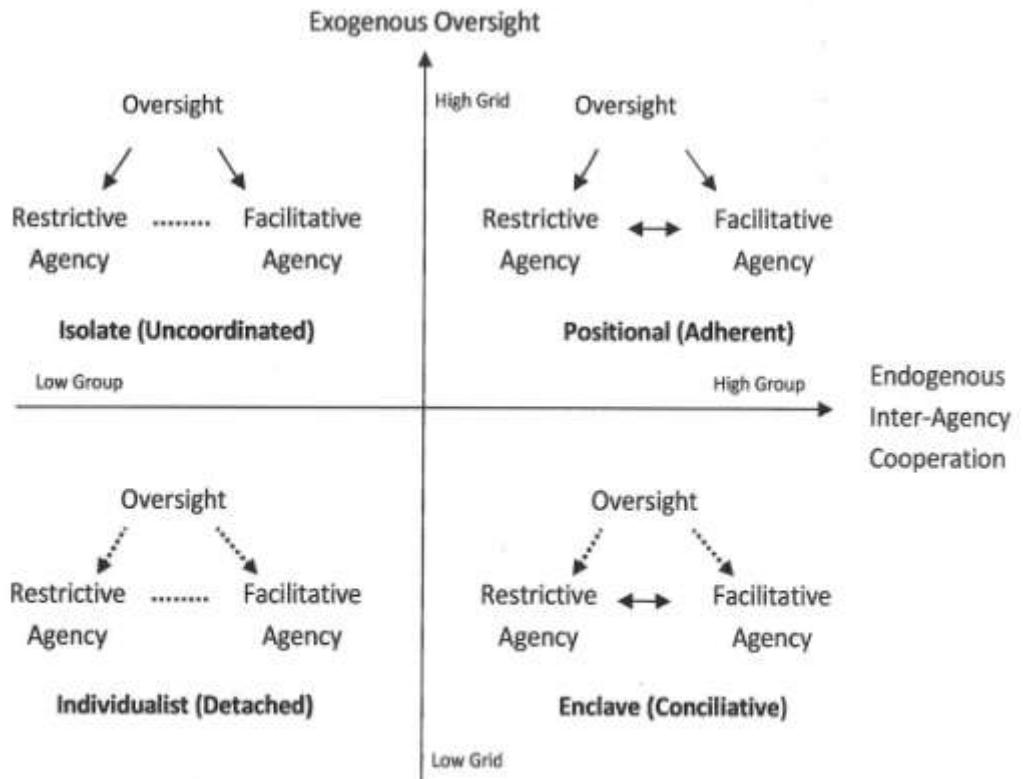


Diagram III Varied Idiosyncrasies of Regimes with Agencies

Note: Solid line means strong and broken line means weak.

Institutionally different, regimes and their agencies are different in performances, interests and strategies in the context of RC. Different features in this regard are shown in Table 3.1.

In a Positional (high-high) regime, both the restrictive and facilitative practices are well monitored, coordinated, information-sharing and hence are performed in a balanced manner. The overall enforcing image of the regime is as a facilitative and reasonable enforcer. It resembles the diagnostic inspectorate in Braithwaite et al's term (1987), who encourages the regulatee's self-regulation and provides technical assistance to solve regulatory problems. The interest of the regime in engaging with RC inclines to be high. The facilitative and restrictive agencies are mutually supportive in order to achieve the dual goals of business attraction and social enforcement. Both are confident in their competence and commitment and optimistic in being the winner. Its major competitive strategy is unlikely to be instrumental, i.e. down-play restriction or up-play facilitation. Instead, a likely choice is to improve the efficiency of regulatory practice and process through innovation.

	Positional (high grid high group)	Isolate (high grid low group)	Enclave (low grid high group)	Individualist (low grid low group)
Distinctive Feature of Regime (Oversight & inter-agency cooperation)	Strong oversight & strong inter-agency cooperation	Strong oversight but weak inter-agency cooperation	Weak oversight but strong inter-agency cooperation	Weak oversight & weak inter-agency cooperation
Distinctive Feature of Agency (institutional constraint & inter-agency cooperation)	Well-constrained; & cooperative	Well-constrained but uncooperative	Ill-constrained & cooperative	Ill-constrained & uncooperative
Characteristics of Agencies' overall Performance (Harrison [2006] and Lazar [2006])	Committed balanced facilitation restriction; coordinative information-sharing	Over-restrictive & under-facilitative; uncoordinated & lack of information-sharing	Over-facilitative & under-restrictive; coordinative, information-sharing sheltering	Uncommitted & ill facilitation & restriction; individualised, fragmented ad hoc (Hawkins and Hutter [1993])
Overall Image of Regime in Braithwaite et al's Taxonomy (1987)	Diagnostic inspectorate	Token enforcer	Conciliator	Modest enforcer
Implications of RC				
Interest in RC	High	Low	High	Low
Major Competitive Strategy	Improve practice and process	-	Lax enforcement	-
Label	Adherent	Uncoordinated	Conciliative	Detached

Table 3.1 Distinctive Features of Different Types of Regimes and Agencies

In an Isolate (high-low) regime, with strong oversight and constraint on discretion, the two agencies are well-disciplined. However they are lacking of mutual coordination and information sharing. Concentrating on their own duties, their

practices follow separate tracks that orient towards converse regulatory goals. The regime tends to be under-facilitative and over-restrictive. The general enforcing image of the regime is roughly like a token enforcer (Braithwaite et al: 1987), who is neither adversarial nor close to the regulated. Considering under-facilitation and the lack of cooperation between the two agencies, the regime is unlikely to be interested in competing for business. Hence the overall interest in RC is low.

In an Enclave (low-high) regime, with weak oversight, the two agencies are highly discretionary and cooperate closely. The regime is over-facilitative and under-restrictive. The agencies are likely to share the belief that business attraction creates benefits, either for self-serving and/or for the interest of local community (Morriss: 2010). Towards this end, they trade off their duties. They coordinate and share information efficiently to perform the role of a conciliator (Braithwaite et al: 1987). Based on the agencies' incentives, the regime has a high motivation to compete for attracting business. Its major competitive strategy is instrumental – through lax enforcement. The regime is ready to be a 'haven' to shelter interested firms.

In an Individualist (low-low) regime, with weak oversight and poor inter-agency cooperation, both restrictive and facilitative agencies have excessive discretion and ill perform their duties. They act like market-players, competing with each other to maximise self-serving interests. Typically, both agencies compete for resources such as revenue. The facilitative agency may try to get a reward for its achievement of business promotion. Thus it is likely to overstate favourable conditions in order to lure potential investors. The restrictive agency may make extra gains from administration fees and penalty charges upon the firm. Thus it tends to fine the firm arbitrarily. The overall image of the regime is a modest enforcer (Braithwaite et al: 1987), who is punitive and deterring and is the nearest to Bardach and Kagan's 'unreasonable regulation' (1982 and 2006). The two agencies' practices are individualised, disorganised, fragmented, ad hoc and random (Hawkins and Hutter: 1993). It is unlikely for them to be committed to RC. Well-informed firms are scared away by the agencies' instrumental and poor performance.

In order to highlight the fundamental features of the varied types of regimes, the regimes are relabelled. In line with the overall enforcing images of the regimes, the high-high regime is dubbed the Adherent, the high-low the Uncoordinated, the low-high the Conciliative, and the low-low the Detached.

To summarise, with different combinations of vertical oversight and horizontal inter-agency cooperation, regimes are different institutionally. They and their agencies perform differently, have different interests in RC and use different competitive strategies. Competing for business is rarely the only regulatory goal for a regime. There is always a tension between attracting business and enforcing social regulation. External RC is not necessarily a drive for all regimes alike to attract business. Instead, agencies' interests, strategies and performances matter. Whether RC rules are enforced and goals are achieved as desired by macro-level rule makers rely on micro-level regimes' actual practices. An awareness of different types and practices of micro-level regimes helps to advance our understanding that RC at macro level through rule setting is fundamentally affected by micro-level enforcement of these rules.

## **2. Regulated Side: Different Firms**

The firm is the target of RC. It is subject to formal and informal controls, controls from the government and the market<sup>9</sup>. Formal control is typically social enforcement of the regime. It is the grid. Informal control is typically social enforcement of the firm's business partner. It is the group. Firms are different in their cognitions and behaviours towards formal and informal enforcement. They can be classified into four archetypes accordingly (see Table 3.2).

Generally speaking, a Positional (high-high) firm is well aware of its market as well as regulated positions. It is active in complying with regulatory standards and sensitive to facilitation by the government. Meanwhile it complies with non-governmental norms and codes. An Isolate (high-low) firm is aware of its regulated position. It complies with governmental regulatory standards because it has to. Yet it does not expect governmental facilitation, nor does it like non-governmental controls. An Enclave (low-high) firm wants minimum governmental regulations but maximum governmental facilitation. It complies with industrial norms only when they are necessary to do business. An Individualist (low-low) firm prefers no controls at all.

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<sup>9</sup> Both formal and informal controls can be enforced by other entities. However this framework simplifies this by concentrating on that exercised by the regime and the firm's business partner. The firm's business partner is likely to enforce industrial norms also, yet this framework pays major attention to social norms.

		Positional (high grid high group)	Isolate (high grid low group)	Enclave (low grid high group)	Individualist (low grid low group)
Typical Preference for Control	Formal	High standard & high gov'l facilitation	High standard	Min. gov'l control & high gov'l facilitation	Min. gov. control
	Informal	Compliance with industrial & social norms	Min. non-gov. control	Compliance with industrial norms as required by trading partner	Min. non-gov. control
Features in an Enforcement Context					
Behavioural Feature		Proactive & Mindful of self-image	Reactive	Profit-Driven, strategic and rational	Avoiding
Type in Category of	Vickers et al (2005)	Proactive learner	Positive respondent	Minimalist	Avoider/ outsider
	Baldwin and Cave (1999)	Well-intentioned & well-informed	Well-intentioned & ill-informed	Ill-intentioned & well-informed	Ill-intentioned and ill-informed
	Kagan and Scholz (1984)	Political citizen	Organisational incompetent	Amoral calculator	Organisational incompetent
Features in an RC Context					
Position towards Regime's RC		Active	Inactive	Active	Inactive
Lobbying Goal		High & converged home, regional & int'l standards to maintain industrial advantage	Technical barriers for foreign competitors	Min. regulatory burden & social responsibility, max pro-business support	Firm's sovereignty & anti-globalisation
Impact upon Regulatory Standard in Murphy's term (2005)		High & converged product & process standards	Diverse and complicated domestic standards	High product standard & low process standard	No standard
Stereotyped Example		A big firm from a HRC	A domestic SME in a HRC	An SME in LRC	A small holding selling home-made produce
Attempt to Expand Business		High	Low	High	Very Low

Table 3.2 Distinctive Features of Different Types of Firms

Specifically, in the context of enforcement, a Positional firm tends to view complying with regulation as obligatory. It is proactive in understanding and abiding regulations. Accordingly, It is well-intentioned and well-informed, a proactive learner or a political citizen (Baldwin and Cave: 1999; Vickers et al: 2005; and Kagan and Scholz: 1984). In an RC context, it poses as an active driving force for the government to engage RC, believing that high regulatory standards are conducive to create and maintain its industrial advantage and positive social image. Under its influence, both product and process standards are likely to increase (Porter: 1990; and Murphy: 2005). A typical example is a big firm in a high-regulating country (HRC) (Vogel: 1997). The firm is highly likely to expand its business.

An Isolate firm is likely to be reactive in an enforcement context. It tends to be well-intentioned and ill-informed (Baldwin and Cave: 1999). Its regulatory problem is likely to be related to organisational incompetence (Kagan and Scholz: 1984). Its compliance with regulation relies on specific enforcement. It is likely to improve compliance if the agency's strategy is carefully chosen and to ill comply if governmental and non-governmental enforcement is lenient. Hence it can be roughly classified as a positive respondent (Vickers et al: 2005). In an RC context, it is inactive but may accept high regulatory standards. This is because of active enforcement or because of its belief that high standards offer protection from the threat of market access by foreign competitors. If this type of firm is influential, domestic standards will be diverse and complicated and deter the entry of foreign competitors (Murphy: 2005). A typical example can be a small and medium sized enterprise (SME) in a HRC. This type of firm does not tend to grow its business.

An Enclave firm is rational, strategic and profit-driven. In an enforcement context, it is ill-intentioned and well-informed (Baldwin and Cave: 1999). It is a minimalist (Vickers et al: 2005) or an amoral calculator (Kagan and Scholz: 1984). It actively supports the government's engagement to RC. It lobbies the government to minimise regulatory burden and maximise business facilitation. Under its influence, product standards may upgrade but process standards will downgrade (Murphy: 2005). This is because its business partner actively enforces high product standards and thus it demands competitors' to also comply so as to avoid their undercut of its competitive edge. Conversely, process standards incur extra cost and hence affect its competitiveness. A typical example is an SME in a LRC. Its probability of increasing investment is high.

An individualist firm is an outsider to both enforcement and RC (Vickers et al: 2005). It is ill-intentioned and ill-informed (Baldwin and Cave: 1999). It is likely to be organisationally incompetent (Kagan and Scholz: 1984). It affirms its sovereignty as an independent decision-maker and is anti-globalisation. Reflecting its own interests, there should be little regulation. A typical example is a small-holding selling its home-made produce in a local village market on a Saturday morning. Such a firm is unlikely to be capable of developing business.

In order to highlight the features of these varied types of firms, the firms are renamed to highlight their distinctive features. The high-high firm is labelled as the Proactive, the high-low the Reactive, the low-high the Profit-Driven, and the low-low the Avoider.

To summarise, the firm faces social controls from the government and the market, or formal and informal enforcement structures. They have different cognitions and behave differently towards formal and informal rules. To understand the different types of firms is helpful to understand their different behaviours and choices in the contexts of RC.

### **3. Two Sides: Match and Marriage**

RC for business involves two sides. The regime competes and the firm is competed for. I suggest that a better way to understand RC is to think of it like two sides finding a partner to form a marriage. Winning business is never a one-time deal but entails a long-term regulatory relation and interaction between the two sides. It is based on their thoughtful decisions and involves their mutual selection and match of their preferences. Then how do the two sides' preferences match or mismatch specifically? What does a marriage within a specific regime look like? What is the impact of a marriage with match and mismatch of their preferences? This section 3 will answer the first two questions and leaves the following section 4 to address the last question.

#### **3.1 Match and Mismatch of Preferences**

Both the regime and the firm are aware of the length of a marriage and thus mindful about choosing a suitable partner for marriage. To form a marriage involves choice

and decisions from both sides. The two sides' choice and decisions depend on their individual preferences as well as match and mismatch of their preferences.

On the one hand, the regime has preference and is selective for the firm. The regime is selective because of its institutionally endowed resource and restraint (Levy and Spiller: 1999). Its resource and restraint are peculiar. It can only satisfy the demand and enforce the compliance of a particular type of firm, but cannot satisfy demands or enforce compliance of all types of firms. With peculiar resources and restraint, the regime has preference for a particular type of firm. It accepts the behaviour of a certain type of firm while being intolerant to those of others. Being selective, it targets on and admits the type of firm whose demand it is likely to satisfy and whose compliance it is likely to be able to easily enforce. It declines the entry of the type of firm whose demand it cannot satisfy or whose compliance it is difficult or unable to enforce. Different regimes have different preferences. Some are selective and less tolerant. Others are less selective and more tolerant.

On the other hand, the firm has preference and is selective for the regime. The firm has its own understanding about formal and informal enforcement. It is mindful of the regime's enforcement style and has preference in this regard. Facing various types of regimes with various enforcement styles, the firm chooses its partner and marriage based on its preference. It chooses the regime whose practice best suits its demand and avoids the one whose style it dislikes.

Since both the regime and the firm have preferences, it is an issue as to whether their preferences match or mismatch. Match is two sided, relying on the individual preferences of the two sides. It is a match when the regime and the firm are the preferred and desirable type, each of the other, so that they mutually attract and choose each other and would like to get married. Mismatch is one sided. It is a mismatch when the regime likes the firm but the firm dislikes the regime or vice versa.

As illuminated before, regimes and firms are different in types. So are their preferences for the other side. The following sections illuminate specific preferences of regimes and firms as well as specific match and mismatch of preferences.

### **3.1.1 Regimes' Preferences of Firms**

Regimes' likely preferences of firms can be figured out from their respective expectations about its enforcement versus the firm's compliance and to its business attraction versus the firm's demand satisfaction (as shown in Table 3.3).

	Adherent (high grid high group)	Uncoordinated (high grid low group)	Conciliative (low grid high group)	Detached (low grid low group)
Preferred Reaction from Firm in RC terms	Preferences satisfied reasonably & fairly	-	Preferences satisfied extraordinarily	Tolerance to high regulatory cost
Expected Reaction from Firm in Enforcement Terms (May: 2005)	Civic duty or give-and-take reciprocity	-	Give-and-take reciprocity	Deterrent fear
Favourite Corporate Compliance Strategy	Enforced self-regulation (Ayres and Braithwaite [1992])	-	Creative compliance (McBarnet and Whelan [1991])	Obedience
Favourite Corporate Type	Big & with HRC origins	-	SME with LRC origins	-
Likely Preferred Type of Firm	Proactive	All types	Profit-driven, Reactive & Avoider	Reactive & Avoider

Table 3.3 Regimes' Likely Preferences of Firms

The Adherent regime wants its balanced restriction and facilitation to be appreciated by the firm. This is based on the regime's emphasis on the shared values of the agency and the firm. Hence, it prefers the type of firm which views the regime's performance as satisfying the firm's demands and enforcing governmental rules reasonably. Also the regime expects the firm to react to enforcement with a sense of civic duty, or at least with a give-and-take reciprocity (May: 2005). Its favourite corporate compliance strategy is enforced self-regulation (Ayres and Braithwaite: 1992). The favourite corporate feature is where the firm is large and originates from HRC. Thus the likely preferred type is the Proactive firm. Its preference implies an

emphasis on the quality of investment<sup>10</sup>. Its desired type of firm must also enhance rather than impair its reputation of good commitment to social regulation. It is the most selective regime.

The Uncoordinated regime does not have a particular preference for the type of firm. This is inferred from its lack of interest in business attraction and its uniform command and control strategy towards firms of all sorts. It is the least selective regime.

The Conciliative regime prefers the firm that appreciates its extraordinary performance in satisfying the firm's preferences. It wishes the firm to have a sense of give-and-take reciprocity. Hence the agency can benefit from this exchange. It prefers the firm that has extraordinary pro-business demand and is strategic or even creative in compliance (McBarnet and Whelan: 1991). This type of firm shares the regime's strategic feature. The SME with LRC origins is a favourite of the regime, because this type of firm is keen on lax enforcement. Notwithstanding its preference, the regime welcomes any type of firm that is strategic and welcomes lax regulation. Therefore the Proactive firm is off the list.

The Detached regime prefers the type of firm that tolerates high regulatory cost and seldom challenges the agency's decisions. It expects the firm to have deterrent fear and be obedient to the agency's arbitrary and punitive actions. The likely chosen firms are those the agency can bully: The Reactive and the Avoider.

To summarise, regimes are different in preferences and targets for firms. Comparatively, the Adherent regime is the most selective, the Uncoordinated the least, the Conciliative the most tolerant and the Detached the most manipulating. To understand different regimes' preferences helps to understand why locations are different in attracting businesses as well as in the types of attracted business.

### 3.1.2 Firm's Preference of Regime

Firms' likely preferences of regimes can be figured out based on their respective expectations about the regime's support, reputation, value, enforcement style and strategy (see Table 3.4).

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<sup>10</sup> For more details, see relevant section in Chapter II.

	Proactive (high grid high group)	Reactive (high grid low group)	Profit-Driven (low grid high group)	Avoider (low grid low group)
Preferred Support from Regime	Efficient and well coordinated	No adversary	Business first	No request
Preferred Regime's Reputation	Competitive & well-reputed	Low	Competitive & low-profiled	No request
Expectation of Appropriateness	High	Low	Very low	No request
Expectation of Instrumentality	Low	Low	Very high	No request
Preferred Enforcement Style	Rule-bounded, standardised, reasonable & stable	Easily-followed & coherent interpretation & implementation	Lax & negotiable	Minimum
Favourite Enforcement Strategy	Responsive regulation (Ayres and Braithwaite [1992])	Education & persuasion	Deceptive (Post [2004]) or lax enforcement	Laxest
Likely Chosen Type of Regime	Adherent	Adherent & Conciliative	Conciliative	Conciliative

Table 3.4 Firms' Likely Preferences of Regimes

The Proactive firm has the strictest criteria for a regime. It prefers a regime to provide fair and well-coordinated support and to be competitive. The regime should have a good reputation and manifest a social rather than strategic sense. It provides a rule-bounded, standardised, reasonable and stable enforcement performance. Its favourite enforcement strategy is responsive regulation. Accordingly the Adherent regime is the likely and sole preference.

The Reactive firm has low expectations of any governmental support, reputation and value. Yet it prefers a regime in which the agency's interpretation and implementation of the rules is easily followed and coherent, and its enforcing strategies are educational and persuasive rather than coercive and punitive. Hence the Adherent and Conciliative regimes are likely to be its preferences.

The Profit-Driven firm prefers a regime that puts the business first. It wishes the regime to be competitive but of low-profile, which is typically strategic. It desires enforcement to be lax, negotiable and even deceptive. Its ideal choice is certainly the Conciliative regime.

The Avoider firm prefers a sympathetic regime. It has no demand for the regime's reputation and value, but has a high need for lax enforcement. In a world with omnipresent regulation, the Conciliative regime is the nearest type that the Avoider can find to provide shelter to maintain its freedom.

To conclude, firms are selective but in different ways. An attention to firms' different preferences for the regime is helpful to understand why particular firms choose particular locations to conduct business.

### 3.1.3 Match and Mismatch of Preferences

As illustrated before, regimes and firms and firms have different preferences and choices. Exactly which types of regime and firm match can be figured out and illustrated in Table 3.5.

Firm	Regime			
	Adherent	Uncoordinated	Conciliative	Detached
Proactive	F & R	R	-	-
Reactive	F	R	F & R	R
Profit-Driven	-	R	F & R	-
Avoider	-	R	F & R	R

Table 3.5 Matches of Preferences by Regimes and Firms

Note: F = Firm's preference; R = regime's preference; '-' = no preference by either. The highlighted parts mean a match of preference.

Four pairs of regimes and firms have mutual preferences, which mean their preferences match. The preferences of the Adherent regime and the Proactive firm match. So do those of the Conciliative regime and the Profit-Driven, Reactive and Avoider firms. Though the Uncoordinated and Detached regimes are open to all, they are not preferred by any type of firm. The four matches mean that these particular types of regimes are likely to be popular and attractive to those particular types of firms. The rest are mismatches, i.e. either these types of regimes are not attractive to business or those types of firms are not attractive to regimes. With match of preferences of the two sides, the Adherent regime and the Conciliative regime are likely to achieve the regulatory goal of business attraction. With mismatch of preferences of the two sides, the Uncoordinated and Detached regimes are unlikely to achieve the goal of winning business.

It is noteworthy that existing RC scholars appear to pay attention to the regulated side's preference only. They emphasise the regulating side's competition in order to satisfy various demands and preferences of the regulated, such as Tiebout (1956), Romano (1985) and Vogel (1997). But they generally overlook the regulating side's preference as well as match and mismatch of the two sides. An explanation is that RC scholars assume that only the regulated side is selective, while the regulating side is not. The above elucidation shows that conventional assumption is inadequate and inaccurate.

Match or mismatch of the two sides' preferences determines whether there would be a marriage and if any, whether their marriage is appealing or pleasant. It is noteworthy that empirically, match of preferences does not always entail a marriage, nor does mismatch mean no marriage. The explanations are firstly, match or mismatch of preferences is institutional, while empirically either side's choice is likely to be cognitive. Hence either the regime or the firm's choice can be irrational (Simon: 1957). Secondly when choosing locations, firms usually take many factors into consideration together, regulatory and non-regulatory; rules, favourable conditions and enforcement practice. Some may put more weight on non-regulatory rather than regulatory factors, or on regulatory factors other than enforcement practice, and hence choose places which seem to mismatch their preferences. Thirdly, either side may have insufficient or inaccurate information about the other so that it makes a wrong choice of partner. Finally, when there is regulatory change, either side is likely to be affected and may change its behaviour responsively. Their preferences no longer match mutually and hence their selections are not

synchronised. Match and mismatch of preferences will affect the marriage between the regime and the firm, which will be elucidated in the following section.

### **3.2 Marriage: Different Bilateral Relations and Interactions**

To win business means to begin a marriage - the regime and the firm forms a long-term regulatory relation and interaction with each other regularly. Different regimes are different in their regulatory relations and interactions with regulated firms. Equality, accountability, fairness, listening with empathy, consistency and predictability could form a marriage made in heaven. But in the real world marriages are various and not all pleasant.

Talking about the agency-firm relation first. The agency-firm relation involves relational distance, bargain and social construction<sup>11</sup>. Regimes have different features in these regards. The Adherent and the Conciliative regimes are featured by cooperative agencies. Accordingly, the agency-firm relational distance is generally close; their bargaining power is symmetric; and their agencies are active in social construction. By the same token, in the Uncoordinated and the Detached regimes, the agency-firm relational distance is far; their bargaining power is asymmetric; and their agencies are inactive towards social construction.

Now coming to the agency-firm interaction. The agency-firm interaction involves interactive logic, regularity of working arrangements, institutionalisation of shared values, power structure and enforcement strategies. Regimes have different features in these aspects, as illustrated in Diagram IV and Table 3.6.

The Adherent regime commits itself to the social interest at large, rather than to that of itself, which is usually embodied in the regulatory goals being set officially. This is inferred from the regime's features toward strong oversight and inter-agency cooperation. Strong oversight is necessary to maintain the equilibrium of enforcing social and economic regulations. It restrains the agency-firm interaction from being either too facilitative or too restrictive. Hence it is a warrant for social desirability. With inter-agency cooperation, the agencies tend to regularise the enforcement arrangement. The arrangement may take the form of societal or social contract (May: 2005). Correspondingly the degree of institutionalising the values shared between the agency and the firm is high, as are their mutual trust and accountability

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<sup>11</sup> For details, see the relevant section of Chapter II.

(Black: 1998a). Meanwhile, the agency differentiates between firms in line with their compliance. It deploys responsive strategies to enforce the rules (Ayres and Braithwaite: 1992). The agency listens to the firm's ideas and feedback and if necessary, corrects and improves practice. The firm is likely to be loyal to the regime (Hirschman: 1970). Based on the above analysis, it can be inferred that the Adherent regime expects desirable social effect and shows strong business facilitation.

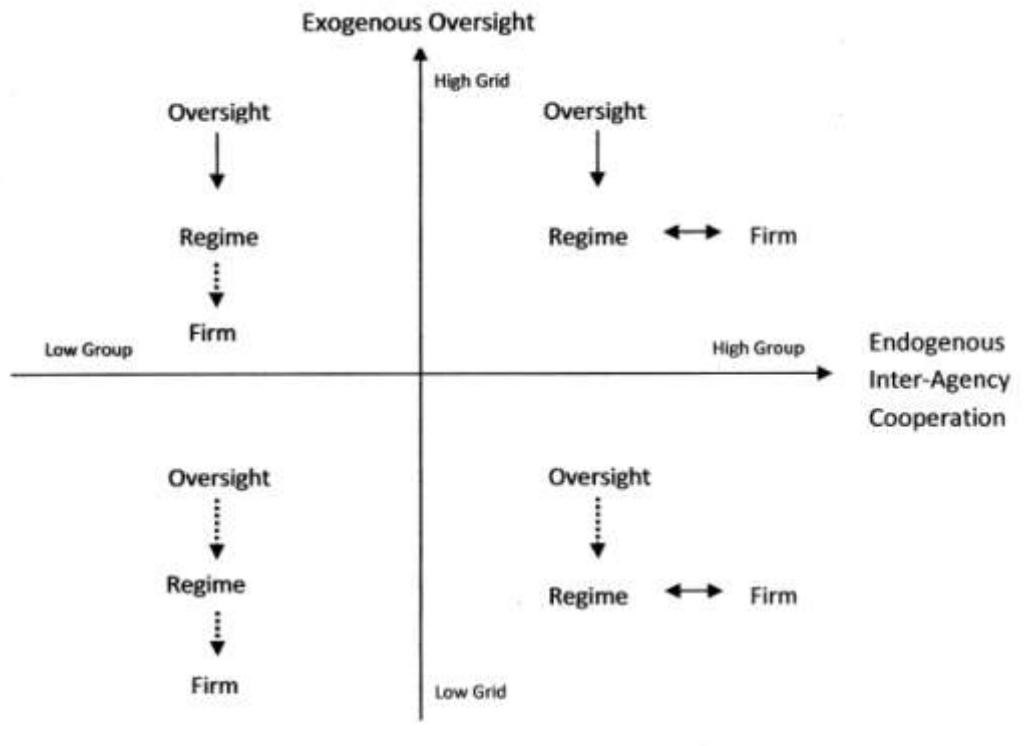


Diagram IV Varied Idiosyncrasies of Interactive Processes  
Between Regimes and Firms

Note: Solid line means strong and broken line means weak.

The Uncoordinated regime is not interested in social construction in the agency-firm interaction, inferred from its features of strong oversight but weak inter-agency cooperation. Albeit that strong oversight entails desirable social effect, weak inter-agency cooperation costs business attraction. The agency's regularised arrangement tends to be characterised as broad-brush and irresponsible. The degree of institutionalisation of the agency-firm shared values is likely to be low as is their mutual trust and accountability (Black: 1998a). The agency does not differentiate firms according to their compliance status. It deploys command and control strategy uniformly (Ayres and Braithwaite: 1992). The agency generally ignores the firm's comment and complaint. The firm is likely to exit the regime

(Hirschman: 1970). Generally the Uncoordinated regime engenders desirable social effect at the expense of business facilitation.

	Adherent (high grid high group)	Uncoordinated (high grid low group)	Conciliative (low grid high group)	Detached (low grid low group)
Relational Distance	Close	Far	Close	Far
Distribution of Power	Symmetric	Asymmetric	Symmetric	Asymmetric
Active Degree towards Social Construction	Active	Low	Active	Low
Logic of Interaction in historical institutional terms	Social appropriateness	Social appropriateness	Instrumentality	Instrumentality
Type of Regularised Arrangement in May's Term (2005)	Societal/ Social contract	(Broadbrush & irresponsible)	Societal/ Social contract	Legalism (unreasonable [Bardach and Kagan {1982}])
Trust and Accountability (Black: 1998a)	High	Low	High	Low
Degree of institutionalisation of Shared Values	Very high/ High	Low	Very high/ High	Very Low
Differentiation towards Firms	Yes	No	No	Yes
Adapted Major Enforcement Strategy in Ayres and Braithwaite's Terms	Responsive regulation	Command and Control	Bi-partisanship	Random 'Big Gun'
Firm's Voice (Hirschman:1970)	Heard and feedback	Ignored	Decisive	Not listened
Firm's Choice between Exit & Loyalty (Hirschman:1969)	Loyalty	Exit	Loyalty	Exit
Social Effect	Desirable	Desirable	Undesirable	Undesirable
Business-Attracting Effect	Strong	Weak	Very strong	Very weak

Table 3.6 Agency-Firm Relations and Interactions

Note: The content in the bracket means that it is extra to the given source.

The Conciliative agency follows the logic of instrumentality in the agency-firm interaction. This means that the regime is committed more to its own self-interest than to any regulatory goal set by its superior authority. This is inferred from the regime's features of weak oversight and strong inter-agency cooperation. Regardless of contradictory duties, agencies are facilitative and flexible. The agency-firm interaction is likely to be dysfunctional in enforcing social regulation. The restrictive agency may adopt a form of societal or social contract to regularise working arrangements (May: 2005). It does not differentiate firms in terms of their compliance. 'Bipartisan' is the description of the agency's enforcement strategy (Ayres and Braithwaite: 1992). The institutionalisation of the agency-firm shared value is at a high degree as are their mutual trust and accountability (Black: 1998a). The roles of the two players are not the regulator and the regulated, with the firm being allowed full access to decision-making. The agency's practice is tailored to the firm's idea. The firm is likely to be loyal to the regime (Hirschman: 1970). While social effect of the regime is undesirable, business facilitation is very strong.

The Detached agency follows the logic of instrumentality in its interaction with the firm. It inherits the regime's institutional features of weak oversight and weak inter-agency cooperation. There is no regular working arrangement and the agency's style is unreasonable and punitive (Bardach and Kagan: 1982; and May: 2005). The degree of institutionalisation of the agency-firm shared values is very low as is their mutual trust and accountability (Black: 1998a). The agency differentiates between firms not according to their compliance but to their bargaining powers. It bullies the weak SMEs but minds the strong and big firms, because the latter can challenge its decisions and will complain to the superior authority (May: 2005). It deploys a 'Big gun' randomly in order to make profit. The agency never listens to the firm's opinion. Hence it may encounter the firm's backfire. The firm tends to exit the regime (Hirschman: 1970). Bearing in mind that the agency's enforcement style is not based on the regulatee's compliance, this regime is likely to have undesirable social effect and very weak business attraction.

The regime's and firm's relation and interaction offer a window as to how their marriage may look. On the one hand, some regimes are more business-friendly than others and not all regimes are suitable for conducting business. On the other hand, some firms are better behaved than others and not all firms comply with rules voluntarily. Different regimes prefer different types of firm to others, so do firms.

Underpinned by match or mismatch of their preferences, the bilateral relation and interaction entail RC outcomes.

### **3.3 Summary**

I suggest that RC is better understood in terms of the regime and the firm finding a partner to form a marriage, bearing in mind that winning business entails long-term regulatory relation and interaction for both regulating and regulated sides. It involves the two sides' mindful decisions and preferences as well as the match of their preferences. The regime's preference relies on the regime's resources and restraints. The firm's preference is related to its demands. Different regimes and firms have different preferences, which either match or mismatch. Since different regimes have distinctive enforcement styles, the marriage of each type of regime has its particular features in relation and interaction with the firm. To understand RC in terms of match of preferences helps us to understand why no location is able to win business of all sorts or to enforce compliance of firms of all sorts; why an area is particularly popular to business; and why firms avoid some locations to conduct business. The impact of match and mismatch of preferences will be elucidated in the following section.

### **4. Effects of Match and Mismatch**

This section further clarifies the implications of match and mismatch of preferences by elucidating corresponding regulatory effects, or RC outcomes. Forming a lasting regulatory relation and interaction with each other, the regime generates regulatory effects such as business attraction, social enforcement and regulatory advantage. Business attraction is an economic effect. It is only achieved when the preferences of the regime and the firm match. Enforcement effect is social. It relies on the joint functioning of formal and informal enforcement structures. Regulatory advantage is mostly economic, although its refined terms, i.e. comparative and competitive advantages, involve social concerns and are related to business attraction and social enforcement. All three effects intertwine with each other and all are considered as integral outcomes of RC.

RC outcomes depend on both regulating and regulated sides. Match or mismatch of preferences of the two sides is considered as underpinning the RC outcomes of any

specific regime. It takes two sides rather than the regime on its own to achieve economic and social goals. In spite of being the major player of RC, the regime is unlikely to succeed in business attraction or social enforcement without the participation of the firm. Indeed, the regime's practice is always affected by that of the regulated firm. With no firm's recognition and appreciation, the regime cannot be popular or attractive to business and certainly cannot gain regulatory advantage. Without the firm's self-enforcement or social enforcement by the firm's business partner, at best it is costly for the regime to enforce corporate compliance and at worst the regime fails social enforcement. Taking into consideration the firm's participation requires a wider perspective and is necessary for a balanced and accurate understanding of RC. It is distinctive from conventional RC theories, which consider the RC outcomes as generally related to the institutions and used instruments on the regulating side.

#### **4.1 Business Attraction**

The first effect of match or mismatch of preferences, also an RC outcome, is business attraction. Business attraction is likely to happen if the regime's and the firm's preferences match so that each side chooses the other to form a pleasant marriage. A location with match of preferences of the two sides is likely to be a winner of RC for business and achieve economical goals. The Adherent and Conciliative regimes are such examples. It is noteworthy that both regimes are business-friendly. Business attraction is unlikely to happen if the two sides' preferences mismatch. Since one's style is not suitable for the other, either does not choose the other as partner. Even if both choose each other to form a marriage by chance, the marriage with mismatch of preferences is not pleasant to one side at least. Either the regime faces a misbehaving firm, e.g. an Adherent regime with a profit-driven SME from LRC, or the firm is subject to an unfriendly or even adverse regime, typically a well-intentioned and well-informal big company in an Uncoordinated or a Detached regime. Bilateral relation and interaction involve tension and dispute (for details, see Table 3.6). A marriage with mismatch is costly to both sides and is economically and/or socially undesirable.

As clarified in the previous section about match of preferences, regimes and firms are concerned about mutual choice, preference and attraction. Different types of regimes and firms are different in attraction. Some types of regimes are not attracting, typically the Uncoordinated and the Detached, but some are, such as the

Conciliative and the Adherent. While most types of firms are attracted by very pro-business regimes, empirically for instance the Conciliative Delaware (Cary: 1974; and Romano: 1986), some firms are attractive to those with high standard, like the Adherent California (Vogel: 1997). It is precise if we say: To the firm, Conciliative and Adherent regimes are more attractive than the Uncoordinated and Detached. To the Adherent regime, the Proactive firm is the most attractive. To the Conciliative regime, the Profit-driven firm has the highest attraction. Comparatively, the Conciliative is the most attractive of all types of regime.

Depending on match or mismatch of preferences, business attraction is also institutional rather than instrumental. A regime may succeed by taking competitive measures to attract business. However it must be competitive institutionally by matching the firm's particular preference to succeed. A lasting success in business attraction relies on the match of preferences of the regime and the firm. Institutionally mismatching the firm's preference, a regime is unlikely to maintain success based only on account of its competitive measures.

## 4.2 Enforcement Effect

The regime's preference implies its acceptance and tolerance of the firm's social behaviour. Bearing in mind regimes are of different types, different regimes agree and accept different types of firms' social behaviours. A marriage between the regime and the firm entails joint functioning of formal and informal structures that generate regimes' overall enforcement effect. Formal structure is typically shaped by the agency's restrictive practice. Informal structure takes effect through the firm's self-enforcement and compliance of social norms enforced by its business partner. However, formal and informal structures do not always function in harmony. Regimes' enforcement effects are different. Depending on the specific type of regime, the firm's social compliance enforced by its business partner is encouraged, ignored, discouraged or distracted by the agency's practice (see Table 3.7).

	Adherent	Uncoordinated	Conciliative	Detached
Formal Enforcement	Responsive	Irresponsive	Negligent	Dysfunctional
Informal Enforcement	Encouraged	Ignored	Discouraged	Distracted
Overall Enforcement Effect	Efficient	Burdensome	Lax	Deterrent

Table 3.7      Regimes' Enforcement Effects

The Adherent regime's restrictive performance is responsive, fair and balanced against business facilitation. The firm's social compliance is appreciated and encouraged. The enforcing practices by the regime and the firm' business partner complement mutually. The regime's overall enforcement effect is efficient. In the Uncoordinated regime, the restrictive agency's performance is irresponsive and broadbrush-styled. The firm's social compliance enforced by business partner is ignored by the agency. The enforcing practices by the regime and the firm' business partner are in parallel rather than complementary. The regime's overall enforcement effect is burdensome. The Conciliative Regime trades off its restrictive duty for achieving the business attracting goal. Hence restriction is negligent. Also the firm complies with social norms and codes only if they are necessary for doing business. The enforcement by the regime discourages the firm's social compliance. The regime's overall enforcement effect is lax. The Detached regime does not perform enforcement appropriately. The firm's good compliance is not recognised justly by the agency. The regime's dysfunctional practice distracts the enforcement of the firm's business partner. This regime's overall enforcement effect is deterrent. Generally, enforcement effect is most desirable when formal and informal structures are functioning complementarily and is most undesirable when formal structure distracts informal one.

### **4.3 Regulatory Advantage**

Regulatory advantage is mostly related to facilitative practice and concerned with fulfilling the economic goal of business attraction. A location with regulatory advantage is competitive for business, while one without is not. The concept of regulatory advantage has two refined derivatives - comparative advantage and competitive advantage. A location with comparative advantage is likely to fail social goal and have social effect undesirable to rule makers. In contrast, an area with competitive advantage achieves both economic and social goals and shows economic and social effects desired by rule makers. Regulatory advantage implies a comparison between different types of regimes in the context of RC for business.

#### **4.3.1 Regulatory Advantage**

The concept 'regulatory advantage' is defined by referring to Romano (1985), Porter (1990) and Baldwin and Cave (1999). It means *an institutional superiority of the enforcement regime in attracting business*. It is noted that favourable conditions are competitive instruments that are imposed by the regime. Like the rule to the regime, favourable conditions *per se* are not the resource of regulatory advantage, rather their deployment is. The deployment of favourable conditions is bounded by the institutions of the regime.

After defining 'regulatory advantage', an immediate question is what are its features and how can we compare regulatory advantages of various regimes. RC and enforcement scholars have suggested attributes of regulatory advantage. Being modified, the attributes are restrictive and facilitative responsiveness, flexibility and certainty (Levy and Spiller: 1994; and Romano: 1985 (see Table 3.8). All are related to the agency's practice.

Institutional Characterisers		Adherent	Uncoordinated	Conciliative	Detached	
Restrictive	Responsiveness	H	L	L	VL	
Facilitative		H	L	VH	VL	
Flexibility		H	L	VH	VL	
Certainty		VH	L	H	VL	
Regulatory Advantage		H	L	VH	VL	

Table 3.8 Ranking Results of Regulatory Advantages

Note: V=very, H=high, and L=Low

The Adherent regime is ranked ‘high’ for flexibility, restrictive and facilitative responsiveness. The deployed enforcement strategies are responsive and reasonable. The restrictive and facilitative duties are performed in balance. The agencies work efficiently and cooperatively. These aspects are not ranked as ‘very high’. The reason is that, comparatively speaking, the regime is more facilitative and less restrictive than the Uncoordinated regime, while less flexible and efficient than the Conciliative regime. Because of the agency’s well-organised practice and well-constrained behaviour, it is scored ‘very high’ for certainty. The sum of the rankings is ‘high’.

The Uncoordinated regime is ranked ‘low’ for responsiveness, flexibility and certainty. The restrictive and facilitative agencies do not cooperate with each other. Though both agencies are well-restrained in exercising their duties, the facilitation is not active and the restriction is broadbrushed. Weak inter-agency as well as lack of agency-firm social construction affect certainty. The regime is of limited attraction to business. Accordingly, its regulatory advantage is ranked ‘low’.

The Conciliative regime is ranked ‘very high’ for facilitative responsiveness and flexibility, ‘low’ for restrictive responsiveness and ‘high’ for certainty. Facilitation is tailor-made and restriction is overwhelmingly minimised. The agencies are cooperative in satisfying the firm’s demands. They are extraordinarily flexible and

efficient. The certainty is not as high as the Adherent regime. It is certain that the agencies are highly supportive to the firm, but the agencies' over-flexibility may arouse pre-emption from superior authority. This regime is generally ranked as 'very high' in regulatory advantage.

The Detached regime does not perform facilitation or restriction adequately. Driven by their self-interest maximisation, the agencies are not responsive to the firm. The flexibility and certainty are very low, given the random, unstable and unreasonable working style of the agency. It scares away business. The overall advantage of this regime is 'very low'.

With ranking results known, the regimes can be compared. The Conciliative regime is the champion with the highest-scored regulatory advantage. The runner-up is the Adherent regime, with a 'high' score. With a 'low' score, the Uncoordinated regime does not have regulatory advantage and does not attract business. The Detached regime gets the lowest score, and can be said to be at a regulatory disadvantage. These results contribute to our understanding as why, subject to the same rules, some locations are popular to business while others are not.

#### 4.3.2 Comparative and Competitive Advantage

Evoked by Porter's conceptions (1990), regulatory advantage is refined as comparative advantage and competitive advantage. Both emphasise an extra resource for business attraction - regulatory innovation<sup>12</sup>. Furthering the definition of regulatory advantage, comparative advantage is defined as *an institutional superiority of the enforcement regime based on strategic actions*.<sup>13</sup> The strategic action, with the feature of instrumentality, is exemplified as the regime's alignment of practice and deployment of resources aimed at winning competition for business, at the expense of social regulation.

In contrast, competitive advantage is *an institutional superiority of the enforcement regime based on legitimate improvement*. This definition emphasises legitimacy<sup>14</sup>. Legitimate improvement is exemplified as the regime's value of self-image and reputation in achieving economic and social goals. The regime's innovation aims at

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<sup>12</sup> For details, see Section 1.4.1 of Chapter I.

<sup>13</sup> For the logic of instrumentality, see the section about economic institutionalism in the Introduction.

<sup>14</sup> For the logic of social appropriateness, see the section about sociological institutionalism in the Introduction.

generating productivity. It supports the firm to save compliance cost and sharpen competitive edge. Bettering agencies' performance and cooperation is to enhance both social and economic interests. Consequently, legitimacy engenders desirable effect for both business attraction and social enforcement.

Accordingly, comparative and competitive advantage can be understood through three essential features: innovation, legitimacy and instrumentality. Table 3.9 shows these features of each type of regime. Their sum reveals which regime has what type of regulatory advantage.

Characterisers	Adherent	Uncoordinated	Conciliative	Detached
Innovation	Y	N	Y	N
Legitimacy	Y	Y	N	N
Instrumentality	N	N	Y	Y
Advantage	Competitive	No advantage	Comparative	Disadvantage

Table 3.9 Regimes' Regulatory Advantages

Note: Innovation, legitimacy and instrumentality are evaluated in terms of yes (Y) and no (N).

The Adherent regime involves innovation and legitimacy but not instrumentality. The agency is willing to learn to improve business attraction and enforcement effect in a balanced fashion. The agency manifests a sense of legitimacy in both facilitative and restrictive performance. Economic and social regulations are exercised in a balanced fashion. The regime despises the logic of instrumentality. The Uncoordinated regime does not involve innovation or instrumentality but legitimacy. The agency is unlikely to improve business attraction or enforcement effect. Although having a strict sense of correcting wrong-doings, the agency lacks any sense of facilitating business. Legitimacy is over-emphasised in its restrictive performance at the cost of upsetting business. The economic regulatory goal is not achieved, but the social goal is. The Conciliative regime involves innovation and instrumentality but no legitimacy. The agency is keen on learning to improve business attraction, most likely at the expense of restrictive performance. Hence its

action is strategic. The agency is extraordinarily pro-business in order to maximise benefit in this regard. Towards this end, it manifests a worldview of instrumentality where there is little room for legitimacy. The economic regulatory goal is achieved but the social one is not. The Detached regime involves instrumentality but no legitimacy or innovation. The agencies are driven by tangible economic gain. Hence both restrictive and facilitative performance is destructive to both business attraction and enforcement effect. Neither economic nor social regulatory regulation is exercised properly.

Therefore, the Adherent regime has competitive advantage, whereas the Conciliative regime the comparative advantage. The Uncoordinated regime has no advantage and the Detached regime has disadvantage. It is noteworthy that the regime with competitive advantage is less attractive than the one with comparative advantage. An explanation is that a regime with competitive advantage is more selective and less tolerant to inappropriate corporate conduct than one with comparative advantage. Understanding the difference between comparative and competitive advantages helps us to understand why some competitive locations have desirable social effect while some do not.

#### **4.3.3 Summary**

The RC outcome of regulatory advantage is also an effect of match or mismatch of preferences. It is mostly related to regulatory facilitation and concerns the economic goal of business attraction. A location with regulatory advantage is attractive to business. Its social effect is likely to be undesirable if the advantage is comparative or desirable if the advantage is competitive. The concepts of regulatory advantage, comparative advantage and competitive advantage contribute to our understanding as to what factors underpin the difference between competitive and uncompetitive locations as well as between their desirable and undesirable social effects.

### **5. Conclusion**

In this chapter, I propose my main argument about RC through the so-called ER Framework. Focusing on the dimension of enforcement, I alert that enforcement of rules at micro level will fundamentally affect RC through rule-making at macro level because micro-level regimes and firms are of various types. I suggest that a better way of understanding RC for business is to think of it like the regulating and

regulated sides finding a partner to form a marriage. Winning business is never a one-time deal but entails long-term regulatory relationship and interaction between the regulating and regulated sides. Bearing in mind regimes and firms are of various types, their preferences are different, and so are their marriages. Depending on the match or mismatch of the two sides' preferences, regimes have differential regulatory effects, typically RC outcomes of business attraction, enforcement effect and regulatory advantage. Next I will use the ER framework to interpret the findings of my fieldwork in China and pay attention to whatever outstanding issues for the framework to explain.

## Chapter IV Introduction to Empirical Research

The ER Framework was developed after the field research for the purpose of making sense of the findings from my empirical research. Further, the empirical research provides a chance to see whether the framework is convincing to interpret the empirical phenomena of RC. The empirical research begins with introducing the observational focuses and the macro and middle contexts of micro-level regimes. It follows by reporting four case studies. Each of the four cases roughly indicates one type of regime according to its grid (vertical official oversight) and group (horizontal inter-agency cooperation), as typified by the ER Framework. Thus the reader can easily follow specific interpretations about specific cases.

This general introduction has both methodological and empirical purposes. The methodological purpose is to clarify how the ER Framework will be used for interpreting the empirical research and why the sample country, cities and cases were chosen. The empirical purpose is to descriptively analyse macro, middle and micro regulatory contexts of the subject of the case studies – the micro-level regime. Knowing the macro and middle regimes, is to know the RC and enforcement contexts, the benchmark of legitimacy of RC for attracting business, regulatory goals, preference on the regulating side, information and idea exchange, formal and informal enforcement structures. The analysis of the contexts makes it possible to understand that RC through making rules at macro and middle levels is closely linked to the enforcement of those rules at micro level; that the micro regimes' are not always responsive upwardly as wished by rule-makers at macro and middle levels; nor are their regulatory outcomes always desirable to the governments at macro level. Differing from macro and middle levels, the micro regime involves the frontline agencies and firms, which act and interact vis-a-vis each other. It is the right level to use the ER Framework for interpreting the empirical phenomenon of RC.

### 1. How to Use the ER Framework

Like the ER Framework, the four case studies borrow their structure from the regulatory enforcement literature review. They all begin with determining the type of regime according to its 'grid' and 'group' properties. Then it reports faithfully and systematically the findings from triangular sources concerning the players' understanding, actions and interactions. Specific findings are noted in the

corresponding terms of the ER Framework. In this way, the readers can understand the theoretical implications of the specific finding. Next, it summarises the empirical findings by using the terms of the ER Framework to emphasise their theoretical implications. Finally, any finding which appears to disagree to specific argument of the framework is singled out for specific scrutiny. If an explanation can be made convincingly for this specific disagreement, the ER Framework can be concluded as plausible to interpret the empirical phenomenon of RC. The case studies will cover the following aspects and focuses of attention<sup>15</sup>. Their theoretical implications will be noted specifically in the text.

*Regulating side* The focuses of attention are the representative agency's upward accountability and inter-agency cooperation; interest and strategy of RC; preference of firm; commitment and balance of practicing facilitation versus restriction; differentiation in business attraction and enforcement. It is noted that the agency's upward accountability and inter-agency cooperation are the 'grid' and 'group' respectively, which are institutional. The focus on them implies an attention to the institutions on the regulating side.

*Regulated side* The focuses of attention are the firm's size and investment origin; preference of regime; stance toward formal and informal control; intentioned and informed manner.

*Two-sided Marriage and Match* The focuses of attention are the agency-firm relational distance; status, mode, interest, value, trust and accountability in bilateral working contact; regularity and irregularity of arrangements including regulatory incident and problem; effect of firm's voice; firm's tendency of exit or loyalty. Wherever possible, judgment is involved for facilitative and restrictive responsiveness; certainty and flexibility; innovation, legitimacy and instrumentality. The implications of the regime-firm match are to be articulated.

*RC outcomes* The focuses of attention are the regime's open profile and the structure of domiciled firms. The indicators for business attraction, enforcement effect and regulatory advantage are to be articulated, which include the match of the types of regime and firm; and efficient, burdensome, lax or deterrent performance.

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<sup>15</sup> These aspects and focuses are covered by the questionnaires used in the interviews. See the questionnaires in Appendix II.

## 2. Sample Country, Cities and Cases

Involved in the empirical research are the sample country (macro), city (middle) and sub-city jurisdiction (micro). China is chosen as the sample country because it evidently has prevailing inter-jurisdictional RC for foreign investment<sup>16</sup> and is the most successful developing country in attracting foreign investment<sup>17</sup>. The foreign investment sector is chosen to typically demonstrate issues that are relevant to RC for attracting business. The foreign funded electronics and toy manufacturers are chosen as the sample sectors under scrutiny. The two industries typically reflect the distinctive stances and strategies towards attracting foreign investment of the Chinese national government and its agencies<sup>18</sup>. The rationale of the sample choice is that, if the empirical finding in the typical foreign investment sector does not challenge the ER Framework, it is convincing to claim the plausibility of the framework.

Two coastal cities are chosen for the empirical research. One is the city of Shenzhen, in the Province of Guangdong in southern China (the Pearl River Delta) and the other is the city of Suzhou, in the Province of Jiangsu in eastern China (the Yangtze River Delta). Since the two cities are located in different regions of the country, the information collected from them is significant in terms of both contextual difference and contextual comparison. Notwithstanding China's overall achievement, there is considerable regional disparity in the way and effect of competing for foreign investment. The two chosen cities are active in competing for foreign investment and are widely acknowledged as the most successful among all Chinese cities in this regard<sup>19</sup>. Being in the economically developed eastern and southern regions, they are obliged to compete for quality rather than ordinary foreign investment. Accordingly, they are regarded as representative of RC and advantage. The rationale underpinning the selection of these cities is that, if in the most advantageous areas the micro regimes, namely sub-city jurisdictions (SCJs), are found to have different RC and enforcement practices and outcomes, it is more likely to find that the micro regimes in less advantageous areas are different in RC and enforcement practices and outcomes. Thus to choose cases from

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<sup>16</sup> For more details, see a later section of this chapter. Interview CAZD

<sup>17</sup> For relevant information, see <Foreign Direct Investment: The China Story> at the website of the World Bank Bank <http://www.worldbank.org/en/news/2010/07/16/foreign-direct-investment-china-story>. For relevant research about foreign investment in China, see Fetscherin, Voss and Gugler (2010)

<sup>18</sup> For more details, see the Appendix I.

<sup>19</sup> Reference includes a research carried out by the Institute of Industrial Economics of the Chinese Academy of Social Science and the China Business in 2006 with a finding that Shenzhen and Suzhou were voted by multi-internationals as the Number One investment-worthy cities respectively in the south and east China (<http://finance.sina.com.cn/focus/kggsjz2006/index.shtml>)

advantageous areas is helpful to examine the plausibility of the ER Framework. Whereas the cases are selected from the well-acknowledged advantageous cities, at first glance, they appear to be selected based on the outcome of RC so that the selection is suspect of reverse engineering<sup>20</sup>. Yet a more careful check will find that the cities themselves are not the sample cases, but their SCJs are. The cities serve no more than the middle-level context of the sample cases. Therefore the selection is free from such worries.

The SCJ is the sample case<sup>21</sup>. The SCJs involved in the case studies are incidentally chosen because they are the abodes of the accessible informants<sup>22</sup>. All the SCJs are randomly selected. They are indicative and none is representative of the archetyped regime. Random selection avoids systematic bias of empirical research (King, Keohane and Verba: 1994). The SCJs are of myriad types – special investment zones (SIZs) and non-SIZs; entities established by the governments of different levels – national, provincial and municipal; and empowered with integrated or fragmented regulatory authorities and targets. Each SCJ has its particular local context and ‘rules of the game’. The agencies and regulated FOEs have distinctive cognitive, behavioural and interactive features. The empirical research of the SCJ concentrates on the enforcement practice and process of the agencies, as addressed by the ER Framework. All governmental agencies based in an SCJ make up the regime. Meanwhile, the general-purpose agency, not the specific-task agency, is considered as the representative of the regime.

The distinction of the type of regime is made according to its official accountability. An SIZ has stronger ‘grid’, while a non-SIZ does not. In this research, an SIZ is defined as *all types of zones that are approved to establish by the Chinese national government for the primary purpose of competing for overseas investment*. Examples of SIZ are export processing zone, free trade zone and high-tech development zone<sup>23</sup>. A zone that is set up by a sub-national government even for the same purpose in a similar name is not an SIZ. An SIZ is entrenched with municipal, provincial and national governments’ special commitment and is particularly accountable for its business-attracting achievement. It is subject to wide exposure and imposed accountability for its performance to the authorities above municipal level. The achievement of an SIZ is reported with updated information

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<sup>20</sup> For the problem incurred in this regard, see King et al (1994).

<sup>21</sup> This part focuses on addressing the institutional properties of cases. Concerning how these cases, namely SCJs, became the subject of scrutiny, see the section about the method of empirical research in Appendix I and II.

<sup>22</sup> For the details about the informants, see the following section and the Appendix I.

<sup>23</sup> See the official website of the CADZ.

regularly at the official website of the China Association of Development Zones (CADZ). In contrast, a non-SIZ at the sub-city level is generally accountable to the village, town or county authority. Its performance is mostly unknown to the public. Attracting business is only one of the regime's regulatory goals, for which it is not particularly accountable.

### **3. A Snapshot of Hierarchy of Regimes**

Foreign investment is regarded as a trade-related issue by the Chinese national government as well as by the WTO<sup>24</sup>. Foreign investment had been introduced to promote the country's exports. By 2010, more than 50% of the country's trade and 84% of its processing trade were contributed by foreign invested manufacturers<sup>25</sup>. Accordingly, foreign investment was governed by the foreign trade regime of China. The WTO Trade Policy Reviews 2006 (WT/TPR/S/161/Rev.1) identified the foreign investment enforcement regime<sup>26</sup> of China as characteristic of hierarchy. This hierarchy comprised three layers of regimes, at macro (national), middle (provincial and municipal) and micro (sub-city, namely county, town and village) levels. Correspondingly, there were three levels of enforcement agencies<sup>27</sup>.

At the macro level, the Ministry of Commerce (MOFCOM) was the specific agency that was delegated with the main authority for promoting and facilitating foreign investment, as well as formulating, implementing and coordinating all foreign investment related rules, including laws, regulations and policies<sup>28</sup>. Other national agencies involved in implementing foreign investment rules included the National Development and Reform Commission, the Ministry of Finance, the General Administration of Customs, and the Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) (see Table 4.1). These agencies were all constituents of the national or central government, namely the State Council. As the highest-level executive, the State Council was accountable to the national legislature, namely the National People's Congress.

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<sup>24</sup> See the website of the Ministry of Commerce (MOFCOM) at <http://www.gov.cn/fwxx/bw/swb/index.htm>; and the WTO Trade Policy Review 2006 WT/TPR/S161/Rev.1

<sup>25</sup> The WTO TPR 2010 Part 3 'Foreign Investment Regime' pp21-22

<sup>26</sup> Hereinafter simplified as 'the regime'

<sup>27</sup> Hereinafter simplified as 'the agency'

<sup>28</sup> See WT/TPR/S/161, pp40-43. Hereinafter, law, regulation and policy of all sorts are referred simply as 'rule'.

Regulator	Main responsibility
Ministry of Commerce (MOFCOM)	Policy coordination and implementation for all trade-related issues
Policy Research Department	Proposing trade policy
Department of Treaty and Law	Formulating laws and regulations related to trade, international economic cooperation and foreign investment; facilitating bilateral and regional trade negotiations and IPR related issues; and dispute settlement negotiations
Department of Foreign Investment Administration	Guiding foreign investment, formulating relevant laws and regulations, and administering foreign-invested projects
Bureau of Fair Trade for Import and Export Bureau of Industry Injury Investigation	Formulating anti-dumping, countervailing, and safeguard regulations, and taking relevant measures
Bureau of Quota and Licence Affairs	Administering import and export quotas
Investment Promotion Agency	Promoting foreign investment
Trade Development Bureau	Promoting international trade
National Development and Reform Commission	Guiding overall economic reforms; formulating policies for economic and social development, such as industry policy and energy policy; and restructuring the investment regime
Ministry of Finance	Fiscal policy, tariff, government procurement, tax policy
People's Bank of China (the Central Bank)	Overall monetary and exchange rate policies; regulating inter-bank lending market and inter-bank bond market; managing the State treasury; and maintaining financial market and banking system stability
State Administration of Foreign Exchange (SAFE)	Subordinate execution body of the Central Bank on exchange rate policies
Ministry of Land and Resources	Natural resources
General Administration of Customs	Enforcing customs legislation, levying and collecting customs duties and other taxes, and preparing and submitting customs statistical data
State Administration of Taxation	Taxation policies
National Bureau of Statistics	Macroeconomic development statistics

Regulator	Main responsibility
State Administration for Industry and Commerce	Facilitating fair trade, protecting consumer benefits, registering enterprises, including foreign-invested enterprises, supervising trade marks, and market regulation, etc.
General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) China Standardization Administration (SAC) China National Certification and Accreditation Administration	Standardization, quality certification, testing, surveillance, and metrology
State Intellectual Property Office (SOIPP)	Proposing guidance, plans, and policy recommendations on IPR protection work; supervising the disposal of major IPR infringement cases; communicating and coordinating with foreign investment enterprises; enforcing IPR laws, and conducting international exchanges and cooperation
State Food and Drug Administration	Supervising the safety management of food, health food, and cosmetics; and regulating drugs
Legislation Affairs Office of the State Council	Drafting laws and regulations
National Bureau of Energy*	Formulating energy development strategy, plan and policy
Ministry of Industry and Information Technology (MIIT)*	Carrying out research; proposing industry development strategy; formulating and implementing industry and sectoral plan, policy and regulations
Ministry of Human Resource and Social Security (MOHRSS)*	Drafting labour laws, policies, standards and regulations; managing social security
Ministry of Environmental Protection*	Drafting and implementing laws and regulations concerning environmental protection

Table 4.1 National Enforcement Agencies of Foreign Investment Rules

\* Source: WTO Secretariat, based on Chinese Government online information.

\* Added by the author. These were established in the institutional change between the WTO TPRs in 2008 and 2010.

At the middle and micro levels, the composition and structure of the agencies roughly mirrored those at the national level. There were a few exceptions. For instance, the General Administration of Customs and AQSIQ were national agencies. Whereas the practice of their sub-national branches was based locally,

they were independent from sub-national governments. The sub-national agencies at the same levels were the constituents and affiliates of the governments at corresponding levels<sup>29</sup>. These agencies were obliged to implement the rules set by their sub-national legislatures and governments. At the same time, they implemented the specific rules that were set by the corresponding superior agencies (see Diagram V).

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<sup>29</sup> See Mertha (2006)

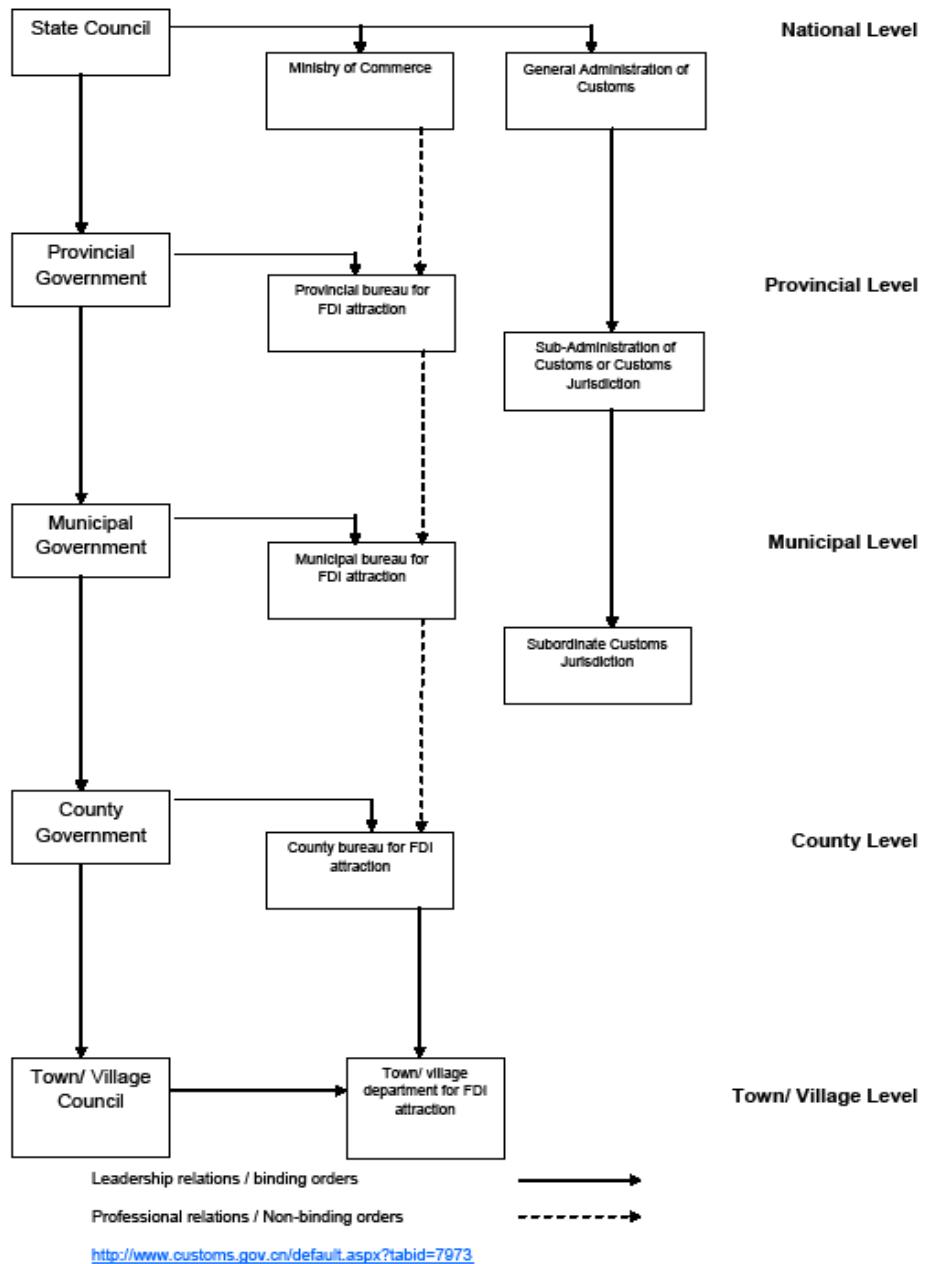


Diagram V Vertical Governmental Relations Exemplified by Two Enforcement Agencies

Note:

1. This diagram adapts from the Figure 5.3 China's anti-counterfeiting bureaucracy of Mertha (2005) pp190. The agencies that are chosen as examples are edited and different from Mertha's diagram.
2. The relations within the organisational system of the Customs refer to the information at the official website of the General Administration of Customs of the People's Republic of China at <http://www.customs.gov.cn/default.aspx?tabid=7973>. The levels of customs' jurisdictions are not corresponding to those of the sub-national governments

#### 4. Macro Regime

Identified in the Table 4.1, the national agencies were not directly involved in RC inside China<sup>30</sup>. Instead, they played dual roles: the rule maker and the rule implementer. As the rule maker, the agencies set national rules and strategies for foreign investment attraction. As the rule implementer, they practised downwardly and outwardly. Downwardly, they monitored the implementation of sub-national governments' activity. Outwardly, they reacted to foreign trading partners' voice strategically.

##### 4.1 Setting Benchmark for Legitimacy

The national government formulated not only administrative rules but also some laws. Its affiliated agencies issued departmental rules<sup>31</sup>. These rules took force in the whole country. Governing the foreign investment affairs, there was no general foreign investment law but a synthesis of specific national rules<sup>32</sup>. These rules included the <Law on Chinese-Foreign Equity Joint-Ventures>, <Law on Chinese-Foreign Contractual Joint-Ventures>, <Law on Foreign Capital Enterprises>, <Provisions on Foreign Invested Investment Companies>, <Company Law>, <Contract Law>, <Insurance Law>, <Arbitration Law>, <Labour Law>, <Provisional Regulations on Value-Added Tax>, <Provisional Regulations on Consumption Tax>, <Provisional Regulations on Business Tax>, and <Law on Protection of Investment by Compatriots from Taiwan><sup>33</sup>. The specificity of the rules implied more practicality for implementation than articulating the ideology<sup>34</sup>.

The national government articulated the ideology particularly in non-legal forms. This was incarnated in a set of strategies, typically, the <11<sup>th</sup> Five-Year Layout for Using Foreign Investment>, <Guiding Catalogue of Industries for Foreign Investment> and <Catalogue of Favoured Industries for Foreign Investment in Middle and Western Regions><sup>35</sup>. Indeed, these strategies set the national benchmark for judging the legitimacy of foreign investment related practice.

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<sup>30</sup> The Investment Promotion Agency affiliated to the MOFCOM was competing with other countries for foreign investment.

<sup>31</sup> See WT/TPR/S/161, pp36

<sup>32</sup> 'Laws and regulations' are the terms used by the WTO in its Trade Policy Review 2006. I use the term 'rule' to refer to all sorts of regulatory documents issued by the Chinese government.

<sup>33</sup> The WTO TPR 2008 Part 3 gives the source as 'Invest in China' at [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/GeneralLawsandRegulations/BasicLaws/t20060620\\_50886.jsp](http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/BasicLaws/t20060620_50886.jsp) [11 February 2008]

<sup>34</sup> Black (1999)

<sup>35</sup> Since both sampled cities of the case study locate in the successful eastern coastal region, the information for western and central regions is generally limited.

In 2006, for the first time, the national government explicitly redefined the objectives of foreign investment tasks in the <11<sup>th</sup> Five-Year Layout for Using Foreign Investment><sup>36</sup>. The Layout was drafted based on consulting 40 members and affiliates of the State Council including the Ministries of Foreign Affairs, Finance, Commerce and the People's Bank; 11 trade associations; the development and reform organisations of local governments; and some research institutes, enterprises, experts and scholars. The Layout became a new part of the five-year layout of the national economy<sup>37</sup>. The five-year plan was the plan for developing the national economy within a specified five years. It stipulated the nation's key construction projects, productivity distribution and major proportionality of the national economy, as well as the goals and directions in the five-year duration.

The Layout charted the '*guiding ideology and general strategic goal* for attracting foreign investment for the years between 2006 and 2010<sup>38</sup>. The main points were: '*Push further the use of foreign investment to change fundamentally from 'quantity' to 'quality', so as to truly shift the keystone of the use of foreign investment from supplementing the shortage of capital and foreign currency to fetching in advanced technology, managerial skills and high-quality talents. Attach more importance to ecological construction, environmental protection, and a comprehensive and saving utilisation of resources and energy. Truly marry the use of foreign investment with the improvement of national industrial structure and technological standard.*' '*Try hard to divert the foreign investment from simple processing, assembling and low-standard manufactures to the new areas such as research and development, high-end design... etc. Propel our country to become one of the global making bases for the products with high added value... Further strengthen the economic globalisation and international competitiveness of the east coastal area.*'

The guidelines of the Layout were reflected in the relevant laws enacted later. Typically, <Law of the People's Republic of China on Foreign Funded Enterprises>

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<sup>36</sup> Herein after simplified as 'the Layout'. More specific details will be given in the following sub-section. Drafted and promulgated by the National Development and Reform Commission on 9<sup>th</sup> November 2006. For the full text, see <http://finance.people.com.cn/BIG5/8215/74587/74589/5068303.html>. This document is named as 'Layout' rather than 'Plan' as before 2006 in order to highlight the change in the Chinese government's perception in terms of attaching more importance to the basic role played by the market in allocating resources while emphasising the governmental role as macro regulator and strategy setter. For more details, see <http://theory.people.com.cn/GB/40557/54239/54241/3779457.html>.

<sup>37</sup> The 'Five-year plan' is part of the plan for the national economy of China. For details, see 'China's Ten Five-Year Plans and Eleventh Layout' at <http://www.chinanews.com.cn/news/2006/2006-02-21/8/692907.shtml>.

<sup>38</sup> See Preamble and Part Two of the Layout at <http://finance.people.com.cn/BIG5/8215/74587/74589/5068303.html>.

and <Law of the People's Republic of China on Joint-Ventures Using Chinese and Foreign Investment>, both of which were enacted on 16th March 2007. Article 3 of the former stipulated '*A foreign-funded enterprise to be established must benefit the development of China's national economy and be capable of gaining remarkable economic results. The state encourages foreign-funded enterprises to use advanced technology and equipment, engage in the development of new products, realise the upgrading of products and the replacement of old products with new ones, economise energy and raw materials, and it is also encouraged to establish foreign-funded enterprises which are export oriented.*' Article 5 stated that the application to establish an enterprise will be declined if it is '*not in keeping with the requirements of China's national economic development*' or '*may result in environmental pollution.*' Article 3 of the latter stated: '*Joint ventures established within China's territory should be able to promote the development of China's economy and the raising of scientific and technological standards for the benefit of socialist modernisation. The industries in which the establishment of joint venture is encouraged, permitted, restricted or prohibited shall follow the provisions of the state on guiding the direction of foreign investment and the guiding catalogue of foreign-funded industries.*'<sup>39</sup>

The Layout further specified the main foreign investment tasks for different regions of the country<sup>40</sup>. For the successful south and east coastal regions, the main tasks included firstly, '*to be the first to accomplish the transformation in the use of foreign investment from 'quantity' to 'quality', and 'to strengthen international competitiveness and sustainable development capacity.*' Secondly, '*to optimise the structure of the origin of foreign investment, actively enlarge the investment scale from the developed economic entities that possess advanced technologies and management skills such as the European Union, North America and Japan, etc.*' Thirdly, '*to reduce the affairs required by the administrative examination and approval, and faithfully standardise and simplify working procedures so as to create a fair and predictable policy environment for the enterprises.*' Fourthly, '*to actively push forward general construction for customs clearance, so as to improve efficiency.*' Lastly, based on the evolution and change of the economic situation, dynamically adjust <Guiding Catalogue of Industries for Foreign Investment>.

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<sup>39</sup> For details, see respectively <http://english.mofcom.gov.cn/aarticle/policyrelease/internationalpolicy/200703/20070304465919.html> and <http://english.mofcom.gov.cn/aarticle/policyrelease/internationalpolicy/200703/20070304465395.html>

<sup>40</sup> Since both sampled cities of the case study locate in the successful eastern coastal region, the information for other regions is generally omitted.

The <Guiding Catalogue of Industries for Foreign Investment><sup>41</sup> was supplementary to the Layout in thumbnail terms. It classified the industries into three categories: encouraged, restricted and prohibited. The industries that encouraged foreign investment mainly included new energy, new materials, biological pharmaceuticals, high-end manufacturing and information industries. Multi-nationals were encouraged to establish their research and development (R&D) centres as well as to extend their industrial chains in China. The Catalogue shared the guiding role of the Layout. This was evident in the relevant enactments and rules. For example, Article 4 of <Law of the People's Republic of China on Foreign Funded Enterprises> stated: '*Trades in which the establishment of foreign-funded enterprises is forbidden or restricted shall be determined and established according to the provisions regarding state guidance for foreign investment orientation and guiding catalogue of industries for foreign investment.*' The Catalogue was also a more dynamic instrument than the Layout. Whereas the Layout was updated once in five years, the Catalogue was revised more frequently. The national government made three revisions of it between 2002 and 2007<sup>42</sup>. In September 2010, the head of the Foreign Investment Bureau of the MOFCOM released that the Catalogue was under revision.

The national government kept updating the general guideline and strategy in order to catch up with the changing regulatory conditions dynamically. The update of the Layout and the Catalogues were examples. In addition, it issued new rules whenever it perceived it to be necessary. For instance, on 6<sup>th</sup> April 2010, it issued the <State Council's Opinions in Further Making Good Use of Foreign Investment>. To strengthen the implementation of the opinions, the national government issued an additional document to clarify the authorities delegated to specific ministries<sup>43</sup>.

#### **4.2 Downward Monitoring**

The national government's downward monitoring was a feature of RC. This feature manifested in reiterating its standpoint regarding competitive measures and administrative procedures. For the former, the national government discouraged the use of favourable financial conditions and low labour and environmental standards, especially in the successful south and east regions. For the latter, it encouraged the improvement of the credibility, operational transparency and efficiency of subordinate governments.

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<sup>41</sup> Simplified as 'the Catalogue'. For the full text of the 2007 revision which went into effect on 1st December 2007, see <http://www.sdpcc.gov.cn/zcfbl/2007ling/W020071107537750156652.pdf>.

<sup>42</sup> See [http://www.ce.cn/macro/more/201009/16/t20100916\\_21823075.shtml](http://www.ce.cn/macro/more/201009/16/t20100916_21823075.shtml).

<sup>43</sup> See [http://www.gov.cn/zwgk/2010-04/13/content\\_1579732.htm](http://www.gov.cn/zwgk/2010-04/13/content_1579732.htm) and [http://www.gov.cn/zwgk/2010-08/19/content\\_1683980.htm](http://www.gov.cn/zwgk/2010-08/19/content_1683980.htm).

Witnessing some cities in the Yangtze River Delta (YRD) competing for foreign investment by minimising land prices and tax rates and admitting polluting projects<sup>44</sup>, the national government issued *<The State Council's Instructive Opinion about Further Propelling Reform, Open-Up, Economic and Social Development in Yangtze River Delta>* on 7<sup>th</sup> September 2008<sup>45</sup>. In Article 11(39), the Opinion affirmed '*standardising the behaviour of promoting business and investment, adopting comparatively unified policies governing the land and taxes, and creating a fair and open investment environment.*' It was acknowledged as the national government's formal '*call to end the vicious competition for foreign investment*' in this region<sup>46</sup>. While the national government tightened restrictions for the developed south and east regions, it allowed the governments in the less developed middle and western regions the discretion to further open policies towards foreign investment. These included the continuous application of favourable income tax rates to the enterprises that met the governmental requirements. The aim of the relaxed rule was stated as '*to orient the transfer and increase the foreign investment into the middle and western region.*'<sup>47</sup>

The *<Labour Contract Law of the People's Republic of China>* promulgated in June 2007<sup>48</sup> was well-acknowledged to provide more specific and practical protection to the employees than the 1995 *<Labour Law of the People's Republic of China>*<sup>49</sup>. On 6<sup>th</sup> April 2010, the national government officially declared a revision of the *<Catalogue of Favoured Industries for Foreign Investment in Middle and Western Regions>*<sup>50</sup>. In the revised Catalogue, the national government added labour-intensive manufacturing with environmental friendliness into the category of the encouraged industries of these two less successful regions. Meanwhile, it kept on requesting the successful south and east regions to discourage labour-intensive manufacturing and to embrace technology-intensive industries. This revision

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<sup>44</sup> See *<Why to Set 'Threshold' for Foreign Investment Attraction? A Reflection of Role of Foreign Investment>* at <http://media.163.com/05/0601/15/1L5VPM1B00141E4V.html>.

<sup>45</sup> For the full text, see [http://news.xinhuanet.com/fortune/2008-09/25/content\\_10107100.htm](http://news.xinhuanet.com/fortune/2008-09/25/content_10107100.htm). This rule is referred hereinafter as 'the Opinion'.

<sup>46</sup> See *<State Council Issues Opinion to Call 'Stop' to Vicious Competition for Foreign Investment in Yangtze River Delta>* [http://news.xinhuanet.com/fortune/2008-09/25/content\\_10107179.htm](http://news.xinhuanet.com/fortune/2008-09/25/content_10107179.htm).

<sup>47</sup> See the Article II (8), (9) and (10) of the Footnote

<sup>48</sup> See <http://english.mofcom.gov.cn/article/policyrelease/internationalpolicy/200703/20070304475283.html>

<sup>49</sup> 'How to Interpret New Labour Contract Law' see [http://news.xinhuanet.com/comments/2007-07/16/content\\_6380415.htm](http://news.xinhuanet.com/comments/2007-07/16/content_6380415.htm).

<sup>50</sup> For details, see *<State Council's Opinions about Making Better Use of Foreign Investment>* at [http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426\\_342583.htm](http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426_342583.htm).

exemplified the national government's lively monitoring and differential interventions in foreign investment attraction in the successful and less successful regions.

In a direct sense, the national government emphasised a stringent ban on the entry of polluting industries in the Layout<sup>51</sup>. In an indirect sense, it listed 113 cities as the Key Environmentally Protected Cities and accordingly applied the highest relevant standards<sup>52</sup>. In the list were the municipalities, provincial capitals and industrial centres. The two sample cities for using the ER Framework, namely Shenzhen and Suzhou, were included in the list.

The national government had decentralised most approval authorities. The limited authorities it reserved were (1) approving the projects with an investment amount over 300 million USD in the encouraged and permitted categories; (2) verifying the projects that were specified particularly in the <Catalogue of Investment Projects Subject to Governmental Verification>. Nevertheless, it was still active in monitoring the subordinate governments' operation. This was embodied in the 2010 <State Council's Opinions about Further Making Good Use of Foreign Investment><sup>53</sup>. It requested the middle-level governments and agencies to optimise the examination and approval system in terms of simplifying the processes, minimising the covered subjects and shortening the processing time. The national government strongly promoted an on-line examination and approval system so as to make the agencies' actions and behaviour transparent, standardised, legally-binding and simple<sup>54</sup>. Particularly, the customs were asked to make a great effort to improve the efficiency of customs clearance.

#### 4.3 Outwards Reaction

The WTO TPR 2006 commented that the fast change of rules was typical of 'the complexity' of the Chinese foreign investment regime. It attributed frequent rule-change to the national government's quick response to the contingency of globalised economic conditions. An FOE interviewee gave an example as to how quick a rule-change could be<sup>55</sup>. In 2008, alarmed by the increased inflow of trans-border mobile capital that seemed to speculate on the stocks, real estate and household materials, the National Foreign Currency Regulatory Bureau, the

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<sup>51</sup> See <http://finance.people.com.cn/GB/70392/5068395.html>.

<sup>52</sup> See <State Council Issues 11<sup>th</sup> Five-Year Layout for National Environmental Protection> <http://www.chinanews.com.cn/gn/news/2007/11-26/1087490.shtml>.

<sup>53</sup> See [http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426\\_342583.htm](http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426_342583.htm).

<sup>54</sup> See [http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426\\_342583.htm](http://wzs.ndrc.gov.cn/zcfg/zhp/t20100426_342583.htm).

<sup>55</sup> Interview EJSI2E

MOFCOM and the General Customs jointly issued the < Measures for Online Inspection of Foreign Currency Collection and Settlement of Export Proceeds><sup>56</sup>. This regulation was announced on 2<sup>nd</sup> July and went into effect on 14<sup>th</sup> July. Accordingly the FOEs had to put their export earnings in their export accounts for the regulators to verify the authenticity before being able to further use them. The FOE interviewee commented a change like this, while being unpredictable, was not unusual.

The national government demonstrated sensitivity to particular concerns expressed by the main trading partners of China, typically the USA and the EU<sup>57</sup>. Referring to the Layout, the likely underpinning reason was that the national government regarded the USA and the EU not only as the most desired overseas investment origins but also as the major markets for China's export products. The government was attentive to these big trading partners' concerns in order to quickly ameliorate negative impacts upon their investment to China and their imports of Chinese-made products. Some examples indicated the characteristics of the outward response by the national government. One regarded the labour issue and the other regarded the product safety issue.

On the occasions when American multinationals were under domestic criticism for their labour abuses in China, the Chinese government and the governmentally-controlled media were strongly on the firms' side. One example was that on 1<sup>st</sup> February 2009, the Pittsburgh-based National Labour Committee published an investigation report to criticise the deplorable working conditions of a Taiwanese-owned factory, which was producing computer keyboards for IBM, Microsoft, Dell, Lenovo and Hewlett-Packard<sup>58</sup>. In two weeks, the Electronic Industry Citizenship Coalition, of which all the named and shamed companies were members, responded by initiating a third-party audit<sup>59</sup>. Leaving the result aside, on 25<sup>th</sup> March, the Beijing-based Xinhua News Agency<sup>60</sup> published a so-called 'special report' giving a notably different account of the story. It asserted the National Labour Committee's report as being '*susceptible to distortion and exaggeration.*' It concluded by quoting anonymous experts' views that some foreign groups were

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<sup>56</sup> For the text in English, see [http://www.safe.gov.cn/model\\_safe\\_en/laws\\_en/laws\\_detail\\_en.jsp?ID=3060000000000000.15&type=&id=3](http://www.safe.gov.cn/model_safe_en/laws_en/laws_detail_en.jsp?ID=3060000000000000.15&type=&id=3).

<sup>57</sup> Mertha's research was an example of the China's legislature's response to the USA's pressure to improve intellectual property rights (IPRs) protection.

<sup>58</sup> See <High Tech Misery in China> at <http://www.nlcnet.org/reports?id=0006>.

<sup>59</sup> See <Tech Coalition Launches Sweatshop Probe> at [http://news.cnet.com/8301-1001\\_3-10164325-92.html](http://news.cnet.com/8301-1001_3-10164325-92.html)

<sup>60</sup> This news agency has a similar status as the BBC in the UK. But rather than independent, it is acknowledged as an agency of the national governmental voice.

keen on ‘exposing the dark-side of the labour rights protection for the sake of relieving domestic employment pressure.’<sup>61</sup> True or not, this example showcased the importance attached by the government to the interest of the multinationals. There was another example in this regard. Foxconn, the world’s largest maker of electronic components as well as the largest contracted manufacturer of the Apple iPhone, iPod and iPad<sup>62</sup> had 15 workers who committed suicide between January and November 2010<sup>63</sup>. Soon after the press conference held by Foxconn’s Chairman Terry Gou on 26<sup>th</sup> May<sup>64</sup> and the entry of the investigation group led by the National Federation of Trade Unions and the MOHRSS on 28<sup>th</sup> May<sup>65</sup>, the major Chinese media agencies got an order from the Central Propaganda Department to refrain from uttering negative words against Foxconn<sup>66</sup>. These examples showed that the national government inclined to sympathise with and comfort the big high-tech multinationals regarding labour issues. Likely, its intention was to avoid negative impact upon the inflow of the most desired sort of foreign investment and sale of Chinese-made products caused by a deplorable labour protection image.

In contrast, the national government seemed to be limitedly tolerant towards product quality and safety issues. A typical example was the national government’s reaction towards Mattel’s recall of Chinese-manufactured toys. In August and September 2007, Mattel, the biggest toy seller in the USA, recalled more than 18 million toys because they contained either magnets that had the potential of being swallowed or they had excessive lead in the paint<sup>67</sup>. The national government reacted in four ways. The first way was that the AQSIQ immediately organised an investigation and declared the result. It tracked down the liable enterprise with investment originated

<sup>61</sup> <Special Report: Survey of ‘Sweatshop’ in Dongguan Exposed by the USA> [http://news.xinhuanet.com/focus/2009-03/25/content\\_11057607.htm](http://news.xinhuanet.com/focus/2009-03/25/content_11057607.htm).

<sup>62</sup> <http://www.foxconn.com/CompanyIntro.html> and <http://en.wikipedia.org/wiki/Foxconn>.

<sup>63</sup> See <Steve Jobs Says Apple is ‘All Over’ Foxconn Suicides> <http://www.telegraph.co.uk/finance/china-business/7798741/Steve-Jobs-says-Apple-is-all-over-Foxconn-suicides.html> and <Foxconn’s New Suicide Fear, 14th Worker Died> <http://www.telegraph.co.uk/finance/china-business/7929938/Foxconn-faces-fresh-suicide-fears-as-14th-worker-dies.html>. For broad reports, see <Comprehensive Report about Workers’ Suicides in Foxconn> [http://www.worldjournal.com/pages/wjtopics?widget=search\\_content&tags=topic523&id=+1-%E5%AF%8C%E5%A3%AB%E5%BA%B7%E5%93%A1%E5%B7%A5%E8%B7%B3%E6%A8%93%E4%B%A%8B%E4%BB%B6%E7%B6%9C%E5%90%88%E5%A0%B1%E5%B0%8E](http://www.worldjournal.com/pages/wjtopics?widget=search_content&tags=topic523&id=+1-%E5%AF%8C%E5%A3%AB%E5%BA%B7%E5%93%A1%E5%B7%A5%E8%B7%B3%E6%A8%93%E4%B%A%8B%E4%BB%B6%E7%B6%9C%E5%90%88%E5%A0%B1%E5%B0%8E)

<sup>64</sup> See <Foxconn CEO Officially Meet the Press> at [http://www.msnbc.msn.com/id/37354853/ns/business-world\\_business](http://www.msnbc.msn.com/id/37354853/ns/business-world_business) and <Chinese Factory Asks ‘No Suicide’ Vow> [http://www.msnbc.msn.com/id/37354853/ns/business-world\\_business](http://www.msnbc.msn.com/id/37354853/ns/business-world_business)

<sup>65</sup> <Investigation Group from National Government Entered Foxconn This Morning> [http://xinmin.news365.com.cn/jd/201005/20100528\\_2720514.htm](http://xinmin.news365.com.cn/jd/201005/20100528_2720514.htm)

<sup>66</sup> <‘Foxconn Effect’ Central Propaganda Department Bans Report> [http://www.worldjournal.com/view/full\\_news/7918090/article-%E3%80%8C%E5%AF%8C%E5%A3%AB%E5%BA%B7%E6%95%88%E6%87%89%E3%80%8D-%E4%B8%AD%E5%AE%A3%E9%83%A8%E7%A6%81%E5%A0%B1%E5%B0%8E-?instance=hot](http://www.worldjournal.com/view/full_news/7918090/article-%E3%80%8C%E5%AF%8C%E5%A3%AB%E5%BA%B7%E6%95%88%E6%87%89%E3%80%8D-%E4%B8%AD%E5%AE%A3%E9%83%A8%E7%A6%81%E5%A0%B1%E5%B0%8E-?instance=hot)

<sup>67</sup> [http://news.wanju.cn/12\\_15169.html](http://news.wanju.cn/12_15169.html)

from Hong Kong and banned it from exports. The police department was invited to find out the paint maker and arrest three responsible persons of the contracted paint supplier. The production of the toy-maker was stopped totally. The Hong Kong boss committed suicide, followed by dissolution of the company and redundancy of 2,500 workers. The second way was that on 27<sup>th</sup> August, the AQSIQ issued an unprecedented rule titled <Provision of Recall of Toys for Children>, which took immediate effect<sup>68</sup>. The third way was that the national government pressurised Mattel into apologising for its 'exaggeration' about the safety problems of Chinese-made toys<sup>69</sup>. The fourth way was that the national government summoned a television-telephone conference on 23<sup>rd</sup> August to arrange a country-wide special campaign to examine the quality and safety of products<sup>70</sup>. On 21<sup>st</sup> November 2007, the AQSIQ summoned another television-telephone conference to arrange a country-wide special campaign to examine exported toys<sup>71</sup>. The goal was to 'safeguard the national image and reputation.' The AQSIQ then dispatched working groups to monitor the process of the campaign to the six main production bases, namely the provinces of Guangdong, Jiangsu, Shandong, Zhejiang and the cities of Shenzhen and Shanghai. The consequence was that more than 3,000 export-oriented enterprises were scrutinised. Among them, more than 600 toy-producers' export licences were revoked due to their '*incomplete quality control system and unstable product quality.*'<sup>72</sup>

According to an interview with an official from the AQSIQ<sup>73</sup>, the country-wide special campaigns were not only triggered by Mattel's recalls<sup>74</sup>. There were many other incidents and complaints about Chinese-made products sold in the USA and Japan both earlier and later. These included pet food, seafood, automobile tyres, toothpaste, beach buggies, and heat-resistant pans. Meanwhile, a big safety scandal was exposed concerning melamine-stained baby milk powder that was made and consumed domestically<sup>75</sup>. The report about the babies' kidney dysfunction caused by drinking the poisoned milk powder was first publicised

<sup>68</sup> [http://www.gov.cn/flfg/2007-09/03/content\\_735585.htm](http://www.gov.cn/flfg/2007-09/03/content_735585.htm)

<sup>69</sup> [http://news.xinhuanet.com/fortune/2007-09/22/content\\_6767059.htm](http://news.xinhuanet.com/fortune/2007-09/22/content_6767059.htm)

<sup>70</sup> <http://www.sda.gov.cn/WS01/CL0339/25318.html>

<sup>71</sup> [http://jyjgs.aqsiq.gov.cn/gdwx/200711/t20071122\\_55010.htm](http://jyjgs.aqsiq.gov.cn/gdwx/200711/t20071122_55010.htm)

<sup>72</sup> See <Over 600 Toy Enterprises Revoked Export Licences in Special Examination> at <http://huahuangjituancn.exports6/jck1060.htm>

<sup>73</sup> Interview AQSIQ1. This interview was made during the seminar of China's Toy Safety Regulation in the Peking University, Beijing, China in September 2008. The seminar was funded by the LSE Seed Fund for China's toy safety research programme.

<sup>74</sup> Interview AQSIQ1. For more details, see <Who is Damaging 'Made in China'?> at [http://news.xinhuanet.com/world/2007-08/09/content\\_6500995.htm](http://news.xinhuanet.com/world/2007-08/09/content_6500995.htm).

<sup>75</sup> See <NZ Official Blew Whistle on Milk Scare> <http://www.stuff.co.nz/national/628081>

overseas by the producer's New Zealand's shareholder Fonterra. The national government worried about the magnitude of overseas negative opinions towards the quality and safety of the Chinese-made products. '*The reports are detrimental to the image and reputation of Chinese-made products. They will leave the importing countries excuses to set up technical barriers against Chinese-made products.*' At the same time, '*other countries will take over the market share from China.*' Bearing in mind that 80% of processing export was generated by FOEs<sup>76</sup>, the government's response showcased its tough standpoint towards product safety.

To summarise, the characteristics of the national government's outward response are: firstly, the national government held overseas concerns about labour and product safety issues as relevant to foreign investment attraction. The labour issue was relevant as long as an FOE hired local workers. The product safety issue became involved when the product was made by an FOE and sold in a developed country. Secondly, the national government attached an uneven importance to the labour and product safety issues. Indeed, while the labour issue is related to the process standard, it is less visible than the product standard, to which the quality and safety issues appertain. This implies that the government was more attentive to product than process standard in its responses to overseas concerns. Thirdly, the national government's sensitivity and tactics reflected its foreign investment strategy. It tended to be soft towards the constituents of the multinational industrial chains and big FOEs in the high-tech sectors, typically the electronics manufacturers but it was tough towards those in the low-tech sectors, typically toy making. Finally, if necessary, the national government intervened right to the bottom in order to demonstrate its seriousness about the overseas voice. This was typically represented as an organised and highly targeted ad hoc enforcement campaign.

#### **4.4 Summary**

The national government and its affiliated agencies play dual roles in exercising foreign investment duties: the rule maker and the rule implementer. Playing the former role, they cooperate closely and set the benchmark to gauge the legitimacy of the subordinate governments' practice. Thus being selective and making a differentiation according to the firm's industry, investment origin and size as well as balancing between promoting business and enforcing social regulation are representative of legitimacy. Playing the latter role, they are active in monitoring and correcting the subordinate governments' undesirable practice. The concerns

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<sup>76</sup> The WTO TPR 2006

national government show in the lower-level implementation practice suggest its recognition that the success of RC through rule making at macro level would be fundamentally affected by implementation practice at lower level. This implied that macro-level RC through rule-making is closely linked to micro-level RC through rule enforcement. Meanwhile they react quickly to overseas voice or change of conditions. Considering the high accountability, exposure and coordination, macro regime and agencies are characteristic of high grid and high group, namely Adherent. The macro context reveals that when competing for foreign investment, it clarifies the preferred type of investors, sets the benchmark for legitimacy and regulatory goal, attaches importance to formal (vertical dimension of governmental hierarchy) and informal (horizontal cross-border supply chain) enforcement structures as well as alerts the significance of rule enforcement at lower levels.

## **5. Middle and Micro Regimes**

Similar to their counterpart at macro level, the agencies at middle and micro levels were both the rule maker and rule implementer, but differently, the rules made by these agencies were valid only within their respective jurisdictions. Additionally, their implementation involved horizontal competition. Bearing in mind the national government's active top-down monitoring, middle-level competition necessarily demonstrated a concern for legitimacy.

### **5.1 Jurisdictional Disparity**

Jurisdictional disparity was noteworthy at middle and micro levels. This disparity could be said to be a joint outcome of the deliberation of the national government and the authorities of sub-national governments.

The national government inclined to implement unprecedented policies exclusively in specified zones on a 'trial' and 'gradual' basis in order to easily observe their effect<sup>77</sup>. After the trials, the government would decide whether to turn these policies into formal rules to take force in the whole country. On a small scale, the national government approved the establishment of a special economic zone, free trade zone, export-processing zone, economic and technological development zone. Their establishment was to experiment with foreign investment related policies with various emphases. Establishment of the SIZs was learned and copied by the provincial, municipal and even village governments. Yet, the main purpose of these

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<sup>77</sup> See WT/TPR/S/161/Rev.1, pp29

sub-national governments was not experimental but determining: to attract overseas investment. On a large scale, the national government allowed the southern and eastern coastal regions to reform and open up for foreign investment as early as the 1980s and 1990s, but only did the same to the central and western regions after 2000<sup>78</sup>. All these trials had caused jurisdictional disparity, fragmentation and gaps in the foreign investment achievements.

Immediately under the national level, the 31 provincial governments implemented national rules as well as the provincial legislations that were promulgated by their respective People's Congresses<sup>79</sup>. At the same time, they and their affiliated agencies tailor-made provincial rules according to the conditions of their specific provinces. The provincial regulations took effect within the geographical borders of their respective provinces and the localities of lower administrative levels, namely cities, counties, towns and villages. Under the provincial level, the 49 municipal governments implemented national and provincial rules and the municipal legislations that were made by their People's Congresses, which were the lowest-level legislative bodies. Meanwhile, they and their affiliated agencies made municipal rules that took sole effect upon their territories of the cities and localities at sub-city levels. At sub-city level, the counties, towns and villages were not entitled with legislative power, but they and their affiliated agencies were allowed to make local bespoke rules.

## 5.2 Inter-City Competition with Legitimacy

Based on a broad search of the internet, it was evident that the competition for foreign investment continued to prevail throughout the country. Such competition was mostly reported as happening between the cities. For example, Suzhou was reported as the city that by 2006 had attracted the most foreign investment<sup>80</sup>. Shanghai had become the city with most regional headquarters of multinationals as well as foreign funded research and development (R&D) centres in mainland China by September 2010<sup>81</sup>. Chengdu endeavoured to be the city for attracting the most foreign investment in the western region<sup>82</sup>. Chongqing received the most amount of

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<sup>78</sup> For details, see <http://www.chinawest.gov.cn/web/index.asp>.

<sup>79</sup> The term 'provincial' refers to the administrative class, to which the provinces and autonomous regions belong.

<sup>80</sup> See <Suzhou - City Attracted Most Foreign Investment in China – Promoting Business in London> at <http://business.sohu.com/20060504/n243110659.shtml>.

<sup>81</sup> See <http://www.caijing.com.cn/2007-10-22/100034524.html>.

<sup>82</sup> See <http://www.weste.net/2010/8-23/09282428924.html>

actual operational foreign investment in 2009 and 2010<sup>83</sup>. These examples showed that the quantity of attracted foreign investment was still significant to the cities in both the advantageous south and east regions and less advantageous middle and western regions. Meanwhile, the structure of the foreign investment, in terms of the investment origin and destined industrial sector, was emphasised. Specific single projects with an amount more than 50 million USD in the advanced manufactures such as telecommunications, computer and related electronics, and pharmaceuticals were regarded as symbolic for enhancing the cities' prestige<sup>84</sup>. These examples suggested that the cities shared the similarity of using foreign investment intentionally and purposefully according to the strategic goals set by the national government. The implication was that they were attentive to legitimacy when competing for foreign investment.

The governments of the sample cities and their provinces were found to be trying to attune to the regional strategy set by the national government. This was highlighted by two sorts of governmental actions. One sort was general, exemplified by the governments' endeavour to replace the unwanted types of FOEs by the wanted types. The governmental aggressiveness was embodied in slogans such as 'empty the cage for big birds'<sup>85</sup>, 'creating forest to attract phoenixes'<sup>86</sup> and 'twin transfers'<sup>87</sup>. For example, the Guangdong provincial government declared using 'carrot plus stick' to drive labour-intensive manufacturers from the Pearl River Delta (PRD) to the peripheral east, north and west areas of the province<sup>88</sup>. To accommodate the transferred FOEs, the provincial government established 23 Transferred Industrial Parks in these peripheral areas. The 'empty the cage' slogan was quoted often by

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<sup>83</sup> See <Western-Region Version of Attracting Foreign Investment: Chongqing Topped Actual In-Use Foreign Investment in Two Consecutive Years> <http://finance.ifeng.com/city/cq/20100423/2095823.shtml>.

<sup>84</sup> For the criteria for defining the size of a manufacturer, see <Interim Regulation for Criteria of Small and Medium Sized Enterprise> at [http://news.xinhuanet.com/zhengfu/2003-03/07/content\\_764043.htm](http://news.xinhuanet.com/zhengfu/2003-03/07/content_764043.htm). For manufactures, a medium sized enterprise is defined as one with at least 300 employees, total sale RMB 30 million yuan (USD 3.65 million) and investment amount RMB 40 million yuan (USD 5 million). Lower than this criterion is defined as small-sized and higher, big-sized. For examples, see <Big-Sized Firm Swarm in Beijing: Actual Overseas Investment Exceeds USD 3.5 Billion> <http://www.bjonline.net/Channel/content/2010/201007/20100726/14934.html>.

<sup>85</sup> Initiated by the Guangdong provincial government in March 2005, see <Routes of Guangdong's 'Emptying Cage for Big Birds> at <http://www.xyzlove.com/Transshipment/Market/gdthnlxt/gdthnlxt.htm> and <Pearl River Delta Empties Case for Big Birds – 244 Exited and 7000 Newly Entered> at [http://www.stnccchinafin/200803/t20080318\\_748813.html](http://www.stnccchinafin/200803/t20080318_748813.html).

<sup>86</sup> See <People's Government of Guangdong Province: Opinions in Propelling Transformation and Upgrade of Processing Trade> at <http://search.gd.gov.cn/detail?record=10&channelid=8907>.

<sup>87</sup> Means to transfer cheap labour and labour-intensive manufacturers to less successful locations, see <'Twin Transfer' Strategy, New Engine for Upgrading Guangdong> <http://www.gd.xinhuanet.com/zt08/shzhyi/>

<sup>88</sup> <Big Obstacle for Industrial Transfer? Try Carrot Plus Stick> <http://gd.news.163.com/08/0116/10/42AQ3CJ1003600SK.html>

Shanghai<sup>89</sup>. In contrast, in Jiangsu Province, most cities including Suzhou tended to be reserved<sup>90</sup>. The aggressive actions did not seem to please the national government. The People's Daily published an editorial on 27<sup>th</sup> December 2008 to criticise 'some locations' for being biased in perceiving labour-intensive small and medium sized enterprises (SMEs) to be of low productivity and an obstacle to industrial upgrade. 'Emptying the cage' was too harsh for SMEs to survive<sup>91</sup>. Identified from this sort of action were the various understandings of the provincial and municipal governments about the national foreign investment strategy of using foreign investment. It also demonstrated innovation and cross-learning about how to deliver the strategic task among the cities and provinces as well as how to satisfy the national government's verification of legitimacy.

Another sort was specific but also showcased the concern for legitimacy. The cities claimed to be the best or the first in creating certain regulatory effects, typically of labour protection, product safety and environmental protection. The minimum wage standard (MWS) could be used as an indicator of the labour protection standard. Setting and adjusting MWSs was made compulsory for middle-level governments by the MOHRSS at the end of 2003<sup>92</sup>. It was meant to provide a '*legal reference*' for protecting '*the labourers' legal rights of attaining pay*'.<sup>93</sup> However, the middle-level governments used the MWS as an instrument to adjust the labour resource and foreign investment<sup>94</sup>. The year 2008 witnessed coincidental uplifts of the MWSs country-wide. The MWS set by the Guangdong provincial government had been one of the highest. Their growth rate of MWS was 20% for 2010<sup>95</sup>. An official with the MOFCOM justified the active uplift by the Guangdong provincial government as the prerequisite for attracting engineers and skilful workers to the advanced manufacturers<sup>96</sup>. Among the cities, Shenzhen was undoubtedly the most active in lifting the MWS. Being the first city to set the MWS in 1994, it continued to raise the

<sup>89</sup> See <Shanghai Industries Empty the Cage for New Birds, Nantong Jiangsu Sets up Nests for Phoenixs> at <http://218.247.239.222/quy/106607.shtml> and <Empty the Cage for New Birds at the Side of Huangpu River> [http://www.chinasecurities.xinhua.org/xwzx/13/200908/t20090827\\_2193928.htm](http://www.chinasecurities.xinhua.org/xwzx/13/200908/t20090827_2193928.htm).

<sup>90</sup> One exception is Wuxi, see <Ecological Crisis Forces Taihu to Speed up Empty the Cage for New Birds> at <http://finance.ifeng.com/huanbao/zrst/20091009/1312299.shtml>.

<sup>91</sup> See <Local Cage-Empty for New Birds Seem to be Harsh> at <http://bbs1.people.com.cn/postDetail.do?view=2&pageNo=1&treeView=0&id=90091604&boardId=1>.

<sup>92</sup> See <Decision on Minimum Wage> at <http://www.51labour.com/lawcenter/lawshow-29331.html>.

<sup>93</sup> For more details about the MWS system, see <A Short Introduction to China's MWS System> at <http://www.51labour.com/html/3/3023.html>

<sup>94</sup> See <Jiangsu Be the First to Raise MWS – Arousing Heated Discussion about 'Salary Raise'> [http://www.js.xinhuanet.com/xin\\_wen\\_zhong\\_xin/2010-01/29/content\\_18527599.htm](http://www.js.xinhuanet.com/xin_wen_zhong_xin/2010-01/29/content_18527599.htm).

<sup>95</sup> See <Guangdong's MWS Raised to 1100 Yuan Excluding Overtime Subsidy> <http://unn.people.com.cn/GB/14770/21733/11524048.html>

<sup>96</sup> See <Does Guangdong's MWS Determine Future Trend of Chinese Economy?> <http://news.51labour.com/show/95882.html>.

MWS in almost every year. In 2010, the MWS rose to 1,100 RMB yuan (approximately £100) per month<sup>97</sup>. This was the second highest MWS among the big cities, after Shanghai's and equalled those of Guangzhou and Hangzhou<sup>98</sup>. According to the government spokesman, the active up-lift of the MWS by Shenzhen was to enhance the attractiveness for labour resource so as to ameliorate the difficulty of recruitment faced by some enterprises. Comparatively, the city of Suzhou and Jiangsu Province were more reserved in setting higher MWSs than their counterparts in south China. Although Jiangsu was the first to begin raising the MWS in 2010, its growth rate was 12%<sup>99</sup>. The provincial government explained that while it cared about the workers' income level, it was equally concerned about the difficult economic situation faced by the export-oriented enterprises. Hence the government would like to maintain a balance in satisfying the contrasting interests of the two parties.

During the post-Mattel inspection campaign, the cities were in competition regarding product safety and quality. This was also symbolic of the concern of legitimacy. Suzhou claimed to be 'the first' to impose an all-out control method upon the export-oriented toy manufacturers. The method imposed the registration of raw and auxiliary materials contracted processing sites; personnel holding essential posts; and the controls over product design, essential processes of production, quality and safety of final and returned products<sup>100</sup>. Shenzhen emphasised '*100% completion of all assigned tasks*' in the Special Examination Campaign at the end of August 2007. The AQSIQ's branch in Shenzhen enforced 100% of toy-makers to establish quality archives as well as to sign a <Quality Control Liability Statement><sup>101</sup>. Also, the municipal government invited a group of 22 envoys from 14 countries, including the USA, Germany and Argentina, to visit some randomly chosen enterprises to test the quality and safety of their products which resulted in a positive comment upon the Shenzhen-made products being quoted by the American envoy<sup>102</sup>. The government then claimed to adopt 'famous name-brand strategies' and establish the 'Mayor's Quality Award' to enhance the faith of overseas and home consumers in the

<sup>97</sup> See <Shenzhen Press Conference for Adjusting MWS 2010> [http://www.sz.gov.cn/cn/xxgk/xwfyw/wqhg/wbh\\_20100609/](http://www.sz.gov.cn/cn/xxgk/xwfyw/wqhg/wbh_20100609/).

<sup>98</sup> [http://www.sz.gov.cn/sz/fsz/cyc/jqhd/201006/t20100609\\_1545950.htm](http://www.sz.gov.cn/sz/fsz/cyc/jqhd/201006/t20100609_1545950.htm)

<sup>99</sup> See supra Note

<sup>100</sup> [http://www.aqsiq.gov.cn/zjxw/dfzjxw/dfftpxw/200712/t20071203\\_56546.htm](http://www.aqsiq.gov.cn/zjxw/dfzjxw/dfftpxw/200712/t20071203_56546.htm)

<sup>101</sup> See <Toy Sector Makes Effort to Create Good Image for 'Made in Shenzhen'> at <http://www.szcicq.gov.cn/zxzz/ShowArticle.aspx?id=11791>.

<sup>102</sup> See <Make All-Out Efforts to Create Capital of Safety and Credibility> at <http://www.szlh.gov.cn/main/zfjg/zfzcbm/jmj/gzdt/55103.shtml>

products made in Shenzhen. It declared to ‘make all-out efforts’ to turn the city into ‘the capital of (product) safety and credibility’<sup>103</sup>.

Environmental protection was emphasised in the context of RC. This emphasis demonstrated the middle-level governments’ concern about legitimacy in the context of competing for foreign investment. The Vice Governor of Jiangsu affirmed in January 2007 that nowhere was allowed to lower the environment and safety thresholds for projects funded by overseas investment, or to accept polluting enterprises during industrial transfers. Any project that was found to be allowed in with a lesser pollutant threshold would be ceased and removed. The person accountable would be penalised according to relevant rules<sup>104</sup>. The Shenzhen government shared a similar stance. In 2009, the Director-General of the Environmental Protection Bureau pledged good service to the FOEs so that they could survive the financial crisis while maintaining environmental standard<sup>105</sup>. Though both places made similar emphases, the enforcement of environmental regulation by Shenzhen was not as good in practice as that by Suzhou. This was because Shenzhen’s actual achievement in environmental protection was ranked the lowest in the mid-term self-assessment report for the 11<sup>th</sup> Five-Year Layout<sup>106</sup>. This disparity necessitates further analysis at the frontline or micro level.

### 5.3 Implementation at Micro Level

Through a closer look, provincial achievement was a sum of those of its cities, while a city’s success was a sum of those of its SCJs. The SCJs were the micro-level regimes. The SCJs included both SIZ and non-SIZs. Non-SIZs were the county, town, village and their approved industrial zones of various types<sup>107</sup>. The SCJs were disparate in how the rules were implemented. Some regimes carried out implementation conscientiously in line with the rules set by the higher-level governments. Some treated the rules enacted by higher-level governments as secondary to their own concerns. The successes of provincial and municipal RC were generally showcased by those of the SCJs with business clusters. The lack of success of SCJs was kept quiet. This implied that at micro level, the governments

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<sup>103</sup> See *supra* note

<sup>104</sup> See <Jiangsu: Discretionary Lowering ‘Environmental Entry Threshold’ Subject to Regulatory Liability> at <http://env.people.com.cn/GB/1072/5308343.html>.

<sup>105</sup> See <Attitude towards Environment: Facing Financial Crisis Correctly – A Challenge as Well as an Opportunity> <http://jnhb.fu08.cn/hangqing/9928.html>.

<sup>106</sup> [http://cn.chinagate.cn/economics/2008-09/25/content\\_16532857.htm](http://cn.chinagate.cn/economics/2008-09/25/content_16532857.htm)

<sup>107</sup> For example, <Promoting Foreign Investment in Suzhou: Governments Play Well Role of ‘Servants’> [http://www.topfo.com/Elite/Cases200707/CS-000020070706\\_137182.shtml](http://www.topfo.com/Elite/Cases200707/CS-000020070706_137182.shtml); <Overseas Investors Cluster in Chongqing Industrial Parks> [http://www.cq.xinhuanet.com/cq/2010-11/01/content\\_21279879.htm](http://www.cq.xinhuanet.com/cq/2010-11/01/content_21279879.htm)

followed their own 'rule of the game' rather than always paying attention to legitimacy.

According to public media, the non-SIZs at the sub-city level varied dramatically in their strategies and achievements in attracting business. For example, the Taicang County in Suzhou took pride in its success as 'the home to German invested enterprises'<sup>108</sup>. Since the first German invested enterprise was established in 1993, the county had been concentrating on attracting foreign investment originated from Germany. The county council believed that the German invested enterprises were characteristic of intensive use of land, high production output, environmental-friendliness, high added-value, rich technology and humane management skill. From the FOEs' perspective, quoting the remark of the general manager of the Emag (Taicang) Company, '*The council understands very well what we demand. They are ready to help us and work very efficiently.*' Few other counties in Suzhou had also established German Industrial Parks in order to copy the success of the Taicang County. However there was little reported about their achievements.

Another example was about 'emptying the cage' by the Huaqiao Town, Kunshan County of Suzhou. This town expelled more than 40 SMEs that were labour-intensive, energy-consuming and polluting. Rather than promoting new foreign manufacturers, the government was targeting the development of modern tertiary industry<sup>109</sup>.

The third example was negative. In 2008, the council of Muyang County was embarrassed to be one of the lowest for generating GDP in the province. It adopted a strict liability scheme. Under this scheme, the officials of all towns and villages had to take part in the 'competition of Introducing 100-Million-Yuan Projects'<sup>110</sup>. The leaders of the town and village councils who failed to achieve the goal within the designated timeframe would be removed from their post. 14 had been driven out of office by the end of August 2010. The actual consequence was that, after the check-in ceremonies, the settler investors were no longer welcomed or cared about. The promises of a zero price for land lease and other financial conditions were not kept. The construction of factory plants was delayed and sub-quality. Many enterprises could not begin production as scheduled. Then the government began driving away

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<sup>108</sup> See <Why 'Golden Phoenixes' Choose to Settle in Taicang New Zone? Analysing Cluster of German Enterprises> <http://www.cnssz.com/cnssz/germany/xnews.asp?newsid=458>.

<sup>109</sup> <http://kunshan.house.163.com/news2/110408/1/785986-1.shtml>

<sup>110</sup> See <Another Type of 'Empty Cage for New Birds' in Muyang: 100 Sub-County Units Compete in Business Promotion> at <http://finance.sina.com.cn/china/dfjj/20100831/12538578718.shtml>.

the enterprises in the names of '*breaching the investment plan; no actual investment as agreed; change of plan or industrial upgrade: Tens of FOEs had been forced to leave.*' Meanwhile, according to the <List of Large-Scale Enterprises of Muyang Economic Development Zone>, nearly two thirds of the incumbent 132 enterprises were undertaking high-pollution and low-class productions, such as textile, industrial chemical and wood processing. A local native told the reporter that a nearby metal-processing factory did not work during daytime but at night in order to avoid environmental inspection. '*You will see thick yellow smoke emitting after it is dark.*'

#### 5.4 Summary

Being both rule maker and rule implementer, the middle-level and micro-level governments play differently from the national government. They govern smaller and various jurisdictions. The middle-regimes not only compete for foreign investment with each other, but also effect innovation and cross-learning in order to claim legitimacy for their implementation activities. Bearing in mind the national government's active intervention, jurisdictional disparity and competitors' emphases of legitimacy, middle-regimes are high in grid and low in group. Hence they are Uncoordinated. The middle-context offers details about the country-wide RC; inter-city learning and innovation to attain legitimacy for enforcing rules; and variations between cities in their understandings concerning how to attract quality foreign investment.

A province or a city's achievement is the sum of its SCJs. The non-SIZ examples are sourced from the same province<sup>111</sup>. They showcase that foreign investment attraction is predominated by micro-level regimes. Unlike the SIZs, non-SIZs are most distant from the probing of the national government so that they have the most freedom in deciding and following their own 'rules of the game'. Bearing in mind the variations of SCJs, or micro regimes, it is difficult to determine the grid and group of micro regimes based on a cross-regime perspective. Thus it is necessary to investigate each individual micro regime in order to capture their specific characteristics. Micro regime is the frontline of rule implementation. Investigations into the micro regime level is the most likely to show what exactly makes the local jurisdictions so different in their positions, strategies and achievements in attracting foreign investment.

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<sup>111</sup> The first and second counties belong to the same city, namely Suzhou.

## **6. Conclusion**

This introduction to the empirical research begins the empirical part of the thesis. In method, it clarifies the way to use the ER Framework to interpret the empirical phenomenon of RC and the reasons for choosing the sample country, cities and cases. It sets the scene for scrutinising the micro regimes in the subsequent case studies by descriptively analysing the macro, middle and micro contexts of the sample country. It clarifies that to attract quality foreign investment is the national RC strategy, goal and preference; that innovatively improving regulatory process and practice are legitimate, while reliance on lax rules and favourable conditions for RC are instrumental; that top-down monitoring and cross-border supply chains are formal and informal enforcement structures; and that competition happens at sub-national levels, which involves inter-location learning, innovation and legitimacy claiming. It alerts to the sharp distinctive practices and features between macro, middle and micro levels of enforcement regimes. Typically, while the macro-level regime appears to be Adherent, middle-level regimes seem to be Uncoordinated, and micro-level regimes are of various types. It also draws attention to the concerns that the national government showed in the lower-level implementation practice. The different practices as well as the national government's concern suggest their recognition of the success of RC through rule making at macro level will be fundamentally affected by implementation practice at micro level. It is now the turn of the case studies, which will dissect the relevant aspects and characteristics of the micro regimes.

## Chapter V The Adherent Regime

This case study puts the two samples into the Adherent category on the basis of their high grid and high group characteristics. The grid and group characteristics also draft the institutional features of the regimes. Next is to present the observed characteristics and findings of each sample systematically according to the ER framework. It finishes by addressing outstanding issues so as to reach a conclusion about the plausibility of the framework in interpreting the empirical phenomenon of RC.

The two cases chosen are Wangda in the city of Shenzhen and Gongcheng in the city of Suzhou. Both are nation-class special investment zones (SIZs), established primarily for the purpose of attracting foreign investment. Each has a general-purpose regulatory agency – the Regulatory Committee<sup>1</sup>, which is considered as the representative of the regime. The committees are accredited by the respective municipal governments to be the specialised agencies for regulating the SIZs. The committees are routinely accountable to their respective vice mayors for their performance. Both SIZs have high profiles in the public media. As members of the China Association of Development Zones (CADZ), their achievements are updated regularly at the CADZ official website<sup>2</sup>. These are symbolic of high grid. Meanwhile, the regimes of Wangda and Gongcheng demonstrate the following respective ‘group’ characteristics.

The Wangda regime is in charge of the largest nationally approved SIZ in Shenzhen. The committee shares all regulatory authority with other local agencies. Thus, inter-agency cooperation is a huge and demanding routine task for the committee with respect to responsive and efficient problem-solving and facilitation provision. The current director-general (DG) is forceful in improving the inter-agency cooperation, which he perceives as essential to building a desirable environment for attracting investment. Thanks to his efforts and based on tangible means, inter-agency cooperation has reached a desirable standard. This suggests high group. Therefore, Wangda is classified as an Adherent regime.

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<sup>1</sup> Hereinafter simplified as ‘the committee’

<sup>2</sup> For the detailed information about CADZ, see its official website at [www.cadz.org.cn](http://www.cadz.org.cn).

Gongcheng is widely acknowledged as one of the most successful SIZs in attracting overseas investment in the country. It was established based on an agreement between the national leaders of China and a newly industrialised country (NIC) and designed to pose as a role model for attracting overseas investment. The committee has full local authority for governing the zone. Most inter-agency coordination occurs inside the committee. Meanwhile, the committee adopts a pragmatic stance in order to gain the cooperation from non-affiliated national agencies. This is evident of high group.

## **Case 1: Wangda of Shenzhen**

### **1. The Regime**

#### **1.1. Profile of Wangda**

Wangda was the only SIZ in the city that had abundant land able to accommodate large-scale manufacturers. But its use of land was careful and purposeful - reserved for high-tech projects with big investment originated from the USA and the EU. It welcomed big investors only, namely with a single investment minimum of USD 50 million<sup>3</sup>. By the beginning of 2008, there were more than 91 enterprises involving foreign investment – with a minimum 25% overseas capital<sup>4</sup>. All were set up in Wangda after 2001. The average investment amount for each enterprise was USD50 million. Originally most foreign investment came from Hong Kong, Japan, South Korea and Taiwan. Since 2005, the foreign investment from the EU and the USA grew rapidly. The year of 2007 witnessed the establishment of a pharmaceutical enterprise funded by investment from France. It involved an investment volume of 70 million euro for the first stage. Its three main industries were electronics, bio-pharmaceuticals and advanced engineering<sup>5</sup>. Wangda's deployment of land showcased its legitimacy, because it was in accordance with the national strategy to target the most desirable foreign investment. The structure of the domiciled firms was evident of Wangda's regulatory attraction to big firms from high-regulating countries (HRCs).

#### **1.2. Organisational Peculiarity of the Committee**

##### **1.1.1. Role of leadership**

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<sup>3</sup> Interview GISC

<sup>4</sup> Interview GISC

<sup>5</sup> Interview GISC; information at the official website of Wangda

The director-general (DG) was the leader in chief of the committee<sup>6</sup>. He firmly believed that a leader's role was crucial to the business-attracting achievement of a jurisdiction. On the one hand, the leader's standpoint toward foreign enterprises was of concern to overseas investors. *'The investors of Hong Kong, Taiwan and Japan are particularly attentive to who the chief leader is when deciding their destinations. They have a deep understanding about 'the culture of the chief' of our bureaucratic system.'* On the other hand, how the leader valued the goal of business attraction affected the organisational performance. *'Our system has no mechanism to motivate the officials to be committed to the goal (of overseas investment attraction).'* The DG was motivated not only by his accountability to the mayor but also by the joy of personal success. Therefore, *'the team relies on the chief leader to motivate them. It takes me around two years to train them to perform as I wish. Negligence is absolutely intolerable. I have removed two section chiefs from office because of their negligence.'* Nevertheless, the DG was pessimistic about the sustainability of the improved performance and commitment: *'When one day I am not the DG, the idea and performance (of the committee) will certainly change.'* The significance of the leadership to current and future staff's commitment implied that the Wangda regime was characterised by individualisation.

### 1.2.2 Inter-agency relationship

The committee's authority, delegated by the municipal government, was very limited. In a strict sense, it did not have full regulatory authority over any affairs related to foreign investment<sup>7</sup>. It could not issue the permits or qualifications for land lease, construction plan, fire-fighting facilities, favourable conditions, labour recruitment and environmental restriction. The committee's partial authority used to be its blame-shifting excuse to decline facilitating the domiciled enterprises, but the current DG held a different stance, *'We must be devoted to establishing cooperative relationship with other agencies. Only in this way can we overcome our authoritative handicap and provide a favourable business environment.'*<sup>8</sup> It was because of the DG's personal understanding, Wangda developed inter-agency cooperation and a strong interest in competing for business.

To improve the business environment was the ultimate goal of the DG-oriented coordination<sup>9</sup>. A more specific goal was to make the other agencies be committed to

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<sup>6</sup> Interview GIDG

<sup>7</sup> Interview EJSS2 and GIDG

<sup>8</sup> Interview GIDG

<sup>9</sup> Interview GIDG

provisions of responsive facilitation as well as of efficient and effective problem-solving whenever needed by the domiciled enterprises. The improvement in coordination began with the committee's active building of friendships with other agencies. Friendship was based on tangible means such as providing an extra budget for the agencies; reimbursing the individual officers' extra expenses; and gifts or cash on the occasions of traditional festivals. Over a few years, the committee had established friendships with relevant agencies. When the committee contacted the relevant agencies for the problem-solving need, it was generally easy and quick to acquire desirable assistance from those agencies. The finding here implied that the general-purpose agency was vital in actualising inter-agency cooperation; and that it might need to use tangible means to lure agencies to cooperate.

The committee's coordination with the customs was noteworthy<sup>10</sup>. The customs was a key target for the committee's coordination because of its complete discretionary power over the FOEs' imports and exports. Some FOEs used to be reluctant to recommend Wangda because of the poor support from the customs<sup>11</sup>. But they generally acknowledged that the customs' practice was improving. And the improvement involved the DG's personal efforts<sup>12</sup>. He spent a whole year in persuading the Wangda and the seaport customs to cooperate in order to sort out the delays of shipments that had frustrated the domiciled FOEs for years. The background was that, despite both being branches of the Shenzhen Customs, the Wangda and seaport customs had no connected jurisdictions. The Wangda customs' jurisdiction was restricted to the territory of Wangda. Any problem occurring outside the zone was regarded as irrelevant to its discretion. The domiciled FOEs needed to use the seaport to import and export commodities. This pertained to the jurisdiction of the seaport customs. Because the Wangda and the seaport customs adopted different formalities, procedures and styles, what was approved by the Wangda customs was often disagreed and unaccepted by the seaport customs. Consequently there were constant delays for the FOEs in shipping their products overseas. Thanks to the DG's endeavour, the two customs became cooperative. They agreed to adopt mutually accepted formalities and procedures and became facilitative to the FOEs of Wangda.

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<sup>10</sup> Interview GIDG

<sup>11</sup> Interviews EHSS1/2

<sup>12</sup> Interview GIDG

Apart from the committee-led coordination, the other agencies did not all communicate<sup>13</sup>. For example, the land planning and land use agencies did not talk to each other. They had conflicts in determining the purpose of specific areas of land. Some agencies routinely coordinated. The labour and the enterprise-licensing agencies collaborated in an annual review in order to enforce the enterprises' compliance with labour law. The tax agency, the customs and the enterprise-licensing agency shared a database to manage the enterprises' records of paying tax and tariff. They adopted the same credit-rating criteria to classify the enterprises according to their records. Those classified as 'Type A' had high credibility in paying tax and tariff. Those classified as 'Type D' were the opposite. These agencies consequently deployed corresponding strategies in regulating the enterprises. Their arrangements were regularised and approaches responsive.

## **2. The Agencies**

### **2.1 Facilitation**

The DG and his staff showed strong interest in competition<sup>14</sup>. In their opinions, competition for overseas investment was necessary to fulfil the committee's goal of economic development. Given the limited availability of foreign investment, locations must compete in order to succeed. However, the agencies did not have the same sense of competing for business. Nor were they equally committed or responsive to the facilitation to domiciled FOEs. The agencies' commitment and responsiveness appeared to be related to their facilitative or restrictive duties. The enterprise-registering agency, which was in charge of promoting business and reporting economic statistics, was more facilitative to FOEs than the agencies in charge of land, labour and environmental protection. The agencies' mindfulness was shown by their responses in terms of problem-solving for the troubled FOEs. The FOEs' informants' general comments were that the committee's help was the quickest and most effective.<sup>15</sup> The customs was moderate in speed and solution. The land and labour agencies were slow and ineffective. Meanwhile, the FOEs reckoned the agencies' help was related not only to their procedures and the staff's competence but also to the stance of their chief leaders. This implied that individualisation was also characteristic of the task-specific agencies.

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<sup>13</sup> Interview GIDG and GISC

<sup>14</sup> Interview GIDG and GISC

<sup>15</sup> Interviews EHSS1/2 and EJSS1/2

Twenty-five miles from the city centre and surrounded by agricultural fields, Wangda had no geographic advantage compared to other SIZs of Shenzhen<sup>16</sup>. The DG emphasised the provision of excellent service not only as the strategy to make up for the geographic weakness, but also the innovation to attain regulatory advantage<sup>17</sup>. The staff were requested to work as the subordinates of the FOEs so as to satisfy the FOEs' demands whole-heartedly.

The emphasis on efficiency was featured throughout the committee's service<sup>18</sup>. The 'promise scheme' meant that the committee made precise promises to complete specific tasks within specified days for the FOEs. First-instance problem-solving and information-giving were another key point. Express approval procedure was a type of service provided by the committee to a new investor. It enabled the investor to build up the factory plant, recruit and train workers and begin production quickly so as to be first in the fast-changing demands of the market. For each investment project, a responsible person was appointed to track the whole process from sorting out the application formalities to the beginning of production.

Another emphasis was certainty and predictability. According to a section chief's (SC's) observation<sup>19</sup>, the foreign investors expected to face a risky environment when choosing China. They were prepared for the risk engendered by the weak legal system and changeable policies but were concerned about the support provided by specific local authorities. Adversary, arbitrary and bribe-requesting authorities were the risks far more difficult to manage. Disciplined, supportive and helpful local authorities gave the foreign investors' confidence in coping with the regulatory problems caused by a weak legal system and changeable policies.

In contrast, the committee held favourable conditions and lax regulation engendered undesirable rather than desirable effect for attracting foreign investment<sup>20</sup>. '*Big FOEs care less about favourable conditions than SMEs. Although labour and environmental laws are strictly enforced in the zone, it does not discourage them. They prefer Wangda to inland cities, since the policy- implementation of the latter is unpredictable, even though it appears to be laxer. Big FOEs are particularly concerned about the predictability of policy- implementation.*' The agency's

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<sup>16</sup> Information from the official website of Wangda

<sup>17</sup> Interview GIDG

<sup>18</sup> Interviews GIDG, GISC and EJSS1

<sup>19</sup> Interview GISC

<sup>20</sup> Interviews GIDG and GISC

understanding about respective preferences of big firms and SMEs as well as its actual enforcement of social regulations revealed its preference for big and well-complying firms as well as its balanced performance of business attraction and rule enforcement.

## 2.2 Restriction

Wangda was a key member of a hi-tech and bio-chemical industrial base in the municipal government's plan<sup>21</sup>. It allowed entry exclusively to the high-tech, energy-saving, high value-adding and environment-friendly industries, preferably from HRCs. The committee's treatment of FOEs was congruent not only with the differential position of the municipal government but also with the national strategy.

The committee and other agencies treated the domiciled enterprises differentially according to size<sup>22</sup>. To begin with, the committee declined the entry application of small and medium sized investors. According to the committee's experience, big enterprises cared about their reputations and were voluntarily law-abiding. SMEs had the common problem of ill compliance, since they always tried to minimise cost. Big enterprises were also preferred because of their greater contributions to the local economy in terms of generating more revenue, creating more jobs, bearing more social responsibility and generating more exports. The agencies were more supportive to big domiciled enterprises in terms of investing more time and effort on the big enterprises' affairs and responding quicker to their demands. For example, the power supply agency invited only the big FOEs to discuss the allocation of power consumption. It minimised power cuts for them during periodical tight supply.

Most agencies adopted the strategy of compliance-based convenience. This strategy functioned in two stages<sup>23</sup>. At the entry stage, the committee took into consideration the applicant's investment origin. It took an openly rejecting stance towards small and medium size investors from Hong Kong and Taiwan. The committee learned from its experience that the FOEs with investment origins from Taiwan, Hong Kong and South Korea had poor law-abiding records in contrast to those from Japan, the EU and the USA. Some Taiwanese and Hong Kong companies did not pay social insurance or delayed paying wages to their workers. A Korean company carried out body searches on the workers. This selective strategy,

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<sup>21</sup> Interview GISC; information at the official websites of Wangda and Shenzhen municipal government

<sup>22</sup> Interview GIDG and GISC

<sup>23</sup> Interview GISC

taken at the entry stage, ensured easier enforcement at a later stage as well as long-term effectiveness.

At the post-entry stage, the committee collaborated with other agencies to differentiate the well-complying enterprises from the ill-complying ones and to adopt concordant enforcement strategies<sup>24</sup>. The committee took all possible opportunities to alert the FOEs to abide by the laws so as to benefit from the convenience of trusting and friendly strategies. The agencies were considerate, friendly, and more supportive to the FOEs that complied faithfully with Chinese laws and voluntarily engaged in social campaigns such as poverty relief. They were tough and stringent towards ill-complying enterprises. To the repetitive violators, the committee and other agencies together took stringent measures to correct their wrong behaviours.

To summarise, Wangda's facilitation and restriction demonstrate the following general characteristics: Under the leadership of the general-purpose agency, Wangda is active in competing for quality foreign investment. The agencies perform both facilitative and restrictive duties appropriately and cooperatively. Its RC strategy is based on innovation, efficiency and responsiveness. Certainty and predictability also underpin its regulatory advantage. It does not rely on favourable conditions or lax enforcement to attract business. It is selective to new entrants, targeting big and well-complying high-tech firms with origins of HRCs. This selectivity ensures the best use of its land and desirable enforcement effect. Its enforcement arrangements are regularised and its approach is responsive to the firms' sizes, compliance records and social commitment. It institutionalises the shared value of compliance-based convenience over the jurisdiction. Generally, Wangda's RC strategy adheres to the national strategy. Its facilitative and restrictive performance is balanced and involves legitimacy but no instrumentality.

### **3. The FOEs**

As mentioned in previous paragraphs, the compliance with formal rules by the domiciled FOEs was evidently correlated to corporate size, investment origin and industry. As for informal rules, big FOEs seemed to be active in self-enforcing informal high standards<sup>25</sup>. The Japanese FOEs not only abided by Chinese rules but also followed self-imposed norms<sup>26</sup>. The latter included international standards

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<sup>24</sup> Interview GIDG

<sup>25</sup> Interview GISC

<sup>26</sup> Interview EJSS1

such as that of International Organisation for Standardisation (ISO), and the technical norms of major buyers such as Sony and Hitachi. A big Hong Kong printed-circuits producer voluntarily invested a huge amount of money to invent a recycling system to process its industrial waste<sup>27</sup>. It was acknowledged by the municipal government as one of ten models of a recycling economy. The chief engineer was invited by the Ministry of Science and Technology to set the national standard for processing industrial wastes. The Guangdong Provincial Environmental Bureau also consulted him about recycling technologies. The finding indicated that the firm's size and investment origin mattered. The firms that were big or came from HRCs self-enforced higher informal standards. They contributed to Wangda's positive enforcement effect in product quality and environment protection.

#### 4. Agency-FOE Interaction

The agencies and the FOEs generally had close contact with each other<sup>28</sup>. The FOEs could call any staff member of the committee for inquiry and help. But they used the telephone to contact specific officers of other agencies only when familiar with them<sup>29</sup>. The reason was that the officers regarded using the telephone as a sign of insufficient respect. This implied that, whereas the FOEs enjoyed a symmetric status in their close relations with the general-purpose agency, they were in an asymmetric status in their far relations with some task-specific agencies. Some FOEs preferred to use written letters to contact the agencies. A Japanese FOE always wrote letters for inquiries and archived them together with the agencies' feedback, which were referred to as official norms<sup>30</sup>. This exemplified the firm's effort of being well intentioned and well informed so as to prove compliance with regulations as required.

The committee invited the FOEs to hold meetings for the purpose of friendship-building, information-giving, and communication<sup>31</sup>. The committee hosted an annual party before the Chinese New Year's Day. The agencies such as the enterprise-licensing and environmental protection held lectures for the FOEs to ensure preparation of necessary documents in time for the annual reviews. The committee organised a routine symposium attended by the FOEs and all relevant RAs once

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<sup>27</sup> Interview EHSS2

<sup>28</sup> Interview GIDG and GISC

<sup>29</sup> Interview EJSS2 and EHSS1

<sup>30</sup> Interview EJSS1

<sup>31</sup> Interview EHSS1/2 and EJSS1/2

every six months. The meetings were purposeful for both problem-targeting and enhancing agency-FOE dialogue. The customs organised meetings to inform the FOEs of new rules and procedures before their implementation. The tax agency notified the FOEs about the latest changes in tax policies, such as tax exemption, offset and rebate. Generally, the agencies' meetings had specific purposes and the FOEs considered them as worthwhile. These meetings were part of the agencies' social construction. They helped not only to enhance bilateral accountability and trust, but also the formal enforcement effect.

The committee visited the FOEs to listen to their voices<sup>32</sup>. It got the FOEs' feedback about policy changes; acquired their comments on the agencies' performance; investigated and solved the problems encountered by the FOEs; and collected first-hand information for research purposes about business situations. It also showed off the FOEs to potential investors and high-ranking officials. These visits were given early notice. Other agencies visited the FOEs mostly for inspection purposes. For example, the customs made routine checks a few times a year in order to verify whether the FOEs' imported materials and equipments were actually being used for the claimed production rather than sold secretly. It might make spot checks on the FOEs' exported products to verify whether the kind and amount were being declared truthfully. Unlike the routine checks, the spot checks were not given early notice. Some well-complying FOEs regarded these visits as not all worthwhile<sup>33</sup>. '*We voluntarily abide by the regulations even without inspection. Yet the value of the inspections was that in case of a potential problem it would be discovered in good time for correction.*' In the FOEs' opinion, too close a contact by agencies tended to be burdensome; and spot checks were likely to be unnecessary for well-complying firms.

Most problems were related to production disruption caused by water supply shortage, power outage, labour dispute, fire-fighting disqualification, anti-social event, and disapproval by the customs, the AQSIQ or the tax agency. On the FOE side, the problems were usually caused by their misunderstandings of the rules or by overlooking some issues<sup>34</sup>. Not all FOEs complied with the rule. One example was that an Italian furniture maker, one of the earliest settlers in the zone, had a few strikes because of its refusal to pay social security for the workers. It also rejected

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<sup>32</sup> Interviews EHSS1/2 and EJSS1

<sup>33</sup> Interview EJSS2

<sup>34</sup> Interview EHSS2

law-bounded solutions proposed by the committee and the labour agency<sup>35</sup>. On the agency side, some agencies' procedures lacked transparency. Their administrators did not adhere to the procedures. Also different agencies might give contradictory interpretations of the same issue. For example, the provincial product safety bureau regarded the ingredients of a Japanese FOE's product as safe, contrary to the opinions of the corresponding agencies of the municipal and county levels<sup>36</sup>. These problems cost the FOEs repetitive visits before they successfully got official approval. The findings about regulatory problems suggested the FOEs were various in their understandings towards regulation. Hence the regime could not enforce rules effectively on all types of firms. Meanwhile, the agencies varied in constraint, commitment and cooperation. Consequently, their performance was characteristic of uneven responsiveness, reasonableness and certainty.

A Hong Kong high-tech enterprise told a story about how it nullified an unreasonable penalty of RMB 3 million yuan (roughly GBP 300,000) decided by the Wangda customs<sup>37</sup>. The FOE imported large quantities of raw materials for manufacturing export-oriented products. According to the old customs regulation, the import was exempt from tariff. The regulation changed in terms that rather than paying no tariff at all for imported materials, enterprises should pay a tariff first and apply for a refund later. However the FOE was unaware of the change and kept on following the old regulation for more than a year. The Wangda customs regarded the company as having committed an illegal operation and made a decision to penalise the FOE. The coordination manager declined to accept the decision and argued injustice. *'The customs rather than my company should be mainly liable for the fault. While we were unaware of the regulatory change, the customs did not stop us from following the old regulation but allowed us to continue for more than a year.'* Unable to get justice from the Wangda customs, the coordination manager went to its superior. For the first time she visited the Chief of the Tariff Section of Shenzhen Customs to present the evidence. The section chief (SC) was convinced by the evidence and issued an order to the Wangda customs to annul the penalty. However, the Wangda customs refused to implement the order. The coordination manager revisited the Shenzhen Customs. The SC advised to increase the company's registered investment amount, so that the company became legally entitled to a laxer regulation, which was still the same as the old one. The coordination manager followed the advice, and quickly attained a new license with

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<sup>35</sup> Interview GIDG, GISC and EHSS2

<sup>36</sup> Interview EJSS2

<sup>37</sup> Interview EHSS2, GIDG and DGSC

the increased investment amount. The Wangda customs still insisted on its original decision. The manager went to the Shenzhen Customs for a third time. The SC proposed a third solution. Namely the company paid the penalty first and requested the refund later. *'I know it is almost impossible to attain a refund. Hence I requested a deadline for the refund. Unable to promise a date, the SC compromised and authorised an additional order to command the SIZ customs to withdraw its penalty.'* The Wangda customs this time obeyed the order. The company finally won the dispute with the local customs and rescued itself from a huge economic loss. *'This is an absolutely unique case. But if you are expert, no need for bribery or networking, you can win and they will respect you.'* Later, the coordination manager was invited by the Wangda customs to be an external supervisor for its anti-corruption performance!

When the problems could not be sorted out desirably, the FOEs invited the committee to step in as a mediator<sup>38</sup>. The committee's administrators or SCs would communicate with the relevant agencies for solutions. For more difficult problems, the DG became personally involved. One example was that in 2004, the municipal legislature enacted a land plan, specifying that the land for which had been leased to a Hong Kong manufacturer since 2001 should be used for commercial purposes<sup>39</sup>. This legislation outlawed this FOE's use of the land. The DG and the FOE's coordination manager frequently contacted the legislature, the mayor and the leaders of the land and planning bureaus to resolve the problem. After three years of lobbying, the legislature eventually corrected the land plan in 2007, re-legitimising the FOE's industrial usage.

The above two stories about the wrong decisions made by the task-specific agency and legislature show that, wrong regulatory decisions can be corrected through persistent dialogue, communication and bargaining by the FOE. Facing the problems, the FOE trusts the effect of its voice. Its power is symmetric with the agencies. The correction of the wrong decisions not only improves the agencies' accountability to the FOE, but also enhances the FOE's loyalty to Wangda.

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<sup>38</sup> Interview GIDG, GISC and EHSS2

<sup>39</sup> Interview EHSS2 and DGSC

## 5. Findings

*Institutional features* Wangda is classified as an Adherent regime, taking into consideration of its high grid and high group properties – routine and specific accountability and notable inter-agency cooperation.

*Regulating side* The Wangda agencies are well constrained but vary in commitment and interest in competing and supporting business. The DG of the general-purpose agency plays a vital role in motivating the agencies' commitment and improving their performance. Overall, facilitation has become more responsive, efficient and predictable than before, with innovative quick-responding schemes now in operation. They are selective about firms and mostly prefer big high-tech investors from HRCs. They adopt differentiating strategies in enforcement according to the FOEs' sizes, industries, investment origins and compliance records. Such strategies are in accord with the national strategies and benefit both the agencies and the FOEs in responsive and flexible terms. In general, facilitative and restrictive performances are balanced and innovative.

*Regulated side* The desired type of FOEs is attracted to Wangda as planned and the population is on the rise. It is evident that they are typically big high-tech investors from HRCs - well-intentioned, well-informed, and voluntarily self-enforce informal higher standards. They are very selective about the regime and prefer a regime that is characteristic of legitimacy, certainty and responsiveness. Not all domiciled FOEs are law-abiding, typically early-settler SMEs from low-regulating countries.

*Two-sided marriage and match* The agency-FOE relationship is close. This does not please all FOEs, since it costs time and human resource. The distribution of power is symmetric typically for the general-purpose agency and the FOEs, but asymmetric for some other agencies. Led by the general-purpose agency, most agencies are attentive to the FOEs' voice and active in social construction. The bilateral interaction demonstrates the logic of appropriateness. Most working arrangements are regularised, typically in responsive enforcement. Mutual trust and accountability is evident. But agencies do not win trust from the FOEs evenly. Under the current DG, the general-purpose agency plays a leading role in engendering RC achievements. The general-purpose agency is most accountable and is trusted the most by the FOEs. Generally, the regime is suitable for big high-tech FOEs from HRCs and vice versa. The preferences of the regime and most desirable type of FOEs are a match.

*RC outcomes* Wangda regime has been fulfilling the goal of attracting big FOEs from high-regulating countries. This indicates its achievement in business attraction. Meanwhile, there are enforcement problems within the regime. Some are caused by the agencies' unreasonableness, irresponsiveness, poor coordination and commitment. Some are caused by the FOEs' resistance to regulation. These problems are generally solved desirably based on purposeful and appropriate efforts of the involved firms and the general-purpose agency. The solutions enhanced the agency-FOE mutual trust and loyalty. The regime generally encourages and appreciates the FOEs' self-regulation. Hence enforcement effect is considered as efficient. The regime has been evidently in using favourable conditions to attract the most desirable foreign investment. It demonstrates legitimacy rather than instrumentality in RC. Although certainty is likely to be affected if the DG and other individual leaders change, however Wangda demonstrates competitive advantage for quality foreign investment under current leadership at least.

## **6. Outstanding Issues**

It is recognised that most empirical finding for Wangda regime has been accounted for by the ER Framework. Nevertheless there are a few outstanding empirical issues that need to be addressed.

First of all, in reality, the agencies are not evenly committed, cooperative or responsive. A typical example is that the locally based customs stuck to its unjustifiable decision to penalise the well-intentioned and ill-informed FOE in spite of the superior's first correction. The ER Framework seems to give an even account for the agencies that share the same regime. The explanation is that the reality is quite complex, whereas the framework, like all others in social science, is a simplified reflection of the reality. The framework simplifies agencies into two sorts: facilitative and restrictive. Its focus surrounds two types of corresponding regulatory practice – facilitation and restriction. Empirically, the agencies' commitment, cooperation and responsiveness are found to be more or less related to the facilitative or restrictive properties of their respective duties. This finding supports the rationale of the framework in this regard. As long as the agencies demonstrate generally shared characteristics, their diversity and exception are acceptable. Also, the general-purpose agency is viewed as the representative of the regime, as accounted the framework. This point supports the interpretation of the framework.

Secondly, individualisation of the regime is evident empirically but is missed from the ER Framework in two ways. In one way, the leader's role is of vital importance to the performance of the regime. He not only improves inter-agency cooperation but also advances facilitative performance and corrects restrictive errors. The other way is that an individual's significance is not only typical of the committee but also of most other relevant agencies. Any change in individual official is likely to engender a change in the agency's practice. The explanation is that although the used historical institutionalism approach notes individualisation, the ER Framework does not pay particular attention to this issue. Characterising the agency in a collective rather than individual term based on the grid-group typology, the ER Framework does not treat the leader's role exceptionally. Meanwhile, whether the significance of the leader's role is the institutional peculiarity of Wangda regime or is a general trait for all Adherent regimes is still a question. Before examining another Adherent regime, a conclusion is yet to be made about the framework in this regard.

Thirdly, strong inter-agency cooperation does not automatically happen in reality, but is initiated and enhanced through deliberate effort and tangible means by the general-purpose agency. The ER Framework only mentions strong inter-agency cooperation for the Adherent regime. It does not clarify how it happens. As self-declared by the framework, the interpretation is meant to be simplified and heuristic rather than elegant. Thus the lack of clarification in this regard means at most that the framework is not sufficiently refined rather than being wrong.

Fourthly, the close agency-FOE relation is considered by a few FOEs as being unnecessary in reality. The framework seems to be positive in this regard. The explanation is that the framework accounts for this relation rooted in enforcement rather than RC theories. Whereas the enforcement theories do not specify how 'close' is close, it agrees with the factual non-punitive characteristic. Also, the characteristic and effect of frequent visits appear to be contextually specific to Wangda. Unless there is further finding from other Adherent regimes, relational characteristic and effect should not be generalised as a trait of the Adherent regime now, or viewed as an issue to the theory in this regard.

Finally, relevant to the previous two issues, regulatory certainty of Wangda is doubtful in the long run due to potentially changing individuals. Doubtful certainty disagrees with the interpretation of the Adherent regime in the ER Framework. However, this disagreement will be acceptable if considering that at least the regime is of certainty under the current leadership, particularly the DG of the committee.

Indeed, the disagreement confirms that the framework is designed to be heuristic so that it is free from covering the dynamic caused by some fine factors such as individualisation, personal change and their impact. Based on its institutional logic, the framework can be stretched and interprets the individualisation-related uncertainty as an institutional peculiarity of Wangda regime. Without other Adherent regimes being found to be the same in suffering from low certainty, the interpretation of high certainty for the Adherent regime by the ER Framework should not be discounted.

The above-mentioned identified empirical points are explicable. Some are caused by the simplicity of the ER Framework. Some remain to be further checked by other Adherent regimes. It is concluded that the interpretation made by the ER Framework is generally plausible.

## **Case 2: Gongcheng of Suzhou**

### **1. The Regime**

#### **1.1. Profile of Gongcheng**

Gongcheng is considered as one of the best SIZs in attracting overseas investment in China<sup>40</sup>. It was established based on a joint agreement between the national governments of China and a newly industrialised country (NIC) in 1994. It copied the model of the free trade zone of the NIC and was renowned for its agencies' rule-bound practice<sup>41</sup>. Until the second half of 2008, most FOEs in the SIZ were undertaking hi-tech manufacturing. On average, an FOE had an investment amount of USD 30 million. Among the incumbent FOEs, 49% are funded with investment originated from the EU and USA, 20% from Hong Kong, Macao and Taiwan, 18% from Japan and South Korea, 6% from Singapore and other countries<sup>42</sup>. The structure of the FOEs of Gongcheng indicated its extraordinary regulatory advantage in attracting the most desirable foreign investment as defined by the national strategy – big firms from HRCs.

#### **1.2 The Committee and Inter-Agency Cooperation**

The general-purpose agency, or the representative of the Gongcheng regime, was Gongcheng Regulatory Committee. It involved the experts dispatched from the free

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<sup>40</sup> Information sourced from the official website of Gongcheng

<sup>41</sup> Interview SIDG, EJSI2E, ETSIE1 and ETSI4E

<sup>42</sup> Interview SIDG

trade zone of the NIC at an early stage<sup>43</sup>. The committee was delegated with all the authority that the municipal government could afford in order to govern the zone. Most relevant enforcement activities were carried out by the constituent departments and affiliated agencies of the committee. The only exception was the jurisdiction of the national agencies, including the local branches of the customs, AQSIQ, national revenue bureau and foreign currency regulatory bureau.

Inter-agency cooperation did not seem to be an issue in the Gongcheng context<sup>44</sup>. However, the agencies varied in commitment. The DG admitted that the national agencies did not care about the FOEs' satisfaction as much as the committee. Accordingly, the committee took a pragmatic stance. It satisfied the national agencies in both public and private fashions. It provided well-conditioned modern office buildings in which the agencies could work comfortably. It also developed and leased up-market residential flats for their staff. This convinced the national agencies that they were being treated as part of, rather than alien to, the Gongcheng governing body. Hence they had little excuse for non-cooperation with the committee. Some argued that the national agencies' cooperation was partly caused by their awareness of the committee's direct access and accountability to the national government<sup>45</sup>. Non-cooperation, if any, was likely to be reported upwards by the committee and hence incur the criticism of the national government. Yet this position was not supported by open finding. Leaving the true reason aside, the national agencies generally worked cooperatively as the committee wished.

The committee had routine dialogue with the national agencies<sup>46</sup>. Once in every four months they informed each other of the working goals and schedules so as to take consistent steps. The national agencies also coordinated with each other<sup>47</sup>. For example, in 2007, the customs and the foreign currency bureau collaborated closely in order to enforce the national government's command of controlling the speculation of inflowing overseas hot-money. The agencies issued a joint notice to inform the FOEs of the collaboration one week before their actual operation began. This finding showed that, in Gongcheng, inter-agency cooperation was strong and regulatory certainty was high.

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<sup>43</sup> Interview SIDG

<sup>44</sup> Interview SIDG and ETSI4E

<sup>45</sup> Interview ETSI4E

<sup>46</sup> Interview SIDG

<sup>47</sup> Interview EJSIE2

## 2. The Agencies

### 2.1 Facilitation

Gongcheng demonstrated strong interest in RC. The DG perceived ‘*very intense competition for overseas investment*,’<sup>48</sup> and demonstrated a strong sense of maintaining the established advantage of Gongcheng: ‘*We are striving for honour. To be the Number One is the goal set jointly by the two national governments.*’ He held the leader’s role as minimal: ‘*The Hong Kong and Taiwan businessmen care about who is the leader. The EU and the American investors care about the performance (of the agency). We are attentive to our performance like managing a renowned brand-name. It is not related to any individual or the change of the leader.*’

The value that the agencies attached to the regime’s self-image and prestige was evident of their sense of appropriateness. Understanding of the different preferences of the desired and undesired types of firms underpinned the agencies’ competing strategy and performance. The interviewed FOEs confirmed the support given by the administrators of the committee was generally sufficient<sup>49</sup>. It rarely involved the officers at upper levels. The freedom from the effect of individual change in the agencies’ performance showcased institutionalisation of commitment in the regime.

The committee emphasised a fast and standard delivery of service to new investors and incumbent FOEs<sup>50</sup>. It considered efficiency, certainty and innovation were essential to satisfy the taste of the desired type of foreign investors. Serious about the firms’ voice, the committee organised a survey in 2007 and got replies from about 20 domiciled multi-nationals. Each respondent had factories in at least two places in China. They ranked Gongcheng as the best place in the country in satisfying the multi-nationals. A Japanese interviewee confirmed the result by giving an example of the time taken for an enterprise to change the registration of its ownership<sup>51</sup>. While the Gongcheng committee took 10 minutes, the authorities of other jurisdictions in Suzhou took three years, and those in Shanghai four years. ‘*Big FOEs mind efficiency and certainty. That is what we emphasise and we try our*

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<sup>48</sup> Interview SIDG.

<sup>49</sup> Interview ETSIE1/2 and EJSIE2

<sup>50</sup> Interview SIDG

<sup>51</sup> Interview EJSIE2

*best to do. Although the FOEs are upset by changeable policies, they are satisfied with our performance.*<sup>52</sup> Gongcheng won its FOEs' appreciation and trust.

For new entrants, the committee adopted fast-track approval to satisfy them<sup>53</sup>. To establish a new enterprise with an investment amount more than USD 30 million, the committee requested the investor only to register the project. It freed the investor from the approval procedure. The committee only initiated the approval procedure for a project of less than USD 30 million. Yet this procedure could be finished at one stop. For domiciled enterprises, the committee emphasised professionalism in its working arrangement. The officers stayed at arms-length from the enterprise – a distance neither too close, to avoid intrusions, nor too far, as the officers were ready to help in case of need<sup>54</sup>.

The committee had the authority to decide its own privileged conditions and it had used this authority to attract the desired type of foreign investment<sup>55</sup>. These included a two-year tax holiday for the desired types of FOEs, settlement subsidies for expert engineers, and venture capital funding for the projects with technological inventions. The committee had an expert commission to assess the qualifications of the FOEs for the tax holidays, subsidies and funding. The expert commission reviewed the FOEs' qualifications on a yearly basis. Nevertheless, the committee considered the financial incentives to be of limited appeal. '*Financial incentives interest the investors from Hong Kong, Macao and Taiwan but not those from the EU and the USA.*' The finding here indicated that Gongcheng had aligned self-determined favourable conditions with the national strategy appropriately. It implied that its success in attracting big firms from HRCs was based on competitive advantage.

## 2.2 Restriction

The stance of the committee towards the FOEs was identified as different depending on their size, industry, investment origin and compliance<sup>56</sup>. It had express procedures for the big enterprises which were reckoned to be the main contributors to the Gongcheng revenue. It also held that stringent enforcement of the labour and environment regulations benefited the attraction of big investors. '*Big FOEs do not mind labour and environmental cost. This cost is visible and*

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<sup>52</sup> Interview SIDG

<sup>53</sup> Interview SIDG

<sup>54</sup> Interview ETSIE1/2, and ETSI4E

<sup>55</sup> Interview SIDG and EJSIE2

<sup>56</sup> Interviews EJSI2E, ETSIE1 and ETSI4E

*manageable.*<sup>57</sup> This finding indicated the regime's understanding of balanced facilitation and restriction.

The committee set the entry threshold according to the industry<sup>58</sup>. It adopted strategies that mirrored the municipal government's 'empty the cage for big birds'. It emphasised the promotion of foreign investment that funded the manufacturers of the most advanced technologies in the country. These manufacturers featured owning IPR, constant and huge funding for research and development (R&D), and maintaining a high requirement of advanced educational backgrounds for their employees. The committee offered privileged financial incentives to the FOEs with IPR and R&D centres, but not to those without. For the old labour-intensive enterprises, the committee allowed them the freedom to choose to stay or exit, rather than directly driving them away. Most enterprises chose to move to partner jurisdictions of Gongcheng. In this way, they avoided the high labour and land cost of Gongcheng, while enjoying a similar regulatory model as Gongcheng. Environment protection was enforced from the start. Consequently Gongcheng was a pollution-free zone<sup>59</sup>. The finding suggested that while being selective about industries as required by the municipal government's strategy, Gongcheng implemented it in a business friendly and considerate manner. This exemplified how it ensured legitimacy in practice as well as enhanced the firms' loyalty.

Though the committee claimed to treat the FOEs equally regardless of their countries of origins, its preference of Japanese, EU and American investors and disfavour of Taiwan and Hong Kong investors was widely known<sup>60</sup>. The FOE informants held that the underpinning reason was that Japanese, the EU and USA FOEs were faithful law-abiders. They treated their workers well in terms of hiring them permanently and supplying them with good living conditions and other welfare benefits. In contrast, the Hong Kong, Taiwan and Singapore FOEs were mean to their workers in terms of paying low wage, social security, pension and housing. Although the committee's preference for the investors from EU, the USA and Japan was based on the FOEs' compliance, it was not free from doubt. An informant of a Chinese diaspora's enterprise complained: '*They should support us more, because*

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<sup>57</sup> Interview SIDG

<sup>58</sup> Interview SIDG and EJSIE2

<sup>59</sup> Information from the official website of Gongcheng

<sup>60</sup> ETSIE1, EJSIE2 and ETSI4E

*we are Chinese.*<sup>61</sup> This finding indicated that firms were various in their intentions in the context of enforcement.

The customs regulated the FOEs based on categorisation<sup>62</sup>. The FOEs in Category A were given the most trust, with their imports and exports examined with minimum frequency. Those in Category B, C and D were faced with more frequent checks of their imports and exports. Likewise, the local revenue department had internal criteria to assess the tax-paying credibility of the FOEs. Its staff were more friendly to those with good credibility than to those with a poor one. The agencies referred to relevant law and rules to penalise the FOEs that conducted illegal business. ‘*Their use of penalty targets for what had been done wrong rather than for who did it. It is fair.*’<sup>63</sup> This FOE’s positive comment showed that the agencies and the FOEs shared the value of responsive enforcement.

### 3. The FOEs

The FOEs’ compliance with formal rules was evidently correlated to their investment origins<sup>64</sup>. When the Labour Contract Law was promulgated in 2007, it did not cause a stir for the Japanese, European and American companies, but upset some Hong Kong and Taiwanese companies. This implied that Japanese, European and American companies had voluntarily adopted high labour standards, whereas Hong Kong and Taiwanese companies had previously adopted low labour standard. The committee enforced the minimum wage standard (MWS) set by the municipal government. It was one of the highest in the country. This high labour standard attracted skilful workers to Gongcheng and made the supply of labour abundant. A Taiwanese manufacturer then circumvented the new law by hiring 6,000 temporary workers from the job agency in order to avoid spending on long-term workers’ welfare.

All informants’ FOEs were upstream producers. They did not directly export but sold on their products to end-product manufacturers. They adopted the buyers’ imposed product norms. One informant’s Japanese company was a norm-setter for its industry<sup>65</sup>. Given Gongcheng as a pollution-free zone, the voluntary self-

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<sup>61</sup> Interview ETSI4E

<sup>62</sup> Interview SIDG

<sup>63</sup> Interview EJSI2E

<sup>64</sup> Interview EJSI2E, ETSIE1 and ETSI4E

<sup>65</sup> Interview EJSI2E

enforcement of environmental norms was not apparent. Even so, the Japanese company adopted 'Product Environment Management System'. It was committed to applying recycling technology in both development and production processes and to manufacturing products with environmentally-safe substances<sup>66</sup>.

Generally, the firms from HRCs and LRCs were evidently different towards formal enforcement. Those from HRCs had voluntarily adopted social standards that were higher than formal ones. Those from LRCs struggled to meet the requirements of the new stricter labour law. A big firm from LRC even took strategic actions in order to avoid the labour regulation. Nevertheless, all firms complied with the norms imposed by their buyers. This implied the significance of informal enforcement structure.

#### **4. Agency-FOE Interaction**

Most agencies' working arrangements were regularised, simple and stable. The committee departments and the national agencies adopted the 'promise scheme'<sup>67</sup>. They promised the FOEs to complete processing the FOEs' affairs and to reply to the FOEs' inquiries and requests within a specified time. This scheme assured the FOEs efficiency and certainty. Meanwhile, the departments of the committee that directly handled regulatory affairs appointed special coordinators to communicate with specific FOEs. Typically, the Marketing and Economic Development Department of the Committee was in the frontline for handling the FOEs' inquiries and complaints. It was responsible for problem-solving, including coordinating with other departments and agencies. More than 30 persons worked as special coordinators and project managers who were assigned the permanent task of looking after specific enterprises. Both the special coordinators and project managers were accountable to the section chief (SC) of the Marketing and Economic Development Department. Under ordinary circumstances, the special coordinators and project managers were the people of the committee that the FOEs contacted most often<sup>68</sup>. They were commented on by the FOEs as being committed, knowledgeable and helpful in terms of fixing the majority of concerned issues. In case they were incapable of solving specific problems, the FOEs were referred to the SCs.

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<sup>66</sup> Interview EJSI2E. Corporate brochure on file with author

<sup>67</sup> Interview SIDG

<sup>68</sup> Interview ETSI4E, EJSIE1 and ETSIE2

However, not all agencies were friendly, committed and responsive. Among the committee departments, the public fund and local revenue departments were the least friendly<sup>69</sup>. Among the national agencies was the revenue agency. Their unfriendliness was represented by their administrators' impatient attitudes, their ambiguous instructions about procedure and requirements, and poor advance notice of policy changes. Due to ambiguous instructions, the FOEs' personnel had to pay repetitive visits in order to sort out the same issues. Yet the national revenue agency showed some seriousness in considering the FOEs comments<sup>70</sup>. For example, it installed a queuing machine after the FOEs complained about the queuing chaos<sup>71</sup>. The FOEs were invited to give comments on the agencies' performance once a year. But they tended to avoid criticising the administrators so as to avoid potential embarrassment for the long-term frequent contact. This showed the FOEs' tolerance and loyalty to the agencies.

The most used means in the mutual contact was telephone<sup>72</sup>. Each department of the committee and the national agency had a permanent hotline for receiving the FOEs inquiries and complaints. This showed symmetry in the agency-firm interaction. Meanwhile, the committee actively used the internet to inform the FOEs of policy changes before they took effect. For example, the committee announced an increase in the charges for water and electricity. It also publicised the information about the demands of certain commodities in the domestic market so that the interested FOEs could reference for selling their products domestically. The FOEs commented Gongcheng's website as informative.

The committee regularly organised symposiums to listen to the FOEs' opinions<sup>73</sup>. The customs and the AQSIQ hosted meetings to inform the FOEs of policy changes. The local revenue department organised monthly meetings to notify new policies, changes in the rules and other noteworthy issues. Occasionally, it hosted special lectures concerning particular new rules. For example, in 2007 it invited an official from the Ministry of National Revenue to explain the changing trend of the corporate income tax law<sup>74</sup>. The lecture was followed by some seminars attended by legal experts to discuss the change. The FOEs were thus made ready before the new law was promulgated. The FOEs held these meetings as worthwhile. Except for

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<sup>69</sup> Interview ETSI4E

<sup>70</sup> Interview EJSIE2

<sup>71</sup> Interview ETSI4E and EJSIE2

<sup>72</sup> Interview SIDG, ETSIE1, ETSI4E and EJSIE2

<sup>73</sup> Interview SIDG, ETSIE1, ETSI4E and EJSIE2

<sup>74</sup> Interview EJSIE2

the mentioned agencies, the other agencies seldom hosted meetings in order to minimise intrusion to the firms.

With some exceptions, the agencies rarely visited the FOEs<sup>75</sup>. The vice DG of the committee who was in charge of marketing and economic development affairs visited the domiciled enterprises once or twice a year to understand the FOEs' demands and difficulties<sup>76</sup>. The customs undertook an annual check to verify the authenticity of the FOEs' declarations. The local revenue department visited the FOEs to alert them and to avoid any unintentional criminal offence. These visits were made after plenty of notice had been given<sup>77</sup>. The FOEs read the agencies' rare visits as the agencies' trust and appreciation in the FOEs' self-regulation and acknowledgement of achieved positive effect.

There seemed to be few problems encountered by the FOEs. Problems tended to occur when the FOEs were not quite adaptive to changed policies. The FOEs tended to communicate with the relevant agencies directly in case of problems. Usually they sorted them out through communicating with the special coordinators or project managers<sup>78</sup>. For example, a fired FOE employee made a grievance claim to the labour department of the committee. The special coordinator telephoned the human resource chief of the FOE to clarify the cause and procedure for dismissal. After hearing the explanation, the coordinator agreed that the cause for dismissal was acceptable but the procedure followed by the FOE was not correct. Thus the coordinator requested the chief to redo the procedure<sup>79</sup>. Although the agencies' responses to solve the FOEs' problems varied in speed, the help they offered was generally considered as effective by the FOEs. The finding of few problems implied that the agencies and the firms had reached an agreement about what each was obliged to do in the context of enforcement. This agreement was functioning like a societal contract. Both parties abode by it in their action and interaction. Formal and informal enforcement structures complemented mutually. In case of a problem, the two parties discussed to make a solution. Overall Gongcheng maintained positive enforcement effect.

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<sup>75</sup> Interview EJSIE2 and ETSIE1

<sup>76</sup> Interview SIDG

<sup>77</sup> Interview EJSIE2 and ETSI4E

<sup>78</sup> Interview EJSIE2 and ETSIE1

<sup>79</sup> Interview ETSI4E

## 5. Findings

*Institutional features* Gongcheng was typical of an Adherent regime. Its representative agency is accountable to the national government, has been trying its best to maintain the image as a role model in competing for quality overseas investment, and ensures strong inter-agency cooperation in delivering services and enforcing social regulations. These characteristics are evident of high grid and high group.

*Regulating side* With a few exceptions, the agencies are evidently well disciplined, committed and cooperative. The regime maintains a high profile in competing for business with high quality, typically big high-tech investors from HRCs. It values its achievement as a glory and strives to maintain its distinguished reputation. Its competitive strategies are featured by a performance of responsiveness, efficiency, certainty and innovation. The agencies adopt differentiating stances according to the FOEs' sizes, industries and compliance records. These stances are in line with the national strategies concerning overseas investment attraction as well as the Suzhou municipal government's reserved attitude towards 'empty the cage'. Thus they are legitimate. The enforced regulatory standards are high, yet domiciled FOEs' choices are respected. This is symbolic of a balance between attracting business and enforcing rules. The agencies' performance is mostly professional and institutionalised. The change of an individual official, including the leader, is not expected to bring about change in performance. The leader's role, individualisation and the lack of long-term certainty, which are all characteristic of Wangda regime, are not identified in Gongcheng.

*Regulated side* The domiciled FOEs vary in complying with formal and informal rules. Those from HRCs give highest comments on Gongcheng's regulatory legitimacy, certainty and efficiency. They are serious in self-enforcing higher informal standards. These FOEs are well-intentioned and well-informed and are the preferred and attracted target of the regime. The FOEs from LRCs do not seem to be well-intentioned, which is demonstrated typically by their reaction towards labour regulations.

*Two-sided marriage and match* The agency-FOE relational distance is at arm's length. This allows the FOEs to be free from unnecessary disturbance whereas being assured of the agency's ready help in case of need. The general-purpose agency is vital in shaping and structuring the investment environment and winning RC victory. The FOEs can access help from permanent hotlines at any time. The

receptionists and project managers of the agencies play the major role in responding to the FOEs' voice and solving problems efficiently and effectively. The distribution of power is symmetric for both sides. Social construction engenders mutual trust, accountability and loyalty. Regularised arrangement institutionalises shared value. Generally, the preferences of the regime and the targeted firms are in perfect match.

*RC outcomes* The regime's business-attracting achievement is outstanding. The problems encountered by the FOEs are not serious. The agencies' rare visits imply their trust in the FOEs' self-regulation. Formal and informal enforcement structures are functioning complementarily. This indicates efficient enforcement effect. Meanwhile, the structure of the domiciled firms is indicative of the regime being successful in attracting the most desired high-quality foreign investment. It can be viewed as a legitimate rather than instrumental use of favourable conditions. In general, the Gongcheng regime lives up to its reputation as a role model of competitive advantage.

## **6. Outstanding Issues**

Generally speaking, the empirical findings for Gongcheng agree with the interpretation for the Adherent regime in the ER Framework. However there are a few outstanding issues that need to be addressed. One issue is that the inter-agency cooperation in Gongcheng is based on tangible benefits. Sharing commonality with Wangda, this characteristic has been explained in the Wangda case. The explanations for other issues are given below.

One issue is that the case here implies that the Gongcheng regime is the most successful in business attraction. The ER Framework is not explicit as to whether the Adherent regime is the most successful type. But considered from the perspective of the RC outcome of competitive advantage, the framework does have an implication of be the most desirable type of regime in the context of RC and enforcement.

The second is that empirically, the agency-FOE relation is at arm's length, whereas the framework states it as close. This issue can be said as minor. This is because there is no explicit measurement for close and far distance. Instead, the agency's enforcing style is a more reliable indicator. Judging by the agencies' trusting and

non-penal attitude towards the FOEs, the bilateral distance is close. Hence the empirical finding does not disagree to the specific argument of the ER Framework.

The last issue is that neither all agencies nor all FOEs have uniform characteristics as described by the framework. This issue is acceptable. As declared by the framework, the type of agency and firm is characterised as archetype. This means that the framework tolerates some exceptions in the real world.

To summarise, based on the finding of the Gongcheng case, and the explanation of the outstanding issues, the interpretation by the ER Framework is generally plausible.

## Conclusion

Wangda and Gongcheng are categorised as the Adherent regime based on their characteristics of strong upward accountability (grid) and strong inter-agency cooperation (group). Most observed characteristics of their agencies' stances, strategies and performance towards foreign investment attraction and enforcement, the domiciled FOEs' compliance with formal and informal rules, and the agency-FOE bilateral relation and interaction, the match of the preferences of the regime and the FOE as showcased in the structure of domiciled FOEs are agreeable with the corresponding interpretation made for the Adherent regime by the ER Framework. The identified outstanding issues are explicable in terms of the simplified and heuristic limitation of the ER Framework. The framework interprets the players' behaviour and interaction in archetypal and static fashions. Consequently, it is not a surprise to find it falls short in reflecting the reality where the agencies and FOEs do not behave and interact uniformly, and where inter-agency cooperation does not happen automatically. Since there is no finding for individualisation in Gongcheng, individualisation, exemplified as the leader's role, and uncertainty, caused by individual change, could be considered as an institutional peculiarity of Wangda regime. More empirical information is required from other sources in order to determine whether individualisation is an Adherent trait or not. Since the issue of individualisation is uncovered rather than interpreted by the ER Framework, this undetermined issue at most means that the ER Framework is limited rather than its interpretation is doubtful. Generally speaking, the identified outstanding issues do not pose a challenge to the interpretation of the ER

Framework. Based on the findings of the two cases, it is concluded that the ER Framework is convincing in its account for the Adherent regime.

## Chapter VI      The Uncoordinated Regime

This case study first explains the reason for categorising the two samples as the Uncoordinated regime based on the grid and group characteristics, as well as the institutional features of the samples. The rest of this chapter is a detailed presentation of the observed findings based on the ER Framework and a brief scrutiny of the outstanding issues. It ends with a conclusion about the plausibility of the interpretation of the ER Framework.

The two samples are Fujia of Shenzhen and Ximo of Suzhou. Both of them are nation-class special investment zones (SIZs) that were established for the primary purpose of attracting foreign investment. Their achievements are regularly updated at their own official websites, those of Shenzhen and Suzhou municipal governments and China Association of Development Zones (CADZ). For both zones, the Regulatory Committees<sup>1</sup> are the specialised general-purpose regulators accredited by their respective municipal governments. The committees are considered as the representative agency of the regimes. The director-generals (DGs) are the chief leaders of the committees, who are regularly accountable to the vice mayors. These characters show that Fujia and Ximo are of high grid. Meanwhile, they are different types of SIZs and have different group characteristics.

Fujia is one of the earliest SIZs that was endowed a special tariff policy. Approved by the central government for the establishment, it used to serve as a role model of its type. Having drawn wide attention, the regime is further considered to be high in the 'grid'. The performance of the committee is commented on by its older FOE residents as getting worse since the change of the DG. The committee and other relevant agencies lack coordination, which is a sign of low 'group'.

Ximo was established particularly for the purpose of attracting foreign investment in the high-tech sector. Its official profile emphasises the portfolio and achievement of high-tech business recruitment. This additionally indicates high 'grid'. The committee departments and national agencies seem to mostly lack coordination, given their noteworthy disparate working attitudes, styles and arrangements. This implies low 'group'.

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<sup>1</sup> Hereinafter simplified as 'the committee'

## Case 1: Fujia of Shenzhen

### 1. The Regime

Fujia was one of the earliest SIZs approved by the national government. Its committee had served as a role model in successfully recruiting foreign investment to develop export-oriented manufacturing<sup>2</sup>. By the beginning of 2008, there were more than 60 FOEs of various sizes resident in the zone. It was almost fully occupied and had little space available for additional entrants. There were three main industries in the zone: the IT industry, with most investment originating from Taiwan, and the toy making and jewellery processing invested by Hong Kong businessmen. This structure of the firms indicated Fujia's popularity among big low- and high-tech investors from low regulating origins (LRCs).

The committee was not delegated full authority to regulate the economic affairs of the zone<sup>3</sup>. The most essential authorities, including the registration to establish an enterprise, labour, lease of land and construction of factory plants, was ultimately in the hands of the corresponding county or municipal bureaus. In recent years, the committee had become inactive in communicating with the related agencies. '*At least according to my experience, the committee does not coordinate with the customs or the AQS/Q*<sup>4</sup>'. This indicated low group for the regime under current leadership.

### 2. The Agencies

#### 2.1 Facilitation<sup>5</sup>

Considering the little room left in Fujia for newcomers, it appeared to be understandable that the committee was not as active in attracting foreign investment as in the past. Nevertheless, the vice president of the biggest electronic FOE had an insider's view regarding the committee's changed stance. '*The committee is an alien in the current situation of inter-city competition for foreign investment. The governments of Ningbo, Fuzhou and Xiamen*<sup>6</sup> *work very hard to attract overseas*

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<sup>2</sup> Detailed information available at the official website of Fujia

<sup>3</sup> Interview FTFDG

<sup>4</sup> Interview ETSS

<sup>5</sup> Interview ETSS

<sup>6</sup> All are in the eastern region.

*investors. I was surprised by a call from a vice mayor of Xiamen asking about the demand of my company in deciding our next destination. Such a commitment is impressive. Most bureaus of the Shenzhen Government perform well – committed, standardised and friendly. Unfortunately the committee is not among them. The director-general (DG) is not concerned about the domiciled FOEs at all. If he meets me face-to-face, I am sure he doesn't even know who I am. Since he came into office in 2002, the performance of the committee has changed fundamentally. There is no concern, understanding or support for us. The only remaining advantage of the zone is its special tariff policy.'* Based on the FOE's comment, in spite of facing strong RC, the representative agency of Fujia became disinterested and uncommitted in competing for business. The regime demonstrated little regulatory innovation and superiority. Hence it had no regulatory advantage. The relational distance between the agency and the firms was far. They lacked accountability and trust to each other. These problems occurred consequently to the change of leadership. This implied that Fujia was characteristic of individualisation.

## 2.2 Restriction

The committee was not identified as engaging in enforcement activities except for production safety inspection<sup>7</sup>. The production safety department of the committee and the national agencies did not treat the FOEs differently according to their industry. Typically, '*they did not discriminate against the toy-maker.*' However, there was only one toy-maker in the zone and it was unusually the largest toy-maker in the city. It held the intellectual property rights (IPRs) for its brand and products. It took up the largest area of self-built factory plants and warehouses in the zone. Nor did the agencies show particular preference for investment origins. Most FOEs were funded by investment originated from Taiwan and Hong Kong. It was evident that, the representative agency practised restriction more actively than facilitation and that it had no preference for the type of firm.

The product safety department did not differentiate the FOEs according to size and compliance in enforcement activities, yet the national agencies did<sup>8</sup>. '*The customs and the AQSIQ are more supportive to big FOEs like ours. We deserve more support because of the '8-2 law' - 80% of the revenue is contributed by the 20% big enterprises.*' The agencies adopted similar categorising schemes to encourage the FOEs to build and maintain high credibility for compliance. They rewarded the

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<sup>7</sup> Interview ETSS

<sup>8</sup> Interview ETSS

credible FOEs with more convenience and attention. The informant's company belonged to Category A, which meant it had the highest credibility. '*The customs discuss with me about a feasible solution to an unexpected problem and advise me how to avoid any reoccurrence of identical problems in the future.*' Contrastingly, the national agencies were punitive to the ill-complying FOEs. The agencies' enforcement activities were indicative of uncoordination. The enforcement process involved various responsiveness, social construction, logic of actions and shared value with the firms.

### 3. The FOEs

The FOEs' compliance with informal rules was evidently imposed by their big buyers<sup>9</sup>. The informant's company adopted ISO14000 in order to sell its products in the EU market. Meanwhile, '*our contract with Wal-Mart stipulates that our implementation of the SA8000 (Social Accountability Standard 8000) is a prerequisite for the establishment of the partnership.*' In the first year of the contract going into effect, the FOE applied SA8000 exclusively in the workshop where the production was solely arranged for the products sold in Wal-Mart. After the first audit, '*Wal-Mart requested us to apply SA8000 to the whole factory production. Now all our factories in China enforce SA8000.*' Wal-Mart made on-site audits annually. The auditors reserved total discretion in choosing whoever they wanted to ask about the actual working conditions and hours; the company's practice about the worker's health and safety; and the discrimination, discipline and compensation issues of the company. '*We comply with higher labour standard. The Labour Contract Law does not incur problems for the company.*'

According to a special report by a local newspaper<sup>10</sup>, the toy-maker must comply with varied informal rules in order to sell products in its major overseas market – the USA. To attain the accreditation from the International Council of Toy Industry was fundamental. It must also get the qualification from Wal-mart for self-inspecting the qualities of its products. After the September 11 terrorist attack, the FOE had to meet the anti-terrorism requirement newly imposed by its American buyers. The requirement contained 74 terms regarding the use of communication technology and the management of human resources and financial accounts. These rules and requirements were much more stringent than relevant formal rules. The above

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<sup>9</sup> Interview ETSS

<sup>10</sup> Contemporaneous newspaper source, copy on file with author.

finding showed that big firms were subject to enforcement based on the supply chain. This informal enforcement structure was functioning effectively and caused positive effect typically in labour protection and product safety.

#### 4. Agency-FOE Interaction

Most departments of the committee had no regularised arrangements with the FOEs<sup>11</sup>. *'The committee does not have communication with us and does not help us at all.'* This was a sign of the representative agency's indifference to the regulatees' demands and non-commitment to facilitation. The product safety department, the customs and the AQSIQ were the few that did have working arrangements with the FOEs. *'We contact the customs and the AQSIQ very frequently because of our large amounts of exports. The customs' procedure is best arranged, compared with those of the AQSIQ, and the production safety department.'* The AQSIQ changed its working arrangement after the Mattel recalls. *'It has strengthened tests and checks on all exported products, including those by non-toy manufacturers.'* For the toy FOEs, the AQSIQ extended the safety-control scope to their suppliers and sub-contracted factories by means of registration<sup>12</sup>. For the non-toy FOEs, *'the AQSIQ's sample checks become more frequent and careful than before.'* The production safety department was active in examining the safety conditions of the FOEs every single day, since the municipal government urged the prevention of safety incidents following a casualty-involving disaster which happened in the city in early 2008<sup>13</sup>. This practice was characteristic of irresponsiveness, rigidity and roboticism. The contrasting enforcement arrangements and styles of these agencies were additional findings of poor inter-agency coordination.

Additionally these agencies' working arrangements varied in efficiency<sup>14</sup>. The customs used an electronic data interchange system (EDI) to examine the FOEs' declarations as well as to retrieve their import and export records. *'It takes the customs only a few minutes to send us back the examined results. The process is simple, fast and more effective than the old scheme based on written forms.'* In contrast, *'the AQSIQ adopts over-inclusive safety tests. We are not convinced of*

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<sup>11</sup> Interview ETSS

<sup>12</sup> The information was published on the official website of the AQSIQ Shenzhen. The link is omitted in order to protect the identity of the FOE.

<sup>13</sup> The information was published on the official website of the FT committee. The link is omitted in order to protect the identity of the FOE. For the fire disaster, see the report at <http://society.people.com.cn/GB/6933970.html>.

<sup>14</sup> Interview ETSS

*their comprehension of high-tech electronic products – do they have similar safety issues as toys? Meanwhile, ‘the production safety department’s checks are burdensome and senseless. It actually discourages well-complying companies like ours.’ The agencies’ varied regulatory efficiency was additional finding for poor coordination. Efficient enforcement process received the FOE’s positive comment and willing compliance. Frequent and repetitive enforcement upset well-complying FOEs and was counter-productive. Variation of enforcement efficiency entailed various formal enforcement effects.*

The customs, the AQSIQ and the product safety departments hosted meetings to inform the FOEs of new rules and policies<sup>15</sup>. The customs and AQSIQ also organised symposiums to listen to the FOEs’ opinions about their operational procedures. ‘*They are serious. They have modified procedures according to our proposals.*’ The agencies’ meetings were not always necessary. ‘*Some meetings addressing production safety issues are held under the order of the DG. They have no substantial purpose.*’ Some meetings targeted particular problems and solutions. ‘*These are comparatively more meaningful.*’ Varied agencies’ attentions to the firms’ voice implied their varied commitment and responsiveness.

The mentioned three agencies visited the FOEs from time to time<sup>16</sup>. They gave early notice for most of their visits. Similar to the meetings, ‘*not all visits are worthwhile. We welcome those that aim at solving particular problems, but not those that lack specific purposes.*’ The FOEs also paid visits to the agencies. ‘*Our administrators visit the agencies to handle relevant affairs. Our CEO occasionally visits the leaders of the customs and the AQSIQ to extend his appreciation and further our mutual understandings.*’ The CEO did not visit the DG of the committee. ‘*Unlike the customs and the AQSIQ, the committee was not interested in understanding our interests.*’ The agency-firm bilateral visits indicated their relational distance and mutual trust.

The informant commented that the AQSIQ staff were not as competent as the customs<sup>17</sup>. ‘*The officers’ interpretations about the same rule are inconsistent. We follow the advice of one officer which we are told by another is incorrect. We have learnt to be careful to keep their advice in written form so as to minimise the incidents of this sort.*’ She reckoned that not all other FOEs were as careful as her

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<sup>15</sup> Interview ETSS

<sup>16</sup> Interview ETSS

<sup>17</sup> Interview ETSS

company in this regard. This comment showed that the agency's inconsistent interpretation of rules was a problem to well-complying firm. The firm managed to cope with this problem by requiring the agency to put its interpretation in written form.

The informant gave an example of a dispute with the committee<sup>18</sup>. The cause of the dispute was the FOE's use of the ground area beside the main entrance of the company's building for temporarily storing the end products before being uploaded for export shipment. '*The market demand is tremendous and our company is fully packed. There is absolutely not one inch of space left.*' The problem of the storage shortage began when the former DG was in office. The FOE asked the former DG about the proposed ground usage and got his permission. Indeed, '*there was no available storage or warehouse in the zone, the area suggested by us was a part of our leased land, and the usage was at a corner which did not obstruct other companies.*' However when the DG changed, the committee's position changed as well. The supervision department criticised the FOE for affecting the orderly appearance of the zone and threatened the FOE with a penalty if it did not cease the usage. '*We asked the department to suggest an alternative storage place which we could rent. It couldn't and claimed that to find a warehouse was none of its business.*' The FOE then filed a letter to the vice mayor in charge of Fujia to complain about the incident. The vice mayor quickly issued a comment, requesting the committee '*to support rather than to make trouble for the FOE.*' The committee department immediately stopped its action, with no explanation. Since then, neither did the committee department re-enforce nor did the FOE change its storage arrangement. This dispute between the representative agency and the firm indicated that Fujia was characterised by individualisation. The agency's unresponsiveness and poor commitment to facilitation as well as the firm's reliance upon the agency's superior for solving the dispute were characteristic of an Uncoordinated regime.

The toy-maker had encountered punitive actions from the customs for a while<sup>19</sup>. The company had managerial problems for years. It changed the general managers frequently. These general managers were Hong Kong natives. They had limited knowledge about Chinese regulations and had no clue how to comply with them. The persons who were hired to handle the customs affairs were not competent either. As a result, the toymaker often made mistakes in its customs declarations,

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<sup>18</sup> Interview ETSS

<sup>19</sup> Interview FTFDG

typically declaring the wrong kinds, quantities and purposes for imports and exports. The customs became suspicious about the FOE's intention. It then penalised the FOE with a fine and carried out frequent spot checks. The FOE's general manager tried to communicate with the customs but failed to convince the customs of the real cause of the problem. Then the chairman of the FOE in Hong Kong contacted the former DG of the committee for help. The former DG had thorough knowledge about the background of the individual FOEs and was trusted by many as a friend. He was also highly regarded by the customs for his leadership qualities. Hence, the former DG contacted the leader of the customs to state the internal problems, the past record and background of the FOE. '*An FOE like this one can't be interested in smuggling. It has made a huge amount of investment in developing IPR products and leased most factory plants and warehouses in the zone.*' The DG was successful in persuading the customs to switch from its punitive stance to an educational approach towards this FOE. He also urged the FOE to improve its managerial strength and the competence of its customs-declarers. The story of the toy-maker implied that even a big firm could be organisationally incompetent and ill-informed.

## 5. Findings

*Institutional features* Fujia is classified as an Uncoordinated regime because of its high grid and low group properties. It is established for the special purpose of competing for overseas investment, with its representative agency accountable upwards for its achievement in this regard. Inter-agency coordination is poor.

*Regulating side* The current DG and staff of the general-purpose agency shows non-commitment and disinterest in maintaining its advantage for attracting business. They do not target or select firms. Although reaching the SIZ's full accommodating capacity can be used as an excuse for being uncompetitive, it hardly poses as an excuse for the worsened facilitation for the incumbent firms and over-emphasis on social appropriateness. The committee's indifference to the FOE's voice and encountered problems showcases bad facilitation. All agencies are well-restrained but various in commitment, preference for firms, and balance of facilitation and restriction. Whereas the customs' practice is committed, responsive, efficient, predictable and innovative, the production safety department of the committee is mechanistic, irresponsible, inconsiderate and burdensome. The AQSIQ is in the middle – on the one hand, it takes the FOEs' opinions seriously and adjusts

its procedure accordingly; and on the other hand, it adopts an over-inclusive inspection strategy and its staff give inconsistent interpretation of rules.

*Regulated side* The FOEs evidently abide the high regulatory standards as requested by their powerful business partners and affiliated international industry association. Notwithstanding the effective functioning of informal enforcement, the firm's managerial incompetence undermines its compliance with formal rule. This is regardless of its good intention.

*Two-sided marriage and match* The agencies and the firms have various bilateral relational distances, distribution of power, social construction, regularised arrangement, trust and accountability. Such variety further suggests poor inter-agency cooperation. Shared value is limitedly institutionalised. The firm's loyalty varies upon the agencies. Generally, the bilateral interaction is characteristic of over-emphasis of legitimacy at the expense of flexibility. Regulatory problems, which are either the agency's or the FOE's fault, cannot be solved through bilateral communication or inter-agency coordination, but need to resort to external influences for solution. Whereas the representative agency does not show preference for the type of firm, the firm is dissatisfied by the agency. The FOEs domiciled in the SIZ before the leadership of the representative agency changed. The current leadership of the representative agency is responsible for the dissatisfying business environment. There is mismatch between the regime and the firm.

*RC outcomes* The structure of domiciled firms was formed before current leadership. It cannot be used as a reference for regulatory attraction. But based on the information from the informants and other public sources, the regime is generally not competitive or facilitative. At least, the regime shows little business attraction to big investors from HRCs. Whereas the FOEs adopted high social standards that are enforced by the supply chain, the representative agency shows no appreciation but adopts a broad-brush enforcement style. The general enforcement effect is burdensome. There is no finding for the regime to use favourable conditions strategically. Overall, the regime has little regulatory advantage.

## 6. Outstanding Issues

Fujia is determined as an Uncoordinated regime, based on its high grid and low group. Generally speaking, it's observed characteristics agree with the interpretation

by the ER Framework. A few observed issues are outstanding referring to the framework. These issues are explained below.

Firstly, empirically this Uncoordinated regime has attracted so many FOEs that its territorial space is fully occupied. In the contrary, the ER Framework describes it as not attractive. The explanation is that, according to the informant, the Uncoordinated feature took shape only after the change of the DG of the committee. The empirical attractiveness is likely to be historical. By and large the current achievement should be attributed to the performance of the previous regime, which was arguably an Adherent type. Thus, this issue is explicable through a historical perspective.

Secondly, the performance of the Fujia customs is of flexibility, certainty, facilitative and restrictive responsiveness and generates desirable enforcement effect. These characteristics are exactly opposite to what is interpreted by the ER Framework for the Uncoordinated regime. The explanations are that, on the one hand, the customs is not representative of the Fujia regime. Instead the committee, the general-purpose agency, is the officially acknowledged specialist that represents the regime<sup>20</sup>. For the characteristics of the Fujia regime, one should examine those of the committee first and foremost, not those of another agency. On the other hand, the customs follows its own course by being facilitative and has no apparent coordination with the committee. The customs' facilitation is contrasting to the poor facilitation of the committee and is indeed characteristic of an Uncoordinated regime. From this viewpoint, the empirical finding actually supports the interpretation of the ER Framework.

Finally, empirically, big firms from low-regulating investment origins (LRC) vary in compliance with formal rules. Theoretically, this type of firm is not addressed by the ER Framework, which portrays four archetypes only. The archetype is one of the acknowledged limits of the framework. To fully capture the types of firms in a real world, future research needs to develop the framework in terms of characterising more types of firm, for example hybrid. However, the finding means the framework is limited, not wrong, since the framework does not interpret, rather than interprets incorrectly, the mentioned type of firm.

The identified outstanding empirical issues are explicable. The explanations are made by emphasising historical dimension or the limited archetypes of the ER

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<sup>20</sup> For reference, see the section about sample cases in Chapter IV.

Framework. To summarise, the Fujia case generally supports the ER Framework concerning the characteristics of the Uncoordinated regime.

## **Case 2: Ximo of Suzhou**

### **1. The Regime**

Ximo was a nation-class SIZ established for the purpose of promoting foreign investment in the high-tech industries<sup>21</sup>. The committee had full local authority to regulate the foreign investment issues in the zone. Except for the national agencies, the other 19 economic and social regulatory agencies were the constituent departments of the committee. Inter-agency coordination was limited according to the informants<sup>22</sup>. A few departments were mentioned as exceptional. The land planning and construction departments contacted each other when their standards were in disagreement, which would cause the procedures of the construction plan of an informant's company to grind to a halt<sup>23</sup>. The labour department invited other departments to join in the inspection<sup>24</sup>. The two examples were identified as different in nature. The former, which was for facilitative purpose, was ad hoc; whereas the latter, which was for restrictive purpose, was routine. Various working styles inside the general-purpose agency indicated a lack of coordination.

According to the information given by its official website<sup>25</sup>, Ximo currently had abundant land available for accommodating large numbers of manufacturers. The industries involving foreign investment included computer and peripheral devices, integrated circuitry, electronic components and materials, semi-conductors, automobile components, marine devices, aviation materials, precise instruments and meters, and communication devices. Nevertheless, the informants revealed that there were also FOEs undertaking traditional manufacturing such as garment making<sup>26</sup>. The finding of Ximo's superiority underpinned by abundant land and its admission of undesired low-tech industry indicated that the regime was disinterested in competing for quality foreign investment through targeting and innovation.

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<sup>21</sup> Information at the official website of Ximo

<sup>22</sup> Interview ECS3I2E

<sup>23</sup> Interview ETS3E3

<sup>24</sup> Interview ETS3E3

<sup>25</sup> The website address is omitted in order to protect the identities of the informants.

<sup>26</sup> Interview ETS3E3

## 2. The Agencies

### 2.1 Facilitation

According to the informants from an early-settler FOE, '*the committee's service is getting worse. What it has promised is not actualised. It promises to sort out the problems of power and water, but the supplies are as poor as ever.*'<sup>27</sup> Meanwhile, '*most section chiefs (SCs) and administrators don't help. As a matter of fact, how helpful they are depends on your relationship with them.*' The worsening service upset the old established FOE: '*We used to be active in introducing new investors to the zone. We have made contributions to its development. Now we don't do it any more. We have no interest in contacting or interacting with the committee.*' As the agency became poorly committed and facilitation became individualised, the firm demonstrated less loyalty and more exit tendency.

Asked what could underpin the change in the committee's service, a cynical answer was '*the committee doesn't need to provide a good service to appeal to foreign investors, does it? The zone still has abundant available land, whereas others don't.*'<sup>28</sup> A tolerant answer was '*the committee has too many enterprises to serve. The workload is heavy. It cannot afford a quality service to all enterprises at all times.*'<sup>29</sup> This finding suggested that the agency was not committed to RC or facilitation.

Notwithstanding the complaint about the downgrading of the committee's facilitation, the informants still believed that an SIZ was better than a non-SIZ. '*The officials are not corrupted.*'<sup>30</sup> The committee was comparatively centralised and specialised. Hence, '*we know to whom and where we should approach for specific issues. We can find them in one shop.*'<sup>31</sup> Besides, the favourable conditions were still effective for the IT investors from Taiwan, which allowed the high-tech FOEs to enjoy complete exemption from corporate income tax for the first two operating years and half rate for the following three years.<sup>32</sup> The finding here indicated that the agencies were well disciplined. Also, favourable conditions rather than regulatory innovation were an attractor to high-tech investors from LRCs.

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<sup>27</sup> Interview ECS3I2E

<sup>28</sup> Interview ECS3I2E

<sup>29</sup> Interview ETS3I3E

<sup>30</sup> Interview ECS3I2E

<sup>31</sup> Interview ETS3I3E

<sup>32</sup> Interview ETS3I3E

The committee organised the annual Spring Festival symposium for the FOEs' bosses and general managers to make suggestions. However, '*one cannot give a serious opinion on such an occasion.*'<sup>33</sup> The committee also hosted comprehensive coordination meetings once or twice a year. These were attended by the constituent departments. The officials listened to the FOEs' comments and suggestions about living, working, transport conditions and social order. However the informants could not identify any positive effect from the meetings. An understanding informant commented: '*our proposal is based upon our narrow interests. But the committee has broad concerns.*'<sup>34</sup> A cynical comment was, '*I cannot figure out exactly what the committee is concerned about.*'<sup>35</sup> Being an exception, the customs listened and streamlined the procedure according to the FOEs' suggestion<sup>36</sup>. Generally, the agencies did not take the firms' voice seriously. The two sides lacked mutual accountability and trust.

## 2.2 Restriction

The committee and other agencies did not demonstrate noteworthy differentiation between the FOEs regarding size, industry and compliance<sup>37</sup>. '*They do not particularly treat the big FOEs better than the SMEs. Except for providing a 'green passage' to a very few extra-large FOEs like Foxconn*'<sup>38</sup>, *they do not provide extra convenience for big companies.*' Nor did the agencies differentiate the FOEs according to industry. '*They treat the hi-tech FOEs the same as the garment makers. Yes, it is unusual. The equal treatment makes the garment-making FOEs in other locations envious.*' The agencies penalised wrongdoers, but they did not reward the good ones with noticeable convenience. For instance, '*though the customs categorises the enterprises according to compliance, the extra convenience which a Category-A enterprise like ours can enjoy is marginal. We pay less guarantee deposit but still need to go through the common formalities.*' However, the informant admitted '*the formalities are simple.*' The agencies were identified to differentiate the FOEs according to investment origin. They preferred the American and Korean funded enterprises to the Taiwanese ones. '*There are only a handful of American and Korean enterprises in the zone. They treat the workers better than the Taiwanese companies. The wages are higher and the meals are free.*' The finding here suggested that the agencies were irresponsible in both

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<sup>33</sup> Interview ECS3I2E

<sup>34</sup> Interview ETS3I3E

<sup>35</sup> Interview ECS3I2E

<sup>36</sup> Interview ETS3I3E

<sup>37</sup> Interview ETS3I3E

<sup>38</sup> For the detailed background of the FOE, see <http://www.foxconn.com>.

facilitation and restriction. They had no preference for the firm's industry but investment origin implied their disinterest in competing for high-tech firms on the one hand, and interest in easiness of enforcement on the other.

### 3. The FOEs

The labour department enforced the 2007 Labour Contract Law strictly. It was more protective towards the FOEs' workers than the employers. It invited the TV station to report the state of the workers in the FOEs. The reactions of the FOEs varied. The company of one informant chose to strengthen corporate self-enforcement<sup>39</sup>. '*We have adopted more stringent norms to prevent labour incidents.*' The informants' companies encountered labour disputes after the promulgation of the <Labour Contract Law> in 2007. '*As the law entitles the workers to retrieve under-pay years back, the company has to spend a fortune to compensate the workers.*'<sup>40</sup> In addition, '*the labour department adopted a scheme which enables the workers to litigate against their employers even if they cannot afford the litigation charge.*'<sup>41</sup> A neighbouring company took an entirely different strategy<sup>42</sup>. '*To comply with the new law means higher labour requirements and cost, and hence more managerial challenge. The company chooses an easier way to do it.*' That FOE hired most workers for the short-term, which included three-month probation. Since the law was applicable only to long-term employment, to hire short-term workers saved the FOE large expenditure.

To solve the disputes, the informant of one FOE stated, '*we negotiate with the workers first. If unsuccessful, we resort to arbitration. We trust the justice and expertise of the tribunal.*'<sup>43</sup> Another FOE had a different view. '*We sort out the labour disputes on our own. We don't ask for help from the committee. They have no serious concern about us. Their solution is not speedy or desirable. They make us feel like they are the superior and we are the subordinate. It is a favour not a duty for them to help us, and we should be grateful for their help.*'<sup>44</sup>

Whereas the agencies demonstrated unbalance practice for facilitation and restriction, they typically enforced labour regulation stringently. The firms' reactions

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<sup>39</sup> Interview ETS3I3E

<sup>40</sup> Interview ECS3I2E

<sup>41</sup> Interview ETS3I3E

<sup>42</sup> Interview ETS3I3E

<sup>43</sup> Interview ETS3I3E

<sup>44</sup> Interview ECS3I2E

to the labour enforcement were various. So were their trusts in the agencies' competence. Formal enforcement effect tended to be positive. Some firms improved self-regulation, while some took strategic measures to take the advantage of legal loophole.

#### 4. Agency-FOE Contact

The committee departments had different working styles. The social security department and the human resource market agency were infamous for bad working attitudes<sup>45</sup>. The economic and trade department and the scientific development department were among the few that were friendly and worked efficiently. An explanation was that their achievements were symbolic to that of Ximo's business attraction<sup>46</sup>. The customs, the labour department and the construction department were helpful. The labour administrator gave explicit advice as to how to formulate labour contracts and to proceed to arbitration. If necessary, the SC offered expert consultation. The construction department had clear on-line information about applying for self designed and built factory plants. Also '*The administrator noted all the problems and corrections on the documents at the first submission. This saves me from repetitive visits before finalising the submission to apply for the construction permit.*'<sup>47</sup> It was evident that the agencies varied in commitment which seemed to be related to their respective duties. This varied agencies' commitment implied uncoordination.

One informant complained about the committee's unpredictable implementations. '*The committee issues a new policy in mid-year stating that the policy went into effect from 1<sup>st</sup> January. We have to trace back and correct what we have done in order to ensure compliance.*'<sup>48</sup> She considered the committee's pronouncement was not unusual. '*The committee does not clarify its rules in written form. The officers are free in giving words. We are confused by what and how to comply.*' Because of the representative agency's inconsistent policy making and interpretation, certainty was at issue.

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<sup>45</sup> Interview ECS3I2E and ECS3I3E

<sup>46</sup> Interview ECS3I2E

<sup>47</sup> Interview ETS3E3

<sup>48</sup> Interview ECS3I2E

There were exceptions<sup>49</sup>. The labour department gave notice of forthcoming meetings by fax. The FOEs could use the economic and trade department's websites to send its latest statistics, such as the production and export volumes. The production safety department specified explicit requirements for what the FOEs should and should not do and requested the FOEs to self-enforce those requirements. If the production safety department discovered problems, it requested the FOEs to present written statements about the problems and their corrective actions. The environment department made an annual review of particular electronic FOEs in order to evaluate the ambient air quality and to ensure no impairment to workers' health. The customs' working arrangement was clear and easy to follow<sup>50</sup>. Its examining procedure was '*efficient and humane*.' The AQSIQ did not change its working arrangement with the electronic FOEs after the Mattel recalls<sup>51</sup>. As the FOEs already followed the higher quality standards imposed by the big partners, they did not have any problems passing the AQSIQ's tests. Generally, the mentioned restrictive and national agencies had regularised arrangements. Such arrangements assured the firms of certainty, efficiency and business friendliness. They entailed positive formal enforcement effect. The formal enforcement effect was complemented by the firms' compliance with informal regulation, which was however not awarded responsive enforcement by the agencies.

Particular agencies organised purposeful meetings for the FOEs to attend<sup>52</sup>. One was to notify the FOEs of the agencies' implementation methods. These included the method and procedures on labour and environmental protection, technological research and development, and production safety. Another was for training. The agencies entrusted special training institutes to irregularly lecture the FOEs about formal rules. These meetings were regarded as worthwhile by the FOEs and engendered positive enforcement effect.

Most agencies made few visits to the FOEs<sup>53</sup>. The customs, the labour department and the production safety department were the expected visitors. The customs made routine inspections once or twice a year. The labour department made spot checks on the FOEs' compliance irregularly. The officers randomly picked workers to inquire about their working conditions, pay and other welfare issues. The checks

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<sup>49</sup> Interview ETS3I3E

<sup>50</sup> Interview ECS3I2E

<sup>51</sup> Interviews ECS3I2E and ETS3I3E

<sup>52</sup> Interview ETS3I3E

<sup>53</sup> Interviews ECS3I2E and ETS3I3E

might be attended by the director-general (DG) of the committee, who brought TV reporters to film the activity. Each year, the production safety department selected 12 key enterprises and visited one each month. The visitors came in a group, attended also by the police, transport regulatory agency, urban management agency and the FOEs' production safety managers. They investigated the safety facilities and conditions of the enterprises, diagnosed potential safety risks, suggested corrections and alerted the FOE participants to reflect and improve the state of their companies. The informant held the agencies' visits functioned as an alert. While the agencies varied in their interactions with the firms, the mentioned agencies were committed to social construction. This social construction enabled both parties to share the value and logic of appropriateness. It entailed positive formal enforcement effect.

## 5. Findings

*Institutional features* Ximo is categorised as an Uncoordinated regime based on its characteristics of high grid and low group. It is specifically and openly accountable for the achievement of competing for high-tech industries. The coordination between facilitative and restrictive agencies is typically poor.

*Regulating side* The general-purpose committee as a whole does not show commitment or interest in RC for the targeted type of firm as required by its regulatory goal. Its possession of abundant land makes it unrivalled by surrounding jurisdictions. Though not openly disclosing, the regime actually admits low-tech traditional manufacturers. Its facilitation is getting worse and it does not seem to take the FOEs' voice seriously. Certainty it is undermined by the committee's changeable policies and its staff's inconsistent interpretation and facilitation. These indicate the regime's poor commitment to the official business-attracting goal. Contrary to the disinterest in facilitation, restrictive regulation is paid extraordinary attention. It is generally carried out in active, stringent and coordinative manners. Nevertheless, the restrictive agencies do not differentiate the FOEs according to corporate size, industry or compliance. Hence both facilitation and restriction lacks responsiveness.

*Regulated side* The firms from low-regulating origins vary in their intentions and reactions towards formal enforcement. Facing the enforcement of the new labour law, some enhance self-enforcement but others play strategically. The few

firms from high-regulating countries (HRCs) demonstrate good intention and voluntary self-enforcement.

*Two-sided marriage and match* The agency-firm distance and social construction varies depending on the agencies' duties. The distant and arrogant facilitative agencies are 'opted out' by the FOEs in the bilateral interaction. In contrast, the restrictive agencies are active in regularising enforcement arrangement and institutionalising shared values and logic of appropriateness. These include the national agencies, particularly the customs, whose performance is predictable and efficient. Nevertheless, the FOEs have contrary opinions. Some consider the restrictive performance worthwhile and expert. Some view the agencies as untrustworthy and unaccountable. The representative agency is responsible for the worsening facilitation and regulatory environment. Whereas the representative agency is not selective about firms, incumbent firms are unimpressed of the business facilitation. This indicates a mismatch between the agency and the firms.

*RC outcomes* The structure of the domiciled firms shows that Ximo is particularly attractive to those from LRCs - an undesired result according to the national foreign investment strategy. These firms make up the majority of the resident population. Such an attraction is mostly based on its high-tech favourable conditions. This implies the regime's limited business attraction to the desirable type of firm. The agencies' impose stringent, expert and coordinated enforcement of labour regulation. However their enforcement does not show responsiveness, indicated as the agencies' depreciation of firms' good compliance. This is evident that formal and informal enforcements are not complementary. Considering also the lack of legitimacy and innovation, the Ximo regime lacks regulatory advantage to quality overseas investment.

## **6. Outstanding Issues**

Most observed characteristics of the Ximo regime are agreeable with the interpretation as the Uncoordinated by the ER Framework. There are a few outstanding issues requiring explanations. These explanations will by and large support such a conclusion that the empirical finding of the Ximo case is plausibly interpreted by the ER Framework.

Firstly, the Ximo agencies seem to exercise restrictive duties in a coordinated, expert and fair manner. This manner seems to be contrary to the interpretation of

the ER Framework, which is uncoordinated. The explanation is that, the mentioned characteristics are of the restrictive agencies only, not of both facilitative and restrictive agencies. The description about weak inter-agency cooperation by the ER Framework for this regime is between the two types of agencies: facilitative and restrictive. With a simplified assumption, the framework does not pay attention to the cooperation within each type of agency. Therefore, the empirical finding does not challenge the framework's interpretation.

Secondly, empirically the regime attracts many high-tech firms from LRCs, whereas the ER Framework interprets the Uncoordinated regime as of little attraction to any types of firms. One explanation is that current industrial structure is likely to form when the regime was active in competing for foreign investment, or when it was not an Uncoordinated. The information given by the early-mover FOE supports this explanation. Another explanation is that the regime is empowered to grant favourable conditions. These conditions rather than the agency's performance are found to be appealing to those from LRCs. This finding supports such a note by the thesis that regulatory practice, including enforcement, is only one factor that affects the firm's choice of destination. Therefore, the empirical finding does not disagree with the specific argument of the ER Framework.

Finally, the restrictive agencies are found to prefer the firms from HRC to those from LRC. This is because the former voluntarily self-enforce high labour standard, whereas the latter are strategic in feigning compliance to the labour law. In contrast, the ER Framework interprets that the firm's compliance with informal rule is not appreciated by the regime. The explanation reminds that in fact, no agency awards or encourages well-intentioned and well-complying firms in any substantial way. This found fact means that the empirical finding is not disagreeable with the specific interpretation of the ER Framework.

## Conclusion

Categorised as Uncoordinated regimes based on their high grid and low group properties, both Fujia and Ximo demonstrate in fact characteristics that are mostly agreeable to the hypotheses made by the ER Framework. Their agencies are well constrained, irresponsible and not selective about business, show little interest or commitment to competing for foreign investment, do not deploy entitled favourable conditions strategically, are more active in exercising restrictive duties than

facilitative tasks and practise regulations in their individual rationales and styles. The preferences of both regimes and their respective domiciled firms clearly mismatch. At the same time, the two regimes are found to have characteristics that are different from the interpretation of the ER Framework. Typically, both SIZs have been successful in attracting foreign investment with varied industries and investment origins. These outstanding issues are explicable through a historical perspective or the heuristic property of the framework. At least so far, based on the empirical findings as well as the explanation of the outstanding issues, it is concluded that the ER Framework is plausible in its interpretation of the Uncoordinated regime.

## Chapter VII The Conciliative Regime

The cases involved in this study are the Lufei Village<sup>1</sup> in the city of Shenzhen, and the Tuqing Town in the city of Suzhou. To interpret them by the ER Framework comprises three stages. The first stage is an initial classification of the two cases based on a simple grid and group analysis. This analysis also briefly depicts the institutional features of the two cases. It is followed by a second stage in which a detailed report is made for the evident characteristics of the Conciliative regime. The final stage is a summary of the empirical findings as well as addressing any necessary outstanding issues.

Despite being of different levels<sup>2</sup>, the Lufei and Tuqing councils are the sub-city governments that govern local economic and social issues. They are viewed as the representative agencies of the regimes. They are not specialist regulatory authorities for foreign investment attraction. Officially, foreign investment attraction is no more than one regulatory goal for Lufei and Tuqing to account for. Neither regime is required to give particular attention to this goal. Particular attention if any is entirely their own decision. Therefore, both are considered as low in grid. The Lufei regime is represented by its village council. Its inter-agency cooperation has been enhanced in order to ensure general provision of business facilitation. Hence, Lufei is viewed as high in group. Similarly, The FOEs in Tuqing are governed by its town council. Most relevant agencies are the departments of the council. They are highly cooperative and committed to the fulfillment of foreign investment attracting and business facilitating goals. Hence the group is high.

### Case 1: Lufei of Shenzhen

#### 1. The Regime

##### 1.1 Profile

The Lufei Village had a low-profile in foreign investment attraction. There was rare public information, including media coverage, for this small village. Such a low

<sup>1</sup> The name of 'village' was replaced by 'Street' in the urbanisation led by the municipal government from 2003 (See <Shenzhen Becomes the First City without a Village> at <http://gd.news.sina.com.cn/news/2010/09/06/991111.html>). In order to avoid the confusion, this thesis still uses the old name to refer to this specific community at the microscopic level.

<sup>2</sup> The village is lower by one administrative level than the town. For more details about the administrative levels, see the DiagramV in Chapter IV.

profile implied low accountability for its practice and freedom from monitoring by those outside the locality. According to the native informant<sup>3</sup>, the most current incumbent FOEs were run by Hong Kong investors. They were SMEs that undertook traditional manufacturing such as making toys, clothes, handbags and shoes. This structure indicated that Lufei was particularly attractive to SMEs in low-tech industries from low regulatory origin (LRC).

## 1.2 Organisational Peculiarity

The village council was the lowest-level government in the bureaucratic hierarchy<sup>4</sup>. The council's budget for public administration was allocated by the higher-level government<sup>5</sup>. Meanwhile, it sourced extra income from assorted administration charges, including land leasing. The resident FOEs were their income source<sup>6</sup>. The specific collection was carried out by an economic entity fully owned by the council – the Economic and Trade Development Company (ETDC). The shareholders of the ETDC were the native villagers, some of whom were the council officials. Once a year, the ETDC issued dividends to these shareholders. The source of the dividends was the charges levied on the FOEs, particularly those undertaking three types of processing (TTP), namely processing with the raw material, according to the sample and by assembling the components provided by overseas clients, and compensation trade<sup>7</sup>. A TTP enterprise did not pay tax to the national or municipal revenue bureaus but paid administration fees to the local authority<sup>8</sup>. This implied that TTP enterprises were an extra revenue source of the regime; and that the regime's competition for TTP enterprise was underpinned by its self-interest in maximising organisational revenue. Meanwhile, paying such an administration fee implied that the firm could evade taxes. In the case of Lufei, it was the ETDC that collected the fees, based on the FOEs' production contracts. The ETDC dispatched a factory director (FD) to each TTP-type FOE<sup>9</sup>. It was mandatory for the TTP-type FOE to accept and pay the FD. The FD was a native villager who was a shareholder of the ETDC. He played the role of a contract-monitor rather than a manager in the FOE. He was the person who bound the council and the FOE financially. This implied that the agency-firm relation was not regulatory but based on business

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<sup>3</sup> Interview THLG1

<sup>4</sup> See Diagram V in Chapter IV.

<sup>5</sup> Interview BOSVDG

<sup>6</sup> Interview THLG1

<sup>7</sup> Hereinafter three types of processing and compensation trade are simplified as 'TTP'.

<sup>8</sup> See <Shenzhen Municipal Government's Provisions on Enhancing Regulation on 'TTP' Enterprises> at <http://www.law-lib.com/lawhtm/1995/25907.htm>.

<sup>9</sup> For details and arguments about this FD-dispatching scheme, see <Shenzhen Longgang Street's Office Dispatches Natives to be Factory Directors in Enterprises> at <http://big5.cri.cn/gate/big5/gb.cri.cn/8606/2005/11/15/641@781739.htm>. Interview THLG1A

contract or bi-partisanship. The FD-based arrangement institutionalised shared value of the regulating and regulated sides.

The informant's Hong Kong Company registered as a TTP-type<sup>10</sup>. The TTP was the prevailing form used by the FOEs when the country began opening up to foreign investment in the early 1980s. The investors from Hong Kong mostly adopted the TTP form to undertake traditional manufactures. In the middle 1990s<sup>11</sup>, the municipal government declared its strategy to discourage the TTP-type FOEs because of their limited contribution to economic development in terms of adding no value to importing capital, advanced technology and management. Consequently, the special investment zones (SIZs) permanently suspended the approval of the TTP-type. Many TTP-type FOEs had left the city for less open and developed locations. According to the data from the Shenzhen Bureau of Industry and Commerce Administration, by 2008, there were about 600 toy FOEs remaining. Nearly all of them resided in the suburban villages, with some categorised as the TTP type<sup>12</sup>. This indicated the difference in enforcement between the SIZ and non-SIZ. The informant's company had kept the TTP status since its establishment in 1991. With this status, the FOE stayed under the protective umbrella of the village council. *'It saves the need to coordinate with assorted governmental agencies. Mostly, we need to face one agency – the village council.'*<sup>13</sup> In itself, this implied that it was easier and cheaper for bribery. Also *'it frees our company from paying tax. Thus we can retain our profit at maximum.'* This showed the SME's intentions of maximising profit and escaping from formal control.

### 1.3 Inter-Agency Relationship<sup>14</sup>

The departments of the council coordinated with each other. This was evident of high group. Some coordination was aimed at self-serving goals. For instance, the power supply department had an agreement with the production safety department for the compulsory use of a designated switch for self-installed electricity generators. The FOEs with self-installed generators must buy from the power supply department to use the designated switch. Otherwise their applications for using the generators would be disapproved by the production safety department and consequently they could not carry out production.

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<sup>10</sup> Interview THLG1

<sup>11</sup> See <Transformation of New Special Economic Zone: Unification of Great Shenzhen> at <http://city.sina.com.cn/invest/t/2010-06-12/10535523.html>.

<sup>12</sup> File archived with the author

<sup>13</sup> Interview THLG1

<sup>14</sup> Interview THLG1

The coordination with the customs was more difficult than that between the departments of the council. However in recent years, the council was successful in bringing the customs in line with its pro-business track. The customs' practice had become predictable. It usually notified the council before its visit, so that the council could in turn alert the FOE. The customs might still conduct a spot inspection if it received a report of an FOE's illegal operation. However an unannounced visit like this rarely happened.

Generally, Lufei's high group characteristic involved the agencies' manipulation and ill constraint. Inter-agency coordination led by the representative agency was aimed at strengthening facilitation and relaxing restriction.

## **2. The Agencies**

### **1.1. Facilitation<sup>15</sup>**

Though the TTP-type FOEs were contributors to the villagers' income, the authority did not always support them. Typically before 2007, the council's labour department took the worker's side whenever settling disputes with the employers. The council did not communicate or coordinate with the customs, as it claimed whatever the customs decided was its own business. The council was not concerned about the FOEs' exit, since it expected newcomers to take up the vacancy. Since the promulgation of the 2007 labour law, many FOEs experienced strikes and failed to survive, and many factory buildings were left vacant. With the very limited entry of new FOEs, the village revenue dropped considerably. The council began to realise that to fill the vacancies with bigger FOEs was nigh on impossible. The village could not afford to compete for the big investors, due to its shabby factory plants, limited available land and other resources. Meanwhile, unlike the TTP-type SMEs, big FOEs contributed to the municipal and national revenues and generated no direct benefit for the village. Thus the council made a dramatic change in its standpoint. It switched from an indifferent stance to a position of befriending the SMEs, particularly the TTP-type. It not only engaged in actively supporting the domiciled FOEs but also opened arms widely to embrace new entrants of TTP-type investors. The finding from a historical perspective further suggested that Lufei's competition and preference for overseas SMEs was driven by revenue maximisation. Opposite to the national and municipal strategies, Lufei's strategy was characteristic of

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<sup>15</sup> Interview THLG1

instrumentality and illegitimacy. Meanwhile, the prevalence of labour disputes and strike indicated the SMEs' poor compliance of labour regulation.

The council's new arrangement and practice became extraordinarily friendly. The council emphasised building friendships with the FOEs. The friendliness and support could be read in the attitudes and actions of the officers of all ranks in the council - from the chief councilor to the administrator. The labour department switched sides and became supportive to the employers rather than the workers. The council's relationship with the customs became notably closer so as to be protective rather than restrictive to the FOEs. The regime's switch of stance and practice from restriction to business facilitation and even protection aimed at pleasing the type of firms that was undesired nationally and municipally. It was indicative of Lufei's strategic choice as well as Lufei being dissident to the national strategy.

### **1.2. Restriction<sup>16</sup>**

The council did not discriminate between FOEs with regard to their size, industry, investment origin or compliance. Regarding the size, all FOEs domiciled in the village were SMEs. Compared with big FOEs, they lacked resources and were vulnerable to regulatory change. Some were too weak to survive a strike. They relied heavily on the council's support. SMEs were more loyal to the village than the big companies. Big ones were in a strong bargaining position and more likely to be targeted and attracted to rival jurisdictions. Therefore, it was safer for the regime to have SMEs. Regarding the industry, a long stay of the TTP-type FOEs of traditional industry was to the financial benefit of the council and the whole village at large. Regarding the investment origin, the SMEs from LRCs seemed to suit better the council's instrumental strategy of foreign investment attraction. The council did not mind being the home of the SMEs all owned by Hong Kong businessmen. Regarding the compliance, the council inspected the ill and well complying FOEs alike. The informant complained about the inspections and would rather have no inspection at all. Lufei evidently preferred SMEs, which was the exact type discriminated by national and municipal governments. The regime and the domiciled SMEs - the main industrial population – were mutually dependent and loyal. Ill-complying firms' benefited from the agencies' favour to escape from targeted and responsive enforcement. The Lufei regime benefited from extra organisational revenue generated by the most undesired type of firms.

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<sup>16</sup> Interview THLG1

### 3. The FOEs<sup>17</sup>

Following the promulgation of the <Labour Contract Law> in 2007, there was a sharp increase in strikes and labour disputes. This finding indicated the domiciled firms' adoption of low labour-protecting standards. The labour department of the council was protective of the FOEs. An example was that, when a strike for a pay rise happened in the factory next-door to the informant's, the labour officers immediately came to the site. They requested the workers to first return the extra money which had been paid by their boss on festive occasions before proceeding to seek a solution for a pay rise. Due to this tactic played by the labour officers, the strike very soon ended, with the workers' aim aborted. The informant's company did not have any strikes because '*I have a friend who used to work in the municipal Labour Bureau. He advised me how to manipulate the structure of the worker's income. Hence I save expenditure on paying the worker's social security and other welfare.*' Unfortunately the trick was identified by two clever workers who sued the company at the tribunal. The informant won the battle, '*because I know more tricks than they, and my labour-expert friend helped me.*' The finding here indicated that the agencies and the firms were in a bipartisanship in enforcing labour law. Whereas the firms complied poorly, the agencies manipulated interpretation and implementation. The agency-firm bipartisanship was based on illegitimate logic and engendered negative formal enforcement effect.

On average, the informant's company had serious problems twice a year. The main causes for the problems were the FOE's ill compliance to the new labour law and smuggling. In spite of the support and coordination given by the council, the FOE had to rely on its own capacity to seek solutions when a crime such as smuggling was spotted. '*Our company was reported by an employee for using tariff-free imported materials to produce machines sold domestically instead of exporting them. It took me personally to sort out the problem with the customs.*' To desirably sort out a problem like this meant to acquire a light penalty. '*It relies on bribery. It cost the company one million RMB yuan (approximately GBP 100,000) to be freed from the penalty. It is expensive, but it still costs less comparing with the amount of fine that possibly could have been incurred.*' The informant methodically switched off her mobile around 5pm each weekday, '*or I will receive calls from the customs to request arrangements for entertainment and relaxation at night.*' These included

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<sup>17</sup> Interview THLG1

dinners, sporting events and massages. '*I ask the factory director to answer their calls, accompany them to the activities and pay the bills.*'<sup>18</sup> This finding indicated that the involved FOE was typically well-informed and ill-intentioned. Its committed crime could be so serious that the general-purpose council was unable to protect it. But the task-specific agency was so ill-restrained that the FOE could get away from penalty through bribery. The agency-firm interaction was characteristic of illegitimate and instrumental logic. There was no finding for the FOE's appropriate self-regulation. Rather the negligent agencies' performance encouraged its incompliance and misconduct.

#### **4. Agency-FOE Contact**

The council and the TTP-type FOE were bound through the FD<sup>19</sup>. The bilateral relationship was evidently close. Yet the FD's role was tricky. If too loyal to the FOE, he would be complained about by the ETDC. But if too loyal to the ETDC, he made the FOE feel betrayed. Thus the FD had to take care in balancing his relationships with both sides. Nevertheless, the FD was likely to abuse his position. An example was given about the FD of a neighbouring FOE. Over the years, the FD had claimed large amounts of money from the Hong Kong boss in the excuse of bribing a councilor to attain certain approvals. The boss eventually found out that while the approvals were still difficult to be attained, the FD, whose explicable income was solely sourced from the company, had bought a nice new car and built a new house. This indicated that the close agency-firm relationship was not free from manipulation, bearing in mind the ill restraint of the agency.

The informant had spent a great deal of money in order to keep her FD faithful to the company<sup>20</sup>. She had not only set an unusually high salary but also offered extra subsidies to the FD. For instance, she bought a car for the FD and paid tuition fees for the FD's daughter. The FOE's generosity was rewarded by the FD's commitment. She helped the FOE in maximising the support from the important agencies, namely the labour department and the customs. Based on the successful experience, the informant recruited a second FD. This one had personal connections with the police office and power supplier. These were the two agencies whose support was now considered as necessary to the FOE. The FOE's way of treating its FD typically indicated a trading partnership for the firm and the agency, in

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<sup>18</sup> Interview THLG1A

<sup>19</sup> Interview THLG1 and THLG1A

<sup>20</sup> Interview THLG1 and THLG1A

which the two parties enjoyed symmetric distribution of power. The ill-intentioned and well-informed FOE was able to 'buy' extra facilitation and lax restriction through investing in this partnership.

The council had close contact with the FOEs<sup>21</sup>. They notified the FOEs by fax and letter to self-examine their compliance with specific regulations and to submit written reports about the results. The customs also used the same contact forms to propel the FOEs' self-regulation. The agencies hosted meetings to inform of new regulations and incidences, such as fires, labour disputes and smuggling. Although the agencies requested the FOEs' bosses to attend, the FOEs usually dispatched the FDs on their behalf. '*It is worthwhile to learn new regulations, but not to hear similar stories again and again.*' The labour department regularly organised training courses to educate the FOEs of labour law and regulations. Aware of the vulnerability of the FOEs in the light of the 2007 <Labour Contract Law>, the labour department organised training programmes for the employers to manipulate their practices so as to best protect their own interests<sup>22</sup>. The agency-firm contact demonstrated lax enforcement and hence negative effect. The agencies allowed the firms to self-report their compliance, in spite of the firms' bad record. Their educations were either ill-structured, so that the investors were disinterested in attending, or manipulating, so that ill-intentioned firms could get well-informed about creative compliance.

The departments of the council frequently visited the FOEs<sup>23</sup>. The councilor visited in order to show his concern for the FOEs. The labour department carried out regular on-site inspections. The inspections mostly concerned the labour contract in terms of whether the content was agreeable with the law and whether or not the wage was set lower than the city's minimum wage standard (MWS). Typically the visits were paid after only giving short notice. The FOEs did not consider the council's visits as worthwhile. '*Most visits lack specific purpose. They are repetitive and bring unnecessary burden to us. Particularly, the boss has to be present for the visits by the labour department and the customs.*' Asked about the FOE's visits to the council and other agencies, the informant replied, '*I do not visit them unless for solving serious problems. I ask the FD to sort out all affairs. But I personally deliver the gifts and money on traditional festivals.*' The finding suggested that the agencies' social construction was ill designed and did not yield positive enforcement

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<sup>21</sup> Interview THLG1 and THLG1A

<sup>22</sup> Copy of the source on file with author

<sup>23</sup> Interview THLG1 and THLG1A

effect. The firms did not trust the agencies' accountability and played tactically in the bilateral interaction.

The informant gave an example of a problem incurred from a production safety inspection<sup>24</sup>. The inspectors were declined entry by the gatekeeper because the visit had not been notified beforehand, nor did the inspectors present their identity cards. The immediate effect was that the FOE received a written notice claiming it had failed to meet the fire-fighting criteria and its production was illegal. The FOE had to halt its production while fixing the problem. It took the FOE much time and money to invite the inspectors to revisit the factory before issuing the approval. The long-term effect was that the FOE's breach of the fire-fighting regulation was tolerated ever since. When the interview was held inside the factory, the informant pointed out the places that were not compliant to the fire-fighting regulation<sup>25</sup>. A building claimed for office use only was built with more floors than permitted and was used for living purposes. The informant's relatives had set up their homes inside the building. They had turned the ground floor into a fully-equipped kitchen and used the upstairs as flats, comprising of en-suite rooms and lounges. A self-equipped power generator was installed with insufficient space left for the objects surrounding it. An outdoor area at one side of the factory plant was transformed into a welding workshop. A roof was built across the top of the factory plant and the enclosure wall. Between the paralleled supporting pillars of the roof were installed rails to run a crane. When asked what the production safety officer would do if seeing these problems, the informant replied, '*money talks.*' This finding showed that the agency-firm interaction was based on the logic and shared value of illegitimacy and instrumentality. The ill-constrained agency first abused authority and then was negligent after taking bribery. Meanwhile, the firm was ill-intentioned to bribe the agency. The enforcement effect was negative.

## 5. Findings

*Institutional features* Lufei was categorised as a Conciliative regime because of its low grid, namely keeping a low and invisible profile, and high group, namely constructing inter-agency cooperation for over-facilitation and under-restriction.

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<sup>24</sup> Interview THLG1

<sup>25</sup> The author's personal on-site observation

*Regulating side* The representative agency has peculiar institutional binding with domiciled TTP-type FOEs. This type of FOE is the major source of the village's extra revenue as well as being the discouraged type according to the municipal and central government's foreign investment strategies. The agency's competition for and preference of the TTP-type is primarily driven by its revenue-maximisation. Towards this end, it switches from an indifferent stance towards domiciled FOEs to an innovative, efficient, predictable, responsive, coordinative and facilitative performance. Restrictive practice is lax and secondary to facilitation. With the FOEs' bribery, the agencies either manipulate the interpretation and implementation of law to the FOEs' benefit, or neglect the FOEs' crime and misconduct. Consequently, the wrongdoers are able to escape penalty.

*Regulated side* The informant FOE is typical of an ill-intentioned and well-informed SME from a LRC. Its characteristic is exemplified in its creative and ill compliance with the labour, customs and production safety regulations. Its favour of Lufei showcases that on the one hand, its choice of investment destination is of strategic characteristic; and on the other hand, this regime is proved to be a haven for regulatory misconduct.

*Two-sided marriage and match* The agency-firm bilateral relation is characteristic of bipartisan rather than enforcer-vs-regulatee. The distribution of power is symmetric between the two sides. Social construction and regularised arrangement institutionalises the shared value of instrumentality and illegitimacy for both sides. The regime shapes Lufei's peculiar business environment, both unfriendly before and excessively friendly later. Although the FOE evidently does not trust the agencies, it is loyal to the regime and has not the slightest idea to exit. The preferences of the regime and the firms match well with each other.

*RC outcomes* The dominant TTP-type in its industrial structure, as well as the lax enforcement effect, strongly suggest that the Lufei regime is a regulatory haven for misbehaving SMEs from LRCs. Driven by revenue maximisation, the regime is instrumental and has established comparative advantage.

## 6. Outstanding Issues

The characteristics of the Lufei regime generally agree with interpretation of the Conciliative in the ER Framework. Typically it is more loyal to its organisational interest than to that of society at large, and protective and attractive to the profit-

maximising type of firm that is disfavoured by the national and municipal governments. It facilitates business at the expense of restriction. At the same time, it is different from the interpretation in the ER Framework in two aspects: revenue-maximisation driven and bribery-involving instrumentality. These two are not interpreted as the traits of the Conciliative regime by the framework. The explanations are: concerning the revenue-maximising drive, the ER Framework emphasises the regime's traits of self-commitment and self-accountability and no commitment or accountability to the mainstream society. Being simplified, the ER Framework does not pay attention to the drive of the regime's prior commitment and accountability. Notwithstanding this inattention of the framework, the empirical finding only gives more fleshly details about the regime's drive. These details do not disagree with the simplified account by the framework. Concerning the involvement of bribery in the agency's instrumentality, this is arguably a trait of the Conciliative regime. Being a trait or not will be shortly found out by the second case of this study. Apart from these two explicable outstanding issues, the ER Framework is concluded as plausible in interpreting the Conciliative regime as based on the Lufei case.

## **Case 2: Tuqing of Suzhou**

### **1. The Regime**

The Town Council of Tuqing designated an industrial zone of 70 square km to accommodate the domicile of FOEs<sup>26</sup>. By the second half of 2008, there were more than 300 FOEs settling in the zone. The investors were from the USA, EU, Singapore, Japan, South Korea, Hong Kong and Taiwan. The investment originating from Taiwan was the biggest, with those enterprises making up one third of the FOEs. Most of them were engaged in the production of IT components. On average, an FOE had an investment amount of USD 4 million and 5-6 years of production history. Originally most FOEs undertook traditional industries such as toys, building components and garments. Currently they were out-numbered by modern manufactures, such as IT, model casting and power wiring. This industrial structure indicated that Tuqing was particularly attractive to SMEs in both low-tech and high-tech sectors of LRCs.

The town council was not a specialist regime for attracting foreign investment. It had sufficient authority to regulate local issues. Although some information about

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<sup>26</sup> Information sourced from the official website of the Tuqing Town Council; Interview LZSC

business attraction was given at its official website, its accountability was broader, including comprehensive issues. This was a sign of low grid. Its constituent departments were the enforcers. Their coordination was mostly intra-organisational, except for the national agencies. The national agencies were commented upon as being supportive to the FOEs<sup>27</sup>. This was evident of high group. The agencies made coordination for specific purposes. For example, when an FOE was shutting down, relevant departments and agencies held meetings to decide what issues should be dealt with as a priority. They usually paid off the workers' wages first so as to prevent potential social unrest<sup>28</sup>.

## 2. The Agencies

### 1.1. Facilitation<sup>29</sup>

The council staff shared a strong interest in competing for foreign investment. According to the informant of the council, '*There is evident competition for foreign investment between different locations. Currently, the Yangtze River Delta (YRD) is more attractive than the Pearl River Delta (PRD) to foreign investors. This is because the officials of all ranks here are more committed to attracting foreign investment.*' Asked about the motivation for the competition, the informant answered: '*the fulfillment of regulatory goals set by the higher-level government; the commitment to the well-being of the hometown; and professionalism.*' He voluntarily emphasised from a personal standpoint: '*I would not render 1% effort if I could commit myself 100%.*' An additional informant said that the bonus paid for the successful foreign investment promoter awarded by the council was high<sup>30</sup>. It was proportionate to the investment volume that he introduced.

The council used both ex ante and ex post measures in competing for foreign investment<sup>31</sup>. Ex ante measures included attracting overseas investors from successful rival cities and adopting a differentiating strategy in foreign investment attraction. Ex post measures were good service and taking the FOEs' voice seriously. These measures indicated that Tuqing's business-attracting strategy and achievement were based on innovation.

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<sup>27</sup> Interview TLZE2

<sup>28</sup> Interview LZSC

<sup>29</sup> Interview LZSC

<sup>30</sup> Interview LWY

<sup>31</sup> Interview LZSC

*Attracting Overseas Investors from Rival Cities*

The council adopted two sorts of strategies to attract overseas investors from rival cities. One was to attend the investment promotion fairs regularly organised by the municipal government of Suzhou in the PRD cities including Shenzhen. These fairs were headed by the mayor and attended by the leaders of counties, towns and villages. The officials held face-to-face conversations with the interested investors, and tried to persuade the investors to visit their jurisdictions. *'The leaders and officials understand the difficulty of persuading an investor to come to Suzhou. Thus, they are friendly and supportive to the domiciled FOEs.'* The agencies' participation and value for achievement in RC explained their loyalty to incumbent firms.

The other was to market the town to the overseas investors through its long-term offices based in rival cities. The offices were established for the particular purpose of attracting the investors who had factories locally. The informant himself worked in the council's office in Shenzhen during 1991 and 1995. He established contacts with local Taiwan and Hong Kong business associations, through which he made himself known to the investors. He then persuaded the investors to visit his town. He accompanied the interested investors to the Tuqing Town, showcasing the local infrastructures and introducing them to his colleagues. The itinerary, including inter-city flight, local accommodation, transport and meals, were all arranged and paid for at the expense of the council from a special fund set up for the purpose of foreign investment attraction. *'All the Taiwan and Hong Kong FOEs established here during the first years were introduced by me.'* The informant's consistent commitment was rewarded by promotion. He currently held two managerial positions. As a government official, he was the section chief (SC) of the department responsible for foreign investment attraction. As a businessman, he was the general manager of the town-owned ETDC<sup>32</sup>.

*Differentiating Attracted Objects*

The council had never been in head-on foreign investment competition with SIZs. *'We benefit from the achievements of the big brothers.'* The frontline competitors, or the big brothers, were the national-class SIZs, such as Gongcheng and Ximo<sup>33</sup>. Because of their foreign investment achievement, one of the country-wide biggest clusters of IT industry came into being in the city. *'They target the big companies. We take the smaller partners of the bigger ones.'* The council was self-defined as a satellite to the SIZs and opened its doors widely for the small sub-contractors of the big FOEs that settled in the SIZs.

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<sup>32</sup> For details about ETDC, see the relevant section of the Lufei case in this chapter.

<sup>33</sup> For details about these nation-class SIZs, see the four cases in Chapter V and VI.

Given its lower costs for land and labour as well as its short distance to the SIZs, the town became a favourable destination for the SMEs. Tuqing's target on SMEs was characteristic of instrumentality.

*Good Practice and Service*      Similar to the other successful sub-city jurisdictions (SCJs), the council emphasised good practice, which was typical of proper constraint of agencies and regulatory certainty. *'In Suzhou, we share this view commonly: standard bureaucratic practice and uncorrupted competent officials account for us in outdoing the PRD in competition for foreign investment.'* The council emphasised good service as of vital significance to the success of its foreign investment attraction. Good service was represented in two ways. One way concerned the approval of a new project with foreign investment. The council provided a one-stop shop and speedy service to new investors. To ensure express approval of a big project, the councillors undertook any necessary coordination with the municipal government. This indicated facilitative responsiveness and efficiency based on inter-agency cooperation. The other way concerned post-approval support. The council made the staff's mobile numbers available so that the FOEs were able to find the relevant officers immediately in case they were needed. The council provided round-the-clock support to the FOEs. The informant and his departmental staff worked all year around except for one day – the Chinese New Year's Day. This showcased the agency's extraordinary commitment to business facilitation. Moreover, it adopted a person-to-firm scheme for working contacts with the FOEs. Accordingly, the council specified explicitly which officer was responsible for the well-being of which FOE. As the departments, other agencies and the FOEs all knew precisely who the responsible officer was, the FOE's demands and the council's feedback were traceable. Negligence could be quickly identified and corrected. Thus the officers' commitment was effectively monitored. Such a person-to-firm scheme was institutionalised in the organisational performance and free from personnel changes. Generally, the agencies' practice was characteristic of consistent commitment, facilitative responsiveness, efficiency, certainty and innovation. It underpinned Tuqing's regulatory advantage.

*Listening to FOEs' Voice*      The council made it a rule to listen to the FOEs' voice. It invited the FOEs' comments and suggestions both regularly and irregularly. Twice a year the council hosted symposiums to learn the FOEs' opinions and proposals. All the councillors and the FOEs' general managers attended them. Irregularly, the council issued questionnaires to gather the FOEs' opinions about particular issues. For instance, the FOEs were asked for their comments on the application for

business visas to Hong Kong and Macao. The council gathered the FOEs' opinions and sorted out the common difficulties. The council also gave feedback to the FOEs about the outcome of their suggestions. For instance, it informed the FOEs that a particular department had streamlined its procedure as a result of their suggestions. The council had improved the street lampposts, sewage system, social order, environmental hygiene, water and power supply, and other facilities. It stressed the cooperation of the FOEs as integral to the building of a good community. Taking the firms' voice seriously, the regime won the firms' loyalty. Developing together a shared community institutionalised their shared values, bound and benefited both interests.

### **1.2. Restriction<sup>34</sup>**

The council was absolutely informed of the national and municipal strategies regarding foreign investment attraction. Nevertheless, it held its position of treating all FOEs the same. '*Enterprises should be treated equally, no matter the size, investment origin and compliance.*' Regarding the size, '*All enterprises begin from small. The government should help a small enterprise to grow big and a big one even bigger. We understand the challenge faced by big enterprises. We also sympathise with the SMEs' struggle for survival.*' With regard to investment origin, '*we note the cultural differences in the FOEs from different home countries. Yet we are the host and should be hospitable to all our guests.*' Regarding the compliance, '*we give warnings to the poorly-complying FOEs to correct their wrong doings. But we do not discriminate against them. In no way should we be adverse to any FOE.*' Labour regulation was used as an example. '*We follow the rule of 'no complaint, no investigation.'*' It meant that the labour department was not active unless receiving a complaint about an FOE. If the department regarded the FOE as wrong, it would request the FOE to correct it. If the FOE continued the wrong doing, the department would penalise it. However, the informant declined to answer as to how the wrong-doer was penalised. It was inferred that the penalty was more likely to be token. If the penalty were serious, the informant would have addressed it frankly. Lenient enforcement was considered as inappropriate in current regulatory context. Tuqing's business attraction apparently followed its own rule of the game. This rule was not aligned with national and municipal governments' and hence was illegitimate. Its practice was unbalanced, typical of over-facilitation and under-restriction.

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<sup>34</sup> Interview LZSC

There were more details for the council's stance towards industry. '*We decline all heavy metallurgical projects, including those with a pollutant process.*' The regime's ban on pollutant industries was based on protecting local environment rather than complying with national strategy. This stance was confirmed by its support for low-tech and labour-intensive firms. Specifically, the council demonstrated an exceptionally embracing stance towards the toy industry, even though it was aware of the industry being a discouraged category. In the informant's words, '*the differentiation is made by the national and municipal policies. We do not discriminate industries. We support all industries alike.*'<sup>35</sup> To explain the reason, '*it is enough for them to face a negative policy environment, severe market competition and rapid upgrade pressure.*' Tuqing's attitude towards the toy industry was extraordinary. As a matter of fact, the Tuqing town was one of the very few sub-city jurisdictions of Suzhou with the presence of toy FOEs. When the author was referred by a municipal governmental official to the county council, the immediate superior of the Tuqing Town Council, the county official phoned numerous times to repetitively emphasise that the existence of a few toy-makers in his territory was against its wish. '*We do not encourage the toy industry at all.*' Whereas the existence of the toy industry seemed to be a shame to its superior, Tuqing was looking after the toy manufactures as usual. This suggested that the Tuqing regime was dissident in a broad regulatory context.

### 3. The FOEs

Both toy FOEs interviewed were established in the 1990s with investment originating from South Korea<sup>36</sup>. One was the first FOE ever received by the town. It was set up in 1993, with a registered investment amount of USD 4.1 million. By 2008, its investment amount increased to USD 6 million, with a total workforce of 2,300. It was the biggest toy-maker in the whole city. The toy maker began production in the form of a TTP but later it turned into an independent legal entity. The owner of this company was the director of the Korean business association in Suzhou. With the increased costs of labour and raw materials in recent years, the FOE moved part of the production to the neighbouring province Anhui. However '*the officials in Anhui are not as supportive as here.*'<sup>37</sup> The firm was convinced the regime's committed service and facilitation were unmatchable by rivals. The other

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<sup>35</sup> Interview LZSC

<sup>36</sup> Interviews TKLZ 1 & 2

<sup>37</sup> Interviews TKLZ 2

toymaker was still a TTP-type. It was a contractor of Disney<sup>38</sup>. Both toy-makers exported all their products to the USA and EU markets through the seaport of Shanghai. They abided by the code of conduct of the International Council of Toy Industry and standards imposed by big buyers such as Disney. The firms were evidently subject to effective enforcement based on the supply chain.

The informants appeared to be reluctant to give information about problems. The limited information in this regard was that problems were mainly related to customs and tax issues. Inter-customs communication and coordination was commented on as poor<sup>39</sup>. In case of problems, the FOEs contacted directly the relevant agencies which were easy to approach. Normally they responded quickly and ironed out the problems effectively. If necessary the FOE invited the town council to negotiate with other agencies. The council's involvement generally engendered FOE-friendly solutions. Hence the FOEs were confident in the council's assistance in solving problems for them. The finding here indicated that the firms and the agencies were mutually loyal, trusting and accountable. Both kept problems internal rather than exposing to outsiders.

#### 4. Agency-FOE Contact<sup>40</sup>

The council and the FOEs had close contact with each other. The procedures of the departments and agencies were regularised and clearly specified, with the responsible persons' named and accountable. '*The procedures are easy for me to understand and follow.*' The administrators and the FOEs' relevant personnel were familiar with each other. '*The administrators were helpful and competent, and worked efficiently and effectively.*'

The departments and national agencies organised training courses about particular regulations. For instance, the labour department organised a lecture to refresh the FOEs' knowledge about handling the annual review. The details covered included the preparation of the required documents, the submission timeframe and the review method and procedure. They notified the FOEs of newly promulgated or altered important regulations such as the labour law, tax policy and social security policy. For example, before the national inspection on toy safety began at the end of

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<sup>38</sup> Interviews TKLZ 1

<sup>39</sup> Interview TKLZ2

<sup>40</sup> Interview TKLZ1/2

2007, the AQSIQ and the council summoned the toy FOEs to explain the cause and purpose. These briefings helped the FOEs to be well informed and better adaptive.

The officers of the council visited the FOEs for three purposes<sup>41</sup>. The first was to solve problems. They went to the sites in the first instance after receiving reports from the FOEs. The second was to understand the impact of particular new policies upon the business. The council visited the big toy makers regularly and the small ones occasionally. The last was to spot check on FOEs' law-abiding status and was not given early notice. The FOEs acknowledged the worthiness of the agencies' visits.

## 5. Findings

*Institutional features* Tuqing was classified as a Conciliative regime because of its low grid and high group characteristics. It was a government at sub-city level and required to be accountable for comprehensive local economic and social governance. Although not a specialist regime for attracting foreign investment, the regime was characteristic of close inter-agency cooperation to facilitate business.

*Regulating side* The council demonstrates a strong sense of competition. Its competing strategy deviates from the mainstream. Rather than competing head-on with the nation-class SIZs, it strategically targets on the disfavoured type – the SMEs from the LRCs – in order to secure an advantage. It adopts an aggressive marketing strategy, and enhances committed, well-restrained, efficient and responsive facilitation. It takes the incumbent FOEs' voice seriously and reacts by making adjustments to enhance facilitation and community-building. The regime never treats its FOEs residents differentially in terms of size, industry, investment origin and compliance. Deviating from the national and municipal foreign investment strategies, hence illegitimate, it demonstrates the regime's commitment and protection for the FOEs. The regime bans pollutant business from entry, which implies its value of the communal interest. The agencies' restriction is lenient and unbalanced against facilitation. Penalty, if any, is not unveiled to an outsider.

*Regulated side* They comply with high informal standards imposed by big buyers. The toy-makers have a high opinion about Tuqing. Like the agencies, the FOEs are reluctant to discuss regulatory problems and solutions. In contrast, they

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<sup>41</sup> Interview LZSC

praise the agencies for their commitment and facilitation. This shows that the agencies and the FOEs are more trusting and accountable to each other than to those outside the regime.

*Two-sided marriage and match* The agency-FOE bilateral relation is close and the distribution of power is symmetric. The bilateral interaction follows the logic of appropriateness to the secluded local community. Social construction and regularised arrangement institutionalises shared value, mutual trust and accountability. The representative agency plays the leading role in establishing Tuqing's business-friendly environment. The FOEs' voice is taken so seriously that the FOEs are extraordinarily loyal to the regime. The Tuqing regime's target and the firm's choice match exactly.

*RC outcomes* The Tuqing regime has been a very successful destination for SMEs in both low and high tech industries mostly from LRCs. It has prior commitment and accountability to the local community and resident FOEs rather than to the city or the country. Its over-facilitation and under-restriction are unlikely to encourage the FOEs' social compliance. General enforcement effect is lax. Its illegitimate, instrumental and innovative competing strategy is characteristics of comparative advantage.

Based on the available information, it is concluded that the Tuqing regime is a perfect example of the Conciliative regime. The empirical finding fully supports the interpretation of the ER Framework. No outstanding issue is likely to be caused by the selectively positive information about the regime given by the agency and firm informants. However such an information-giving manner is an exact characteristic of a Conciliative regime.

## Conclusion

Sharing some common characteristics of the Conciliative, the Lufei and Tuqing regimes are notably different in two respects. The first concerns the drive of competing for foreign investment. The Lufei regime is characteristic of revenue maximisation, whereas the Tuqing regime concerns the overall interest of the local community. The second concerns the discipline of the agency. The agencies' facilitative and restrictive performance involves bribery in the Lufei. Their counterparts in the Tuqing view bribery as a disease for foreign investment

attraction so they consciously avoid it. These two differences between the two regimes suggest that revenue maximisation and bribery are not necessarily attached to the Conciliative regime, just as the ER Framework interpreted. They also suggest that regimes in the real world are more institutionally peculiar and contextually specific than the generalised ER Framework interprets. Notwithstanding the identified limitation of the ER Framework, the findings of the two empirical cases that exemplify the Conciliative regime agree: the interpretation made by the ER Framework for this type of regime is plausible.

## Chapter VIII The Detached Regime

Like the previous three case studies, this one begins by explaining why the cases are classified as the Detached regimes. The explanation is based on the grid and group characteristics, which are also the institutional features of the case. It is followed by reporting the factual characteristics of the two samples and the empirical findings based on the ER Framework, and finally a scrutiny of outstanding issues so as to conclude the plausibility of the theoretical framework.

The two cases the Anke and the Benpo Towns of the city of Shenzhen. Both regimes are represented by their town councils - the intermediate level between the county government and the village council in the Chinese governmental hierarchy<sup>1</sup>. Like other town councils in Shenzhen, the Anke and Benpo Town Councils have identical organisational structures that roughly mirror those of the county governments<sup>2</sup>. They are local governments with comprehensive economic and social authorities. They are not required to pay special attention to attracting overseas business, but are accountable for it as one of their diverse regulatory tasks and goals. In fact, neither council gives information about domiciled industries at its official website. This is why both regimes are considered as low in grid. Neither town council is delegated with complete authority related to business attraction. They are not entitled to approve the establishment of an FOE, renew the FOE's license, collect local revenue or lease land. The first three are their immediate superior, namely the county governments' authorities, and the last is the municipal government's discretion. With diverse authority, the Anke and Benpo agencies have individual regulatory priorities and agendas. Their incumbent FOEs identify mostly inter-agency uncooperation rather than coordination, both among local agencies as well as among local and national agencies. This is a sign of low group. Based on their low grid and low group, the Anke and Benpo regimes are categorised as the Detached regime. Next is to look at their respective characteristics in fact.

### Case 1: Anke Town of Shenzhen

#### 1. The Regime

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<sup>1</sup> See Diagram V of China's governmental hierarchy in Chapter IV.

<sup>2</sup> See <http://www.sz.gov.cn/cn/>

The Anke Town had around 350 FOEs out of 1,500 enterprises by the beginning of 2008<sup>3</sup>. The rest were domestically funded. Most FOEs were classified by the customs as Category-B enterprises, which meant that they were SMEs with a good record in complying with the customs rules. Also, most were funded by investment originating from Hong Kong and Taiwan. A few were owned by investors from Germany, France, Britain and the USA. There were 15 FOEs categorised as high-tech industries<sup>4</sup>. With the FOEs less than a quarter of its total industrial population, the industrial structure of Anke indicated that this regime was more popular to domestic than overseas investors and generally unattractive to big high-tech ones from high regulating countries (HRCs).

Inter-agency coordination was unknown to most FOE informants. This was evident of low group for Anke. Among the limited information, some was positive, some was negative. One FOE informant mentioned that the enterprise-licensing and the revenue departments of the county government made annual reviews jointly in order to ensure that the FOEs had paid tax appropriately<sup>5</sup>. Another informant noted that the customs' and AQSIQ's clearance forms had an identical template<sup>6</sup>. This appeared to be the result of coordination between the two agencies. An informant from a Taiwanese toy-maker described the practice: '*The AQSIQ contacted the customs in order to attain accurate data about our company's exports.*'<sup>7</sup> This finding implied that while there was ad hoc communication between the two agencies, they did not sufficiently share information of common concern. Shipments of an informant's company were repeatedly delayed because of inter-customs bad coordination<sup>8</sup>.

A few informants of the county government gave details about their cooperation with the customs<sup>9</sup>. The county government was the immediate superior of the Anke Town Council. The informants worked in the department that was in charge of examining investment projects. It involved the implementation of a specific rule jointly set by the Ministry of Commerce (MOFCOM) and the General Administration of Customs. The rule was to prevent the enterprises from making fake claims for tariff reduction for importing raw materials and equipment which were not actually

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<sup>3</sup> Interview ACSC

<sup>4</sup> Interview CGSC1

<sup>5</sup> Interview THBA2

<sup>6</sup> Interview EKBA

<sup>7</sup> Interview TTBA

<sup>8</sup> Interview EABA

<sup>9</sup> Interview CGSC1

used for manufacturing export-oriented products. But the rule did not instruct how it was to be implemented. The agencies had to figure out the concrete method for themselves. The customs and the department agreed upon the necessity of an on-site verification of the enterprises' genuine production capacities and needs. Since the customs lacked resources to carry out the verification, it became the task of the county department. Faced with more than 5,000 enterprises, the inspectors were busy all year around. Every day, six groups, two inspectors from each department, visited the enterprises according to pre-arranged appointments<sup>10</sup>. The inspectors issued their reports after the on-site verification, based on which the customs decided the approvals on the enterprises' tariff-reduction requests. If attained, the tariff-reduction approval was valid for three years. Its renewal required a new on-site verification. The FOEs made positive comments on the scheme<sup>11</sup>. This indicated positive effect in business facilitation and rule enforcement. A neighbour county council heard about this scheme and dispatched officials to learn.<sup>12</sup> The informants acknowledged that the cooperation with the customs was unusual, not only in its neighbour county but also in its subordinate the Anke town.

## 2. The Agencies

### 2.1 Behaviour

Although the informants' opinions about the agencies' performances were different, they coincidentally agreed that in most agencies, some officers were well-behaved and others were badly-behaved. Take the customs as an example. A customs-declarer informant commented: '*the receptionist administrator is patient in interpreting the rules. In case I made a mistake in the declaration form, he corrects it for me.*'<sup>13</sup> However an informant from another FOE criticised, '*customs' officials are driven by self-interest. Whether you can get their support or not depends on your relationship with them.*'<sup>14</sup> An informant from the third company said, '*they are improving. In the past, you had to befriend an officer in order to understand what to do to get the approval. Now the customs notifies on its bulletin the required documents and the procedure. If you carefully follow the requirements, you can generally get the approval.*'<sup>15</sup> However, he admitted that the customs' support was

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<sup>10</sup> The author joined a group to observe their practice for three half-days.

<sup>11</sup> Interview CGAD, EHBA1, EKBA and ESMBA

<sup>12</sup> Interview CGAD

<sup>13</sup> Interview EHBA1

<sup>14</sup> Interview EHBA2

<sup>15</sup> Interview THBA2

likely to be related to his company's excellent compliance record. The finding here indicated that the agencies' performance was individualised and uncertain.

The discretion of the agencies' staff was at issue. One FOE commented that the department in charge of foreign investment affairs of the town was helpful in advising how to get the approval to expand and relocate its factory<sup>16</sup>. In contrast, the boss of a Hong Kong electronic FOE complained that the officials within the county government and the town and village councils would only work efficiently if bribed<sup>17</sup>. Any support offered by the labour and revenue agencies was dependent on their personal relationships. '*They are abusing a weak legal system.*' In addition to the agencies' individualised performance, the finding here indicated their various restraint and instrumentality.

There was additional finding of the village and county government abusing their authority. The finding included the county government's approval of establishing the types of manufacturers that were banned by the municipal government. One type was the enterprise that undertook three sorts of processing and barter trade (TTP)<sup>18</sup>. An informant with the county government affirmed that they still approved the TTP-type FOEs, since the villages welcomed them for their revenue and job creation<sup>19</sup>. While pollutant-type FOEs were supposed to be prohibited, it was exposed by an informant whose company resided in a village with polluting FOEs. '*They hide themselves behind the walls. But you can see the drainage and smell the smell. The village council just pretends not to see it.*'<sup>20</sup> The town council also made authority-exceeding approvals. According to an informant with a Taiwanese toy-maker, '*it is a prevailing problem in Anke and Benpo towns that the FOEs like ours cannot attain the land lease certificates. Although we have signed a lease contract with the town council and paid for the lease, the contract is not acknowledged as valid by the municipal land bureau.*'<sup>21</sup> The mentioned finding indicated that the agencies' ill restraint and manipulation were prevailing problems in Anke. Such problems were underpinned by the village council's revenue and employment concerns, and the county government's loose enforcement and monitoring. The finding of the Anke Town Council's immediate superior and subordinate indicated the context of its low

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<sup>16</sup> Interview ESMBA.

<sup>17</sup> Interview EHBA2

<sup>18</sup> For more details about the TTP-type FOEs, see the section about the organisational feature of Lufei in Chapter VII.

<sup>19</sup> Interview CGSC1

<sup>20</sup> Interview LWY

<sup>21</sup> Interview TTBA

grid and low group characteristics. Generally the Anke regimes' facilitation and restriction were misaligned with national and municipal strategies governing quality foreign investment attraction and environmental protection.

## 2.2 Facilitation

According to an informant of the Anke town council, over recent years the total FOEs' number had remained roughly the same. The town was short of land and factory space<sup>22</sup>. Thus it had actively removed ill-complying traditional manufacturers in order to embrace domestic high-tech enterprises. Whereas such aggressive measure appeared to be according to provincial government's 'empty the cage for big birds' strategy<sup>23</sup>, it was more based on Anke's own demand for land to accommodate big investors, which were not necessarily from abroad.

The agencies occasionally collected the FOEs' comments on new policies, suggestions and complaints but the FOEs never received feedback. Some FOEs held that the agencies were not serious in listening to their voice. For example, although a toy-maker repetitively complained through all possible communication channels about the routine power cuts every week, there had been no positive answer or explanation<sup>24</sup>. In the informant's guess, '*the problem is unlikely to be solved in the foreseeable future, considering the insufficient power generation and unavailable facilities in the town.*' Another toy-maker, in a questionnaire in 2007, once suggested adding a new bus route and building a green park<sup>25</sup>. A new bus route was established later but there was still not a green park. Given no feedback, the FOE could not determine whether the establishment of the bus route was as a result of its suggestion. The town council informant confirmed Anke did not take the firms' voice seriously: '*The FOEs are under the direct jurisdiction of the village councils. We do not invite their opinions.*'<sup>26</sup>

## 2.3 Restriction

The agencies demonstrated differentiated practices according to industry, size and compliance. The town council actively drove away ill-complying FOEs. In the informant's words, '*The regulations were not enforced strictly before. They are now.*'<sup>27</sup> A high-tech enterprise got the accreditation by the municipal bureau of

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<sup>22</sup> Interview CGSC1

<sup>23</sup> For details 'empty cage for big bird', see the section about middle-level regime in Chapter IV.

<sup>24</sup> Interview THBA1

<sup>25</sup> Interview THBA2

<sup>26</sup> Interview ACSC

<sup>27</sup> Interview ACSC

science and technology. It enjoyed half-rate for corporate income tax<sup>28</sup>. The agencies treated big enterprises more favourably than SMEs. ‘*We allocate more peak-hour power consumption to big enterprises.*’<sup>29</sup> The customs differentiated between the FOEs according to their size and compliance records. It allowed the well-complying enterprises to use a simpler and faster procedure and charged a lower guarantee deposit<sup>30</sup>. In contrast, the town council did not emphasise the investment origin for the new entrants. An informant with the county government said that they had an order from the municipal government to ‘*enhance the support to domestic private enterprises*’<sup>31</sup>.

Anke’s differential practice tended to be miss-aligned with national strategy for attracting quality foreign investment. Most noteworthy, Anke was required to pay sufficient attention to facilitating domestic enterprises rather than FOEs. Its emphasis on attracting high-tech industry was mostly from home rather than abroad. This explained its disinterest in competing for overseas business as well as the minor percentage of FOEs in its total industrial population. Meanwhile, Anke aggressively got rid of SMEs. Although its aggressive stance could refer to the provincial government’s ‘empty the case’ strategy for support, it was unfair according to the national government’s criticism. Considering its shortage of land for domestic investors, it was understandable why Anke was so adverse to overseas SMEs. With contesting regulatory goals, Anke prioritised rule implementation according to its own logic and interest.

The FOEs had contrasting opinions towards the agencies’ differentiated strategies. A toy-maker informant complained that the agencies’ discrimination against the industry and SMEs was unfair. ‘*All industries and enterprises are entitled to survive and should be treated equally. SMEs also make contributions to local employment and economic development.*’<sup>32</sup> An electronic FOE shared the opinion. ‘*As long as SMEs are environmentally friendly and comply with the law faithfully, they should be supported rather than discouraged.*’<sup>33</sup> A few FOEs questioned the legitimacy of the agencies to determine the right and wrong of the regulatees and suggested that the courts should be the authority in this regard<sup>34</sup>. They also argued that the agencies

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<sup>28</sup> Interview EHBA2

<sup>29</sup> Interview ACSC

<sup>30</sup> Interview EHBA2 and THBA2

<sup>31</sup> Interview CGSC2

<sup>32</sup> Interview THBA2

<sup>33</sup> Interview EHBA1

<sup>34</sup> Interview EHBA2

should aim at educating and correcting the misconduct of ill-complying FOEs rather than simply abandoning them<sup>35</sup>. A toy-maker supporter considered the agencies' preference for high-tech as helpful to improve the local strength of science and technology<sup>36</sup>. The FOEs' opinions reflected both the agencies' poor facilitation but harsh restriction and the firms' distrust in the fairness of the agencies. In spite of variation, the FOEs' perspectives confirmed that Anke was adverse to SMEs, or the majority of incumbent FOEs.

### 3. The FOEs

The Chinese law mostly mentioned was 2007 <Labour Contract Law><sup>37</sup> and the FOEs' reactions varied. A Hong Kong toy-maker was considered as a role model by the county government<sup>38</sup>. It formulated its internal rules according to the labour law, which were discussed, revised and passed by vote at the worker's conference. The rules were enforced under the monitoring of the corporate workers' union. They were reflected in the labour contract signed between the employer and the employees. The rules were registered at the labour department of the county government. A Taiwanese toy-maker mentioned that the labour law pushed the company to automate its production so as to tackle the fast-increasing labour cost. '*We have invested more capital in technological innovation and developed new product series.*'<sup>39</sup> A Taiwanese electronic FOE claimed to be limitedly affected by the labour law. '*We have a high mobility of workers. The majority of the population is short-term. The new labour law is applicable to long-term workers. We don't have dispute.*'<sup>40</sup> The mentioned finding indicated that the firms had various intentions and thus enforcement effects varied. Whereas firms' enhanced self-regulation or technology upgrade were desirable, their creative compliance was not. It was noted here that all interviewed FOEs were the survivors of Anke's aggressive strategy. Their compliance with formal enforcement suggested the ways for their survival.

The FOEs must meet the standards of the market countries in order to export their products. For example, a South Korean mobile phone producer exported all its products to its home country. It complied with the higher product safety standard of

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<sup>35</sup> Interview THBA2

<sup>36</sup> Interview TH2BA

<sup>37</sup> Hereinafter referred to as 'the labour law'

<sup>38</sup> Interview THBA1

<sup>39</sup> Interview TTBA

<sup>40</sup> Interview ETBA

South Korea rather than the Chinese corresponding standard<sup>41</sup>. A Taiwanese electronic FOE applied the relevant American metallic standard to its products that were sold in the USA<sup>42</sup>. An FOE stated, ‘*We must comply with the international standards in order to do business. They are stricter and higher than the standards set by the Chinese law and regulations.*’<sup>43</sup> He stated that the company’s compliance with the Chinese law was secondary in its rule-abiding structure. A TTP-type toymaker which exported 100% products to the USA and the EU complied with these markets’ standards<sup>44</sup>. The finding indicated that the firms’ supply chains were functioning as an informal enforcement structure and entailed positive effect.

#### **4. Agency-FOE Interaction**

The FOEs’ comments on the agencies’ working arrangement were specific, since most agencies’ practice was uncoordinated. The vice general manager of a Hong Kong toy-maker praised the centralised affair-handling pattern adopted by the county government<sup>45</sup>. In this so-called affair-handling hall, all departments of the county government and the national agencies had their permanent receptions. The receptions were staffed by administrators and section chiefs. These officials handled, examined and approved relevant affairs on behalf of their organisations. The FOEs could handle almost all regulatory affairs with one stop. The informant held that this centralised working pattern restricted arbitrary interpretations by the agencies’ staff. This one-stop shop made the agencies’ performance restrained, standard and comparable.

The FOEs particularly denoted the working procedures of the customs and the AQSIQ. One FOE held the customs’ procedure as clearly specified<sup>46</sup>. Another had a different opinion. ‘*The local and the seaport customs have different policies. The change of the section chief engenders a change in the working arrangements. We hire a customs clearance agent to handle all the issues with the two customs. The agent has a private connection with the customs officers. They make money out of it. The agent always has the job done successfully. If we do it ourselves, we cannot be successful.*’<sup>47</sup> This indicated that the agencies’ practice was of fragmented,

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<sup>41</sup> Interview EKBA

<sup>42</sup> Interview ETBA

<sup>43</sup> Interview TTBA

<sup>44</sup> Interview TH2BA

<sup>45</sup> Interview THBA2

<sup>46</sup> Interview THBA2

<sup>47</sup> Interview TH2BA

individualised and gold-digging characteristics. The firm-agency interaction showed power asymmetry.

The AQSIQ's new arrangement was complained about by toymakers. In the words of the vice general manager of a Hong Kong toy-maker, '*since the Mattel recalls, the AQSIQ's policies have been changed too frequently. The implementation of the new policies is unclear. There is no mature procedure. We are very confused about what to do.*'<sup>48</sup> This general comment was supplemented by another toymaker with details: '*The AQSIQ requests us to send both paint samples and a sample of each batch for testing. We can attain the permit for exporting the batch of products only after passing the test. The testing charges are borne by us. The AQSIQ requests also that the paint producer sends the paint for testing. The paint producer must pay for the testing to attain the qualification certificate. The AQSIQ double checks us to ensure the paint used by us is the certified one supplied by the paint producer. The testing method is costly and time-consuming*'<sup>49</sup>. It was evident that the agency's practice was uncertain, inefficient and costly.

The agencies increasingly used their official websites to notify new policies and to receive inquiries and applications. For example, at the website of the county government, the FOEs could undertake the annual reviews of enterprise-licensing and paying tax by uploading and submitting their documents<sup>50</sup>. The customs publicised changes of procedures on its website<sup>51</sup>. The AQSIQ replied to the FOEs' inquiries through emails and notified forthcoming meetings on-line<sup>52</sup>. In general, the FOEs held on-line affair-handling as convenient and transparent.

Some agencies hosted meetings for the purpose of notifying and cautioning problems, informing policy changes and explaining new implementation procedures, training and friendship-building. For example, the enterprise-licensing department trained the FOEs' personnel in handling the corporate registrations and annual reviews<sup>53</sup>. The town council hosted meetings to brief the economic situation and latest policies. The AQSIQ notified the FOEs of the Mattel incident and alerted the forthcoming adoption of intensive testing schemes<sup>54</sup>. The customs informed the

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<sup>48</sup> Interview THBA2

<sup>49</sup> Interview TH2BA

<sup>50</sup> Interview TTBA

<sup>51</sup> Interview THBA2; official website of the county government

<sup>52</sup> Interview EKBA

<sup>53</sup> Interview EKBA

<sup>54</sup> Interview THBA2

FOEs about the change in the policy concerning the guarantee deposit paid for importing materials and equipment<sup>55</sup>. Some meetings were organised for all industries and others for specific industries<sup>56</sup>. The attendant FOEs could make comments, raise questions and get immediate answers. The FOEs held that some meetings were necessary but others were repetitive. Therefore, enforcement was not responsive or efficient.

The FOEs noted that the county government had internal rules to constrain the agencies from disturbing the FOEs through unjustifiable visits<sup>57</sup>. In actual practice, many agencies' visits were arguable. '*They come and decline to leave. It is a hint of requesting a bribe.*'<sup>58</sup> The informant declined to say exactly which agencies were taking bribery. An FOE enjoyed few contacts with the agencies. In the words of its vice CEO: '*They are not very corruptive. But we rarely contact them. It is safe to keep a distance.*'<sup>59</sup> It was evident that the Anke's agencies were ill-disciplined. Their contacts and social construction with the firms were based on inappropriate logic. The firm's opt-out of bilateral interaction and keeping far relational distance were a sign of disapproval of the agencies' values and distrust in the agencies' justice.

Most problems that the FOEs had were in the fields of labour and the customs. Regarding labour problems, the council informant told that before the 2007 labour law was promulgated, there were about 100 labour disputes per year. Afterwards, the dispute figure doubled<sup>60</sup>. A Hong Kong high-tech enterprise had encountered considerably more labour disputes since 2007. The boss complained, '*our products have a very short life-span, which is characteristic of this rapidly developing industry. I must request the workers to work hard and efficiently so as to keep up with the fast pace of the market. The labour department cannot advise me on how to follow the regulation correctly in order to avoid disputes.*'<sup>61</sup> Another FOE held that the labour department was biased in terms of giving better advice to the workers to secure their interests, but showed little empathy with the employers<sup>62</sup>. A Taiwanese toy-maker had a corporate lawyer to advise on the way of coping with the labour disputes<sup>63</sup>. It also got help from the town council and the county government in

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<sup>55</sup> Interview EHBA1

<sup>56</sup> Interview EHBA1

<sup>57</sup> Interview EKBA and CGAD

<sup>58</sup> Interview EHBA2

<sup>59</sup> Interview ETBA

<sup>60</sup> Interview ACSC

<sup>61</sup> Interview EHBA2

<sup>62</sup> Interview TH2BA

<sup>63</sup> Interview TTBA

sorting out the labour disputes. '*Our boss is the deputy director of the Taiwanese Business Association of Shenzhen. He is very familiar with the mayors.*' It was evident that in Anke, the firms' compliance with labour regulation was a big problem. This problem was attributable to both the SMEs' incompetence and ill intentions and the agency's poor education, adverseness and irresponsiveness to investors. This problem was symbolic to Anke's negative enforcement effect. Under such a circumstance, the FOEs engaged in self-defence through legal means and personal networking.

The customs problem mentioned by the FOE informant was related to a cross-jurisdiction disagreement. The FOE suffered from three to four shipment delays each year on average<sup>64</sup>. '*We must use the seaport to ship our containers to the USA. The seaport customs often have disputes on the approvals made by the local customs. When we seek the solution, they always blame each other and never communicate to sort out their disagreement. It usually takes about two months to sort out a dispute.*' The town council informant acknowledged that most customs-related problems were caused by complicated declaration formalities<sup>65</sup>. Meanwhile, incompetence of the FOEs' customs declarers was also pertinent. The town council mostly helped troubled big enterprises and ignored SMEs. '*The SMEs smuggle.*' The finding in this aspect indicated that regulatory problem was caused by both the agencies and the firms. The agencies did not cooperate with each other. Nor did they facilitate business. Meanwhile the SMEs were infamous for ill compliance. They left the Anke an excuse to ignore and abandon them.

## 5. Findings

*Institutional features* The Anke regime is categorised as Detached. As an authority with comprehensive governing duties, foreign investment attraction is not given special attention. This means low grid. Contrary to its superior county government, which acts as an efficient and constraining mechanism, exemplified by its centralised arrangements for handling regulatory affairs, the Anke regime demonstrates limited inter-agency cooperation. Thus it is low in group.

*Regulating side* In contrast to the superior county government, the relevant agencies at the village and town levels do not show interest in competing for overseas investment. They are ill-constrained, exemplified by their conduct of

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<sup>64</sup> Interview EABA

<sup>65</sup> Interview ACSC

approvals that are beyond their delegated authorities in order to raise revenue. Both facilitative and restrictive practices are of fragmented, individualised, profit-driven and uncertain characteristics. Most agencies are indifferent to the FOEs' voice and are open to bribery. They are active in getting rid of low-tech ill-complying overseas SMEs and welcoming high-tech business with domestic investment. This indicates that the regime's aggressive strategy is according to the provincial government's 'empty cage for big bird' policy only in form rather than in principle, because the purpose of the latter is for attracting quality foreign investment and is however criticised as 'unfair to the SMEs' by the national government. With an emphasis on domestic investment origin, the regime's strategy is deviating from the foreign investment attracting goal and hence illegitimate.

*Regulated side* Most incumbent FOEs were SMEs, with investment originating from Hong Kong and Taiwan. They react varyingly towards formal rules. The considerable rise in labour disputes indicates the FOEs' general poor compliance with the labour law. Hiring short-term workforce means creative compliance. Also the SMEs are notorious for smuggling. The FOEs' compliance with informal rules is evidently related to the requests of their overseas markets and buyers. While many FOEs have shut down or left Anke, few big investors from HRCs enter.

*Two-sided marriage and match* The agency-FOE relational distance is generally wide. Some FOEs deliberately keep a distance from the unreasonable and bribery-seeking agencies. The two-sided players have asymmetric distribution of power in their interaction – the agencies are superior and the FOEs are inferior. There is limited social construction, evident as the agencies do not communicate with the FOEs adequately regarding how to comply with regulations. The logic of bilateral interaction is inappropriate - mostly cat-vs-mouse. The agencies have quite varied arrangements. Only a few agencies, typically the county government, have regularised and coordinated arrangements. The regime is primarily responsible for Anke's adverse business environment. The agencies generally do not listen to the FOEs' voice. The two-sided players lack shared values, mutual trust and accountability. Many FOEs have exited. The remained FOEs take varied self-defending measures to survive the adverse conditions. The regime's disinterest in overseas investors and the firms' negative opinion imply a mismatch between their preferences.

*RC outcomes* Notwithstanding certain attraction to the SMEs from LRCs, the Anke regime has become adverse to overseas SMEs and likely scared away big investors from HRCs. Requested to enhance facilitation to domestic private business, the regime deviates further away from the national strategy of attracting desirable type of foreign investment. The agencies' practice is lack of legitimacy and innovation but featured of instrumentality. Meanwhile, the enforcement effect is deterrent, considering the uncertain, inefficient, irresponsive and bribery-seeking performance of the agencies as well as its distraction to the FOEs' compliance with informal standards. Generally, Anke poses as a regime with regulatory disadvantage in attracting overseas investment, particularly one of quality.

## **6. Outstanding Issues**

The above empirical findings of the Anke regime are mostly agreeable with the interpretation of the ER Framework about the Detached regime. Four outstanding issues need to be noted and explained.

One issue is that the Anke regime involves constraint and certainty mechanism, which is exemplified by the county government's centralised affair-handling arrangement as well as its and the national agencies' increased use of the internet for notifying policies and handling applications. In contrast, the interpretation of the ER Framework for the Detached regime is free from any constraining and certainty mechanism. The explanation is that, from a narrow perspective, the Anke Town council, or the representative agency of the regime, is generally characteristic of low constraint and uncertainty. Such characteristics are agreeable with the portrait of the ER Framework. From a broad perspective, in spite of the constraint and certainty of its superior, the county government, the Anke Town Council and its subordinate, the village councils, both behave in a detached fashion. This implies that the constraint and certainty mechanism exerts little effect on the generally detached characteristics of the Anke regime. Hence the existence of this mechanism is viewed as exceptional to the complexity of the real world rather than as a challenge to the theoretical interpretation of the Detached regime by the ER Framework.

The heuristic property of the ER Framework as an explanation also applies to the second and third issues, namely the inter-agency cooperation and the agencies' bribery-requesting. Concerning the inter-agency cooperation, as commented by the informants themselves, the identified inter-agency cooperation is exceptional. Whereas empirically this cooperation is not typical of the Anke regime, theoretically

the ER Framework is general so that it does not pay attention to exceptional feature. Thus, the empirically exceptional existence of inter-agency cooperation is not a challenge to the general theory. Concerning the agencies' bribery-requesting, although this form of raising revenue is not addressed by the ER Framework, but its nature of seeking resources is agreeable with the description of the framework. Besides, in spite of its prevalence in the Anke regime, it is arguable that bribery is necessarily involved in the Detached regime. More finding is required to gather from additional sources in order to make a conclusion. So far the finding of Anke is insufficient to suggest a theoretical modification in this regard.

The last issue is that, the Anke regime has attracted a few hundred SMEs with investment from Hong Kong and Taiwan. In contrast, the ER Framework interprets that the Detached regime does not attract business of any type. One explanation is that, the unattractiveness interpreted by the framework is theoretical, which does not mean that in reality a Detached regime cannot attract business at all. As the framework clarifies, such unattractiveness is institutional rather than cognitive. A firm's choice of a destination is bounded by its rationality. Thus it is not unusual for a firm to choose a destination which is institutionally not suitable. Meanwhile, the ER Framework articulates that while it focuses on regulatory attraction and advantage, it does not deny non-regulatory attraction and advantage. Indeed, in reality, the firm is unlikely to choose a destination entirely based on regulatory consideration<sup>66</sup>. Regulatory disadvantage is likely to be offset by other non-regulatory advantage such as geographical and linguistic proximity. Therefore, the empirical finding of the existence of firms in the Detached regime is not a surprise, and definitely not a disagreement to the specific argument of the ER Framework. The other explanation is that it is empirically evident that the existing FOEs have experienced a dramatic change of the regime, which has become more restrictive, disfavourable and even adverse to SMEs. This implies that the SMEs entered in a time when they were welcomed. The ones that still remain are those that are able to adapt to the change of the regime. Those that are unable to adapt have shut down or exited. This is supported by the facts that the FOEs ameliorate the adverse climate through assorted means, such as improving self-regulation, employing short-term workers, advancing automation of production, hiring lawyer to solve labour dispute, bribing officials and borrowing the power of the mayor based on personal connection. This issue proves that the ER Framework is generally static and is limited in capturing the institutional dynamic of possible regime changing character. Notwithstanding

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<sup>66</sup> This is based on the FOEs' answers to the Question 4 of the Questionnaire in the Appendix II.

this limitation, the empirical finding in this aspect does not mean that the framework is wrong.

Based on the findings as well as the note and explanation of the identified issues, it can be concluded that the case of the Anke regime shows that the ER Framework is plausible in its interpretation of the Detached regime.

### **Case 2: Benpo Town of Shenzhen**

#### **1. The Regime**

In the Benpo Town, there were about 1200 enterprises, including more than 200 FOEs<sup>67</sup>. The remained five sixths enterprises were domestically invested. Most FOEs were SMEs with investment originating from Hong Kong and Taiwan. There were also a few Japanese and Korean invested enterprises. The structure of Benpo's industrial population indicated that this regime was mostly attractive to domestic rather than overseas investment; and that it had nearly no attraction to big overseas investors. Therefore, it was likely to have regulatory disadvantage.

Most informants did not identify inter-agency cooperation. This meant low 'group'. There were some exceptions. At the town level, an informant observed that if an FOE's factory failed to meet the inspection by the production safety department, the environment department would come to examine the FOE's indoor air quality<sup>68</sup>. Yet, he was not sure whether the two departments exercised their duties cooperatively. One informant used to take advantage of his membership of the local business association to enhance communication between the departments of the town council. '*Unfortunately, there is no effect.*'<sup>69</sup> At the village level, an informant mentioned that the family planning and the police departments coordinated to inspect the implementation of the family planning law among the mobile workers<sup>70</sup>. They penalised those who did not comply by a fine in accordance with the criteria set by the county government. Whereas inter-agency cooperation was generally not identified, any cooperative agencies were for restrictive purpose. Considering the town council's ignorance of the firms' voice also, this showed that the Benpo regime was more interested in restriction but not facilitation.

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<sup>67</sup> Interview LWY; information from the Shenzhen municipal government

<sup>68</sup> Interview EHLG1

<sup>69</sup> Interview THLG4

<sup>70</sup> Interview EHLG1

## 2. The Agencies

### 2.1 Behaviour

The village councils had individualised behaviours. An informant of a Japanese toy-maker recounted her experience with the village council: '*The chief councillor is in total control. All permits and approvals must be signed by him. But often he is not in the office and nobody knows where he is and what he is doing. His decision depends on his mood. If he is in a good mood, a difficult problem can be solved quickly. If he is in a bad mood, say the night before he has lost money in playing majong, an easy problem takes a while to be fixed. The council staff follow suit.*'<sup>71</sup> An informant of a Hong Kong electronics company gave an insider's view: '*The native officers are greedy, badly-behaved and incompetent. The non-native university graduates are better. The police department hires comparatively fewer natives. Its performance is better than the other departments of the village council which mostly hires local natives.*'<sup>72</sup> It was evident that the agencies were ill-restrained and uncommitted. Hence their performance was individualised, inefficient and uncertain.

The FOEs' informants had varied views about relationship-building with the agencies. The vice general manager of a Hong Kong toy-maker showed a positive position. '*It is in the company's interest to keep regular communication with the officials. Thus the company can get their support in case of need. Our company is the only one in the whole town that has been supported by the council to solve labour dispute since the promulgation of the labour contract law. Some bosses came to ask about our experience and I said to them: if you do not talk to the officials, they will not talk to you. Who will help you when you are in need?*'<sup>73</sup> This informant's view was agreed by the factory director of another FOE. '*How helpful the officials are depends on how good your company's relationship is with them. If you hire natives, who speak the same dialect, it is easier to attain their support.*'<sup>74</sup> He also warned: '*You should never be close to the officials. Otherwise they raise unlimited expensive demand.*' The finding suggested most firms kept a distance from the agencies. This implied that they distrusted the agencies. However the agency-firm relational distance was relevant to the facilitation that the firms could

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<sup>71</sup> Interview TJLG

<sup>72</sup> Interview EHLG1

<sup>73</sup> Interview THLG2

<sup>74</sup> Interview EHLG1

get from the agencies. While close relations enabled the firms to attain the agencies' facilitation, it also made the firms prone to the agencies' requests for bribe. It was evident that the agencies' facilitation was not regularised and its actional logic was likely to be inappropriate.

## 2.2. Facilitation

The FOEs generally agreed that the town was not suitable for SMEs. The boss of one toymaker considered the town council and the county government as being unsupportive of the FOEs<sup>75</sup>. Many FOEs had left for inland provinces and other countries. The boss had established a toy-making base in Guangxi. '*The investment environment is not like here. The local government is very friendly to overseas investors. Most workers I hire are local natives. The government has effective control over them. There is no labour dispute.*' The vice general manager of another FOE commented: '*The administrative charges are really high here. We have a factory in Huiyang. The corresponding cost is about 15% lower.*'<sup>76</sup> A Hong Kong FOE which was established in 1982 was quite upset by the council declining its expansion plan. '*We were one of the earliest FOEs in the town. We have been faithfully complying with laws and paying taxes. All our workers admire the Hong Kong boss and there is no labour dispute. We are having an increasing market and want to expand our production. But the council disapproved our application because we are not high-tech.*'<sup>77</sup> The finding indicated that Benpo was losing competition for traditional industries to regimes in less developed regions. This loss was attributable to both the firms and the regime. On the one hand, the firms were tempted by lax labour enforcement and over-facilitation of rival regimes. On the other hand, Benpo's business environment was becoming worse for SMEs. High administration fees implied that the regime exploited domiciled firms in order to increase revenue. The regime gave no support for the expansion of well-complying and well-developing SMEs.

The agencies were not concerned about the FOE's voice. The council hosted special and Spring Festival symposiums to invite the FOEs' opinions. The boss of a Hong Kong toy-maker commented, '*these symposiums are diplomatic. The officials talk mostly about politics but little about real issues.*'<sup>78</sup> In one informant's village, the council-run Economic and Trade Development Company (ETDC) organised a series

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<sup>75</sup> Interview THLG4

<sup>76</sup> Interview THLG2

<sup>77</sup> Interview THLG3

<sup>78</sup> Interview THLG4

of investigations into the state of the toy-makers after issues arising from the labour contract law and the Mattel recalls. *'It appears to be a positive sign. But the town council still discriminates against toymakers.'*<sup>79</sup> An informant mentioned that the customs and AQSIQ issued questionnaires to comment on which branches worked well and which did not. The informant thought the questionnaires would not help to monitor the agencies' performance: *'How come the officials are pleased to hear criticism? If we give our genuine negative opinions, they will retaliate upon us.'*<sup>80</sup> The Benpo agencies were evidently uncommitted to facilitation. They did not take the firms' voice seriously. The agencies and firms lacked mutual trust and accountability.

### 2.3 Restriction

The agencies demonstrated discrimination against SMEs and traditional industries, but not towards investment origin and compliance. One informant gave a negative comment: *'Big enterprises grow from SMEs. SMEs like ours are very competitive. Discrimination against SMEs impairs us from growing big and strong.'*<sup>81</sup> Another held an opposite opinion: *'It is reasonable for the government to discourage the SMEs from staying. If the SMEs are forced to move to inland locations, they will help develop the local economy there. The workers can go back to their home towns. It is easier for them as they will be free from homesickness and be less stressed.'*<sup>82</sup> This position was found to be coincidentally agreeable to the Foxconn's announced plan of relocating the factories to inland provinces in the aftermath of a string of workers' suicides in the factory in Shenzhen<sup>83</sup>. A vice general manager of a Hong Kong toy-maker blamed governmental poor planning for the agencies' discriminations. *'The government should have had a better plan so that the FOEs wouldn't pay the price for its bad plan. It should not admit all sorts of FOEs in the first place and later drive away the unwanted ones.'*<sup>84</sup>

The agencies did not show enough appreciation to well-complying FOEs. Typically the production safety and labour departments adopted a broad-brush approach for inspection. *'We are damned by the poorly-complying FOEs.'*<sup>85</sup> Meanwhile, *'the*

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<sup>79</sup> Interview THLG3

<sup>80</sup> Interview TJLG

<sup>81</sup> Interview THLG3

<sup>82</sup> Interview EHLG1

<sup>83</sup> See [http://news.bbc.co.uk/1/hi/world/asia\\_pacific/10182824.stm](http://news.bbc.co.uk/1/hi/world/asia_pacific/10182824.stm); <http://www.ft.com/cms/s/2/77fc3d5a-7304-11df-9161-00144feabde0.html>; and <http://www.chinafinancialdaily.com/financial/news/2010/06/02/12214/terry-gouguo-taiming-foxconn-will-move-the-west-for-mainland-staff.html>

<sup>84</sup> Interview THLG2

<sup>85</sup> Interview THLG2

*agencies do not care who exactly caused the problems for the enterprise. Some wrong deeds are conducted not by the employer but by the employee. The agencies blame and penalise the innocent boss but not the wrongful employees. It is unfair.*<sup>86</sup> Overall, the FOEs considered the agencies' broad-brush approach was inefficient and inconsiderate of well-complying FOEs.

It was evident that the Benpo regime changed its business-competing strategy – becoming to disfavour SMEs. This disfavour was demonstrated by the agencies' discrimination against innocent investors for the fault of wrong-doing workers; and the agencies' depreciation of the firms' good compliance. The agencies' adverse stance had made many incumbent FOEs shut down or exit. It was highly likely to deter overseas new entrants.

### 3. The FOEs

The FOEs' good compliance with the labour law resulted either from the improvement in the regulatory structure or from the authority of governmental legal advice. In the former case, '*in the past, the labour department penalised by a few thousand yuan (a few hundred pounds) if it discovered an enterprise did not buy social security for a worker. Now the penalty is increased to a few tens of thousand yuan (thousands of pounds). The labour department monitors the enterprises more closely.*'<sup>87</sup> The improved compliance was not regarded as a cost by this toymaker boss. '*The social security covers the pension and the compensation for incidents of all sorts, including industrial injury and death. Thus abidance by the law costs less than non-abidance.*' In the latter case: '*I consult the municipal Law Bureau. It is the authority for interpreting all laws. The officials give me advice on how to implement the labour law. Neither the village labour department nor the workers can challenge the company's position.*'<sup>88</sup> The latter case implied that the labour agency was incompetent, and the firm must seek authoritative interpretation about labour regulation in order to properly comply with it. Whereas the agency was unable to ensure a positive enforcement effect, the firms' intentional compliance was essential.

The FOEs' compliance with informal rules was related to their market. A Japanese and a Hong Kong TTP-type toy-maker respectively sold all their products in Japan

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<sup>86</sup> Interview EHLG1

<sup>87</sup> Interview THLG4

<sup>88</sup> Interview THLG2

and the USA.<sup>89</sup> ‘*It is a prerequisite to meet the market countries’ standards in order to sell our products.*’ Although the AQSIQ had applied stricter product safety standards since 2007, both FOEs easily passed the test. Another toy-maker informant emphasised: ‘*The monitoring by our business partners is penetrating our production process.*’ The FOE complied with the codes of the International Council of Toy Industry, ISO and those imposed by Wal-Mart and Disney. Wal Mart and Disney hired third parties to regularly audit the FOE’s implementation of the standards. The standards covered the issues of human rights, product quality and safety, labour and environmental protection. They were broader and higher than the Chinese national standards<sup>90</sup>. This indicated the functioning and positive effect of informal enforcement structure.

#### 4. Agency-FOE Contact

A Category-A FOE was allowed by the customs to make customs declaration through the internet<sup>91</sup>. However it was frustrated by the AQSIQ’s complicated procedure adopted after the Mattel’s recalls. ‘*It takes 70 working days to acquire the approval for the export – 50 days for taking the product-safety test and 20 days for getting the certificate. The certificate is valid for one year. Even with the certificate, we must still send samples for each export batch in order to get the specific export permit for the batch. We have complained to the AQSIQ about the complicated and slow procedure. They stressed the necessity and advised us to apply for the specific export permit four months in advance in order to complete the procedure in time.*’ It was evident that the agencies had contrasting enforcement arrangements. Whereas one was simple and efficient, the other was complicated, burdensome and irresponsible.

The FOEs might use the telephone for inquiries, yet they had an impression that most agencies were not pleased to be phoned. As explained by an informant: ‘*Using the telephone rather than paying a visit is perceived by the agencies as insufficient respect. It is better for us to visit them in order to prove our respect.*<sup>92</sup>’ This indicated power asymmetry between the agency and the firm in their bilateral relation and interaction. This power asymmetry affected facilitation, making it irresponsible and inefficient.

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<sup>89</sup> Interview TJLG and THLG3

<sup>90</sup> Interview THLG4

<sup>91</sup> Interview EHLG2

<sup>92</sup> Interview TJLG

The production safety department appeared to be the most active in organising meetings. The purpose was to notify the FOEs of the latest problems happening in the city, alert them of serious consequences and advise them on precautionary measures. However some meetings were either repetitive or irrelevant. '*They request us to attend meetings concerning safe storage of dangerous chemicals. But our production involves no dangerous chemicals at all.*'<sup>93</sup> The finding suggested that the agency's social construction was not necessarily desirable and enforcement was not responsive or efficient.

Different agencies visited the FOEs at different frequencies and for different purposes. In some villages, councils visited the FOEs once a month in order to show their care<sup>94</sup>. The labour department would visit the FOEs upon receiving a report about a dispute such as a strike. The police visited the FOEs when there was a gang fight, burglary or theft. The customs and the revenue department mostly made spot checks of the FOEs when suspicious about the FOEs' misconduct. Some FOEs held these visits as worthwhile. Through the visits, the agencies could better understand the FOEs' genuine state and demands. In the case of diagnosed problems, the FOEs could make timely corrections<sup>95</sup>. Others worried about the agencies' abuse of the visits. '*Some officers visit us simply to request treats. They arrive around 11am and request us to arrange lunch in a restaurant, followed by hair-dressing and foot massage.*'<sup>96</sup> The FOEs were unable to limit the visits of this sort: '*We cannot decline their visits because they will retaliate against us.*' The agencies evidently varied in constraint and had various regularised arrangements and logics of interaction with the firms. Hence various enforcement effects were expected to be engendered.

The problems mentioned by the informants concentrated in three areas: production safety, labour and the customs. The boss of a Hong Kong toymaker recounted the production safety problems and his way of tackling them. '*The inspectors often pick out minor issues and penalise us for them. The production safety officers insist on the necessity of using their specified power switch. But we consider our choice also meets the national standard with equal quality, but it's cheaper. They dislike our challenge and fine us as they wish. We are charged between 500 and 50,000 yuan*

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<sup>93</sup> Interview TJLG

<sup>94</sup> Interview EHLG2 and THLG2

<sup>95</sup> Interview THLG2 and THLG4

<sup>96</sup> Interview TJLG

*(approximately GBP50 and 5,000). If the fine is high enough, I contact the chief town councillor or the governor of the county government. I know these chiefs very well. They are always helpful and will order the relevant agencies to reduce or nullify the fine.*<sup>97</sup> Problems of this sort happened two to three times a year on average. The finding indicated that the agency was ill-restrained and abusing authority to make profit. The firm had to defend its proper interest by inviting senior officials' intervention to correct the agency's unreasonable and inappropriate decisions. It also indicated that Benpo was a regime that was characteristic of individualisation, little institutionalisation of value and uncertainty.

Regarding labour problems, the boss of a Hong Kong toy-maker stated that since the new labour law came into effect in 2007, there had been several strikes in the factory<sup>98</sup>. He had spent a fortune in compensating the workers. Half of the labour population had left. He complained about both the law and the town council: '*The new labour law over-protects the worker. If one hires the worker for 10 years, he has to look after the worker for a life time. Even the American and the European laws are not so protective to the worker. The town council is not supportive to the investors. It doesn't have the wisdom to advise us on how to deal with the labour issues.*' The finding indicated that any regulatory problem was related to both the agency and the firm. The agency seemed to be incompetent in social construction and inexpert in interpreting labour law. The firm had adopted low labour standard and hence suffered from strikes. This problem implied Benpo's negative effect on labour enforcement.

Regarding the problems related to the customs, the informants pinpointed the customs' over-attention to minor details. '*Our company is frequently subject to the customs' penalties because of minor mistakes. For example we declared "toy shoe" as "toy handbag" by mistake.*'<sup>99</sup> Nevertheless, this FOE seldom missed a shipment. Another Category-A FOE encountered more problems in recent years. The informant regarded the problems as '*an outcome of the increased workload of the customs. The heavier its workload, the less patient it is to put up with mistakes.*'<sup>100</sup> He generalised two causes for the problems. One cause was the FOE's inaccurate forecast of the consumption of imported raw materials. When the customs found that the figures for its export products suggested an unnecessary need for the

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<sup>97</sup> Interview THLG4

<sup>98</sup> Interview THLG4

<sup>99</sup> Interview TJLG

<sup>100</sup> Interview EHLG2

import amount, it would investigate. Another cause was the mistake made by the FOE or its supplier in declaring wrongly the quantity or quality of the raw materials. Again, the customs investigates to decide whether it involved any attempt to smuggle. The finding indicated that the agency adopted a more punitive than educating style towards SMEs. Its performance was uncertain, even to big and well-complying firms.

## 5. Findings

*Institutional features* Like Anke, the Benpo regime is not a specialist for foreign investment attraction. It was not particularly accountable for the achievement in attracting overseas investment. This means low grid. With a few exceptions, its inter-agency cooperation is rare. This means it is low in group. Thus, Benpo is categorised as a Detached regime.

*Regulating side* The Benpo regime is generally characteristic of uncommitted, uncooperative and fragmented agencies. Particularly, the village council is of personalised, uncommitted and ill-constrained characteristics. The regime does not pay attention to attracting overseas investment. This implies its deviation from implementing national foreign investment strategy. In recent years, the agencies' restriction has switched to discriminating against the SMEs in the traditional industries, including those who had well-complying records. This harsh stance is not in concord with the spirit of the national strategy<sup>101</sup>. The restrictive agencies' practice is individualised and unreasonable. The agencies abuse their authorities by selling products and illegitimately leasing land<sup>102</sup> to make profit. Hence, both facilitation and restriction are exercised instrumentally and illegitimately.

*Regulated side* The FOEs' compliance with the labour law is relevant to the improvement of regulatory structure or to the authority of governmental legal advice. Their compliance and use of networks to solve problems seems to be from a self-defence stance in an uncertain, inefficient and inappropriate context. Well-intentioned and well-comply SMEs are disfavoured and upset by the regime. Their adoption of higher informal standards is related to their market in the HRCs and is not appreciated by the agencies.

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<sup>101</sup> For more details about 'empty the case' driving away incumbent overseas SMEs, see the section in Chapter IV.

<sup>102</sup> See Interview TTBA about agencies' behaviours in the case of Anke.

*Two-sided marriage and match*

The agency-firm relational distance varies between the FOEs. Few FOEs consider that a close relational distance helps enhancing social construction, shared value and mutual trust and accountability. Most worry that a close relation makes them vulnerable to the agencies' unrestrained request for bribery. In spite of regularised arrangements, the logic of bilateral interaction is likely to be inappropriate. There is limited finding for institutionalising shared value. The distribution of power between the two regulatory sides is asymmetric. The regime, rather than the firm, was responsible for current adverse business environment. The regime seldom takes seriously the incumbent FOEs' voice. Well-complying FOEs become dissatisfied and tend to exit from the regime. The regime's adversity to SMEs, or the majority of the FOEs, and the firms' disappointment about the regime indicate a mismatch between them.

*RC outcomes*

Based on its current industrial structure, it is indicative of Benpo's little attraction to big investment from the HRC. It discourages overseas SMEs residents, in spite of their loyalty and good record of compliance. The agencies' practice involves no legitimacy or innovation but instrumentality. The enforcement effect is deterrent. Generally, the Benpo regime demonstrates regulatory disadvantage.

## **6. Outstanding Issues**

The above-mentioned observed characteristics of the Benpo regime are mostly agreeable with the interpretation about the Detached regime made by the ER Framework. The Benpo case shows little finding of involving constraint and certainty mechanism. It is different from the Anke regime which involves constraint and certainty mechanism. The difference between the Benpo and Anke regimes confirms that constraint and certainty is arguably a certain trait of the Detached regime. More finding for other sources is needed in order to make a conclusion in this regard. The Benpo regime also shares with the Anke regime such issues as the sporadic inter-agency cooperation, the agencies' bribery-requesting and the adversity to the SMEs. These issues have been explained in the Anke regime. Yet the Benpo regime still has one issue that differs from Anke. This is individualisation, exemplified as the monopoly of stamping approvals by the chief town councillor and the county governor's intervention to reduce or nullify inspectors' unjustifiable fines. The explanation is that individualisation is likely to be contextual to the Benpo. Further investigation is needed from other sources in order to confirm the judgment.

Generally, the remaining issues are not considered as disagreeable with the specific interpretation of the ER Framework.

## **Conclusion**

The Anke and Benpo regimes share in common most characteristics as the Detached regimes. Meanwhile they are different in that, for the Anke regime, the county government has arrangement with certainty and constraint; whereas for the Benpo regime, there is more involvement of individualisation in terms of monopolising approving authority, nullifying subordinate's unreasonable decisions and inferior performance. So far, these identified differences cannot be concluded as universal. Additional finding is needed from other empirical sources in order to determine whether or not the differences are contextual. Till then, they do not amount to a challenge to the interpretation of the ER Framework. In general, both Anke and Benpo cases support a statement that the ER Framework is plausible in its interpretation about the Detached regime.

## Conclusion

The empirical research about RC in China has been reported and the interpretation by the ER Framework has been scrutinised. Now, the whole empirical research is to be summarised; the framework is to be reviewed in the light of the empirical findings; the linkage and contribution of the framework to the theoretically rooted subjects of RC and enforcement are to be clarified; and future research is to be suggested. These are the tasks of this conclusion to the thesis.

### 1. Summary of Empirical Research

This section summarises the general and specific empirical findings and explains the identified outstanding issues. The empirical research provides a chance to see whether the originally proposed ER Framework is able to make sense of the findings from my fieldwork and hence to convincingly interpret the empirical phenomenon of RC. It comprises of a general introduction to the macro, middle and micro contexts of the sample country and four specific case studies of the micro regimes locating in two sample cities. Each case roughly indicates one type of regime of the ER Framework. Particular attention is paid to features that appear to be disagreeable to specific argument of the ER Framework or missed out by the framework. The structure and focus of case studies are borrowed from the literature review of regulatory enforcement, which is also used to structure the ER Framework.

#### 1.1 Findings of Macro and Middle Contexts

The introduction to the macro and middle contexts sets the scene for the four case studies of the micro regimes. The findings show that the institutional characteristics of the regimes at the three vertical levels are not the same. While macro regime is an Adherent with high oversight and high inter-agency cooperation, middle regimes are Uncoordinated with high oversight and low horizontal cooperation, and micro regimes are of various types. Macro and middle regimes shape the RC and enforcement contexts of micro regimes. Typically, the unified national strategies articulate regulatory goals and preferred types of foreign investors. It sets a practical benchmark to determine the legitimacy of business attraction and social enforcement of the micro regimes in the case studies. The top-down monitoring and intervention of the national government indicates its recognition of the significance of rule implementations at lower levels. Its outward responses imply joint functioning of formal and informal enforcement structures. The inter-city and intra-city RC

showcases the middle and micro regimes' various understandings, learning and innovations in fulfilling the regulatory goal of attracting quality overseas investment. The micro level is the right perspective to attain precise information about fundamental factors of RC, where the agency and the firm act and interact vis-a-vis each other in the RC and enforcement context. It is generally found that micro regimes respond upwardly in dramatically different fashions and that regulatory outcomes at middle and micro levels are not always as desired by macro-level government. The findings across the three hierarchical levels suggest that there is close link between macro-level rule-making and micro-level practices. Empirically, as the ER Framework argues, micro-level enforcement of rules fundamentally affects RC through making rules at macro level. The dimension of micro-level enforcement deserves in-depth interrogation so as to provide a more comprehensive and accurate account for the empirical phenomenon of RC for business.

## **1.2 Regulating Side**

The representative of the regime is the general-purpose agency. In all cases, the empirically observed characteristics of the general-purpose agencies are dramatically varying, which agree with the interpretations of the ER Framework. Specifically, the Adherent Wangda and Guangcheng agencies are mostly well-restrained and committed. They show strong interest in winning RC and enforce social regulations in a balanced, responsive and legitimate fashion. They prefer big firms originating from HRCs such as the USA, the EU and Japan, because of their voluntary self-enforcement of high social standards.

In contrast, whereas generally restrained, the general-purpose agencies of the Uncoordinated Fujia and Ximo demonstrate little interest and commitment to competing for desired types of overseas investment or facilitating domiciled firms. Whereas both regimes have the authorities to grant favourable conditions, they do not use them strategically. Restriction is given apparently more importance than facilitation, and is carried out in an uncoordinated manner by Fujia or a coordinated manner in Ximo. The general-purpose agencies of both regimes do not show particular preference to the firm's industry, size and investment origin. Well-complying firms are not necessarily rewarded by responsive facilitation and restriction.

The councils of the Conciliative Lufei and Tuqing show strong interest and commitment to competing for overseas SMEs. These regimes are found to share

some similarities. Both provide innovative, efficient, predictable and responsive facilitation. However their over-pursuit of the facilitative goal deviates from superior governmental strategies and denies their restrictive duties. They target the SMEs from LRCs that are disfavoured by the national government and SIZs. To secure an advantage, the regimes establish a regulatory haven for the targeted firms. The two regimes have their differences. The Lufei council is driven by the maximisation of organisational revenue. Its agencies are not well-restrained. Typically the production safety agency and the customs request bribery from any offending FOE in exchange for pardon. The labour agency manipulates the interpretation and implementation of the law to protect the FOE's benefit. Meanwhile, the Tuqing is motivated by local prosperity. Its agencies are well-restrained. Taking aggressive, committed and responsive competing strategies, the agencies never discriminate firms because of the size, industry and investment origin. Although the agencies react to complaint against firms' wrong deeds, they do not disclose to the outsider how they penalise the wrongdoers. This is indicative of the agencies' protection and prior accountability for the firms.

Unlike their counterparts of the county government, the agencies of the Detached Anke town council and their village subordinates are ill-restrained and uncommitted. Showing no interest in competing for quality foreign investment, they abuse their power in terms of making approvals beyond their authorities and seeking bribery. Their practice is fragmented, individualised, profit-driven and unreasonable. They are active in sending away low-tech and ill complying SMEs and welcoming domestic investment by hi-tech sectors. This aggressive business-attracting strategy is illegitimate and instrumental, since it deviates from the national strategy of attracting foreign investment. Similarly, the performance of the Detached Benpo agencies is uncommitted to facilitative or restrictive goals, fragmented, ill-restrained and unreasonable. The regime is disinterested in attracting overseas investment on the one hand, and adverse to the SMEs in traditional industries on the other. This stance is not congruent with the national strategy for attracting overseas investment. The restrictive agencies abuse their authorities by selling products to make profit. Both facilitation and restriction are illegitimate and instrumental.

Apart from the above-mentioned theory-supporting findings, there are empirical findings that seem to be different from the corresponding interpretations of the framework. Explanations are made for these findings. Firstly, individualisation is found in the Adherent Wangda, the Uncoordinated Fujia and the Detached Benpo. For Wangda and Fujia, individualisation implies institutional change entailed by the

change of the leader of the general-purpose agency. For all three regimes, individualisation implies how crucial is the leader's role in shaping the regime's RC-related stance and performance. To the contrary, the ER Framework does not pay particular attention to individualisation. The framework interprets the agency in a collective rather than an individual way. Accordingly, it does not treat the leader's role exceptionally. It is noteworthy that all the three regimes that share individualisation are in Shenzhen. Yet the remaining regimes in Shenzhen and all regimes in Suzhou are not identified with individualisation. Instead it is institutionalisation that is found in the Adherent Gongcheng and Conciliative Tuqing regimes of Suzhou. These findings tend to suggest that individualisation is likely to be contextual to some micro regimes of Shenzhen. Similar logic applies to explaining the outstanding issue of bribery. Bribery-seeking is found in the Conciliative Lufei and the Detached Anke and Benpo. Bribery is not a factor concerned by the ER Framework, nor is it of most RC and enforcement theories. It is noted that all these three bribe-involving regimes locate in Shenzhen. The remaining regimes in Shenzhen and all those in Suzhou do not involve agencies' bribery-seeking. Hence an open rather than final statement is that bribery is likely to be contextual to the specific regimes. The ignorance of the issues of individualisation and bribery by the ER Framework is attributable to its simplicity and heurism.

Secondly, the agencies within the same regime never behave uniformly. In the Adherent Wangda, the customs branch sticks stubbornly to its wrong decision and only corrects it under repetitive orders from its superior based on the persistent appeal of the affected firm. Even in the mostly successful Adherent Gongcheng regime a few agencies are found to be exceptionally irresponsible, uncommitted and inefficient. The customs in the Uncoordinated Fujia is committed and its practice is responsive, efficient and innovative. In the Uncoordinated Ximo, the restrictive agencies are cooperative and expert in exercising enforcement. In the Detached Anke regime, the county governmental agencies provide facilitation with restraint, coordination, flexibility and certainty through centralising their regulatory activities. In the Detached Benpo, the customs facilitate big well-complying FOEs in terms of making declarations through the internet. In contrast, the ER Framework interprets the agencies within the same regime in a uniform fashion. There are general and specific explanations for the outstanding issues. The general explanation is that the framework interprets the agency in archetypal terms. It simply classifies the agency into facilitative and restrictive groups. Attention is paid to the cooperation between these two types of agencies rather than to that inside each type. Meanwhile, in

reality the agencies' behaviours are much more complex and peculiar. To fully capture their complex and peculiar behaviours is impossible not only for the ER Framework but for any social science research. The specific explanation is that, as clarified in the introduction to the empirical research, in every sample of the case study, the general-purpose agency rather than the specific-task one is to be taken as representative of the regime. Therefore, the specific-tasked agency such as the customs is unrepresentative to the Uncoordinated regime. Also, the customs is exceptional in terms of being embedded in both local and national regimes. This institutional peculiarity is too complex for the ER Framework to capture.

Finally, inter-agency cooperation does not automatically happen. On the contrary, the ER Framework simply assumes inter-agency cooperation will or will not happen. Even for high 'group' regimes, inter-agency cooperation seems to depend on the initiative of the general-purpose agency. In the Adherent Wangda, the director-general of the regulatory committee is playing a leading role to establish inter-agency cooperation. In both Adherent regimes, the regulatory committees need to bribe the unaffiliated agencies in exchange for their cooperation in business facilitation. Similarly, the Conciliative Lufei and Tuqing councils make an effort to improve or maintain inter-agency cooperation in order to establish a regulatory haven for SMEs that are disfavoured nationally and municipally. The superior county government of the Detached Anke plays an active role in collaborating with the customs to verify the actual production capacities of the domiciled FOEs. Nevertheless this inter-agency cooperation is very exceptional. The explanation is that it is necessary for the ER Framework to make simplified assumptions about inter-agency cooperation. The inter-agency cooperation is an adaptation of the 'group', or the horizontal dimension of the institutions of the regime and agencies. To assume the inter-agency cooperation simplistically is necessary to determine the institutional trait of the agency as well as the regime. Therefore, to be simplified in this regard is necessary for the framework.

To summarise, the empirical findings about the regulating side are that micro-level enforcement regimes demonstrate dramatically different institutional features. Notwithstanding a context of prevailing RC for quality foreign investment as well as similar implementing similar rules, micro-level regimes demonstrate dramatically different interests, performances and strategies. Some competed for quality foreign investment as desired by the national government. Some targeted exactly the type of overseas firms undesired by the national government. Some were disinterested in competition. Some were driving away overseas investors in order to make room for

favoured domestic business. Most findings about the distinctive features of specific regimes are agreeable to the interpretation of the ER Framework.

### **1.3 Regulated Side**

On most occasions, firms' stances and reactions towards formal enforcement are found to be related to their specific sizes and investment origins. The findings in this regard are mostly agreeable with the interpretation of the ER Framework. In the Adherent Wangda, big firms from HRCs such as the USA, the EU and Japan have well-complying records, whereas the early-movers from LRCs are ill-intentioned and ill-complying. The SME in the Conciliative Lufei regime is found to be ill-intentioned and well-informed. Its counterparts in the Conciliative Tuqing comply with the informal norms imposed by their big buyers such as the Disney. They are reluctant to discuss regulatory problems about the regime with the outsider. This is indicative of their loyalty and accountability to the regime rather than to external observers. The domiciled SMEs in the Detached Anke have a bad record in complying with the labour law and customs regulation. In the Detached Benpo, the SMEs adopt high informal standards under the request of their buyers in HRCs.

However, firms of the same type do not behave in the stereotyped way as interpreted by the ER Framework. It is found in the Detached Anke that an SME from a LRC enforces self-regulation of labour protection. Similarly, in the Detached Benpo regime, some small and medium sized toymakers from LRCs are well-intentioned, well-informed and well-complying, despite their compliance not being appreciated by the agencies. Meanwhile, the ER Framework does not interpret big firm from LRC – a type which appears to be of different characters. In the Adherent Gongcheng and Uncoordinated Ximo, some big firms from LRCs improve self-regulation to comply with newly promulgated stricter labour law, while some creatively comply by hiring short-term workers to avoid cost. In the Uncoordinated Fujia, while abiding by informal rules enforced by their powerful American buyers, big firms from LRCs are different in terms of correctly or wrongly complying with Chinese customs rules. The explanation for these outstanding issues about firms' behaviours is similar to that for the agency. In reality, firms' behaviours and characters are too complex and peculiar for the ER Framework to capture fully. The ER Framework is heuristic so that it can only interpret firms in an archetype and stereotype fashion. This means that the framework is limited rather than wrong in this interpretation.

To summarise, the empirical findings show that firms are in different types. Their understandings and behaviours are apparently different towards formal and informal enforcement and in the context of RC. Generally speaking, the empirical findings in this regard support the interpretation of the ER Framework.

#### **1.4 Two Sides: Match and Marriage**

Investigating the marriage and match of the two sides, the focuses are the relations, interactions as well as the match and mismatch of preferences of the regime and the firm.

##### **1.4.1 Match of Preferences**

Match of preferences of the regime and the firm are one focus in the empirical fieldwork. The industrial structure of specific regime is indicative of the match or mismatch of its preference with domiciled firms'. Wangda and Gongcheng are apparently the most selective regimes, preferring and admitting only quality foreign investment – typically big high-tech investors from HRCs. Meanwhile, quality foreign investment's fast growth, or having taken up 50% of the total industrial population, is indicative of their preferences for the most desirable type of firms. Generally, the regimes' and the firms' preferences are in perfect match. Similarly, Lufei and Tuqing target on SMEs - the undesirable type according to the national government. The SMEs typically from LRCs favour Lufei and Tuqing because of their unusual friendliness in a general context of RC for big investors from HRCs. The favourable choices of the regimes and SMEs match. In contrast, Fujia and Ximo are not actually selective about the type of firms. There is little finding for either SIZ to be favoured by big firms from HRC, bearing in mind the structures of their incumbent FOEs. Likewise, Anke and Benpo seem to be mostly interested in domestic rather than overseas investors. Not only do they deter incumbent overseas SMEs but offer no attraction to quality foreign investment. The structures of their total industrial populations are indicative of their unpopularity to most desirable types of overseas investors by the national and municipal governments. There are apparently mismatch between these regimes and business firms.

##### **1.4.2 Agency-Firm Relations**

The agency-firm relational distances are found to vary from one type of regime to another. The findings agree with the interpretation of the ER Framework. Comparatively, the bilateral distance is close in the Adherent Wangda and Gongcheng as well as the Conciliative Lufei and Tuqing, but remote in the

Uncoordinated Fujia and Ximo as well as the Detached Anke and Benpo. The mentioned bilateral distances are typically those between the general-purpose agencies and the FOE residents. In fact, under the same regime, the bilateral relational distance is not always the same between the agencies and the FOEs. For example, in both Fujia and Ximo, the early-mover FOEs are now further from the general-purpose agencies than they were before. This is because these FOEs consider the agencies have become disinterested in RC, indifferent to the FOEs' voice, and no more committed to their facilitative duties. They even 'opt out' of the agencies in terms of halting all voluntary contacts. At the same time, the FOEs are close to the customs, which are viewed by the FOEs as facilitative, responsive and trustworthy. In the Conciliative Lufei, the relation between the council and the FOE is bipartisan rather than enforcer-vs-regulatee. It is physically bound by the FOE's production contract and the hiring of the factory director who is a local villager as well as a shareholder of the village-owned revenue-raising company. The Conciliative Tuqing regime and its FOEs have such a close relationship that they are mutually loyal and accountable and neither will give any negative opinion of the other to an outsider.

At the same time, some findings are not addressed by the ER Framework. Close bilateral relation is found to be costly to the firms. The firms in the Adherent Wangda, the Uncoordinated Fujia and the Conciliative Lufei complain about too many inspections consuming extra time and human resources. In contrast, the most successful Gongcheng regime emphasises professionalism in terms of staying at arm's length from the resident firms. In this way, the agencies are restrained from interrupting the firms' routine but ready to offer facilitation in case of need by the firms. Under the Detached Anke, some FOEs would rather keep distant from the agencies because of dreading the agencies' bribery seeking. This view is shared by most FOEs in the Detached Benpo, whereas a few consider a close relation is helpful to gain the agencies' support in case of incidents. The explanation is based on the theoretical origin of Black's literature (1976)<sup>1</sup>. The key point is that the closer the enforcer and the regulatee, the strategy the enforcer uses becomes less formal and penal. Yet it does not address how to measure the bilateral distance or whether close distance would incur unexpected cost to regulated firms. Because of this theoretical origin, the ER Framework also misses out these points. Nevertheless, empirically the agencies are found not to be using formal and penal measures in

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<sup>1</sup> For more details, see the section about the enforcer-regulatee relational distance in Chapter II.

most inspections when their relations with the firms are comparatively close. This finding is agreeable with the implication of the framework.

### **1.4.3 Agency-Firm Interactions**

Most characteristics of the bilateral interactions are found to be agreeable with the interpretation in the ER Framework. In the Adherent Wangda and Gongcheng, the distribution of power between most agencies and the firms is symmetric. Most agencies are active in social construction and have regularised working arrangements. The bilateral interaction mostly demonstrates the logic of appropriateness. Mutual trust and accountability are evident. Most agencies take the firms' voice seriously. Facilitative and restrictive operations are innovative, efficient, responsive and legitimate. The firms are loyal to the regimes. The certainty is ensured for Wangda under the current leadership and permanently for Gongcheng. In the Uncoordinated Fujia and Ximo, the agencies and the firms have varied distribution of power, social construction, regularised arrangement and institutionalised shared values. The FOEs' loyalty, trust and accountability vary by agency. In the Conciliative Lufei, the agencies and firms enjoy power symmetry. Social construction and regularised arrangement institutionalise the shared logic of instrumentality. In spite of dislike of the agencies, the FOE still trusts their support and protection and never wants to exit. The Conciliative Tuing is similar to the Lufei, but different in that social construction and regularised arrangement demonstrate the logic of appropriateness to the local community but instrumentality to the mainstream; and in that the agency-FOE are more loyal, trusting and accountable to each other than to anyone outside the regime. In the Detached Anke, power is distributed asymmetrically between the agencies and the FOEs, which is mostly cat-vs-mouse. The logic of bilateral interaction is mostly inappropriate and instrumental, considering the agencies' incompetent, unreasonable, unpredictable and bribery-seeking performance as well as the FOEs' varied ways of self-defence. Apart from the non-representative county government, most other agencies' working arrangements are fragmented and individualised. The FOEs' voice is not attached with importance. There is little social construction, shared value, mutual trust or accountability. The informant FOEs tend to exit the adverse regulatory conditions. In the Detached Benpo, the distribution of power is asymmetric between the two regulatory sides. Social construction, regularised arrangement, mutual trust and accountability are different for different agencies and FOEs. There is little finding of shared values. The logic of bilateral interaction is not always appropriate. The FOEs' voice is generally ignored. The well-complying FOEs are upset and tend to exit.

A seemingly disagreeing finding is that the restrictive agencies of the Uncoordinated Ximo prefer the firms from HRC to those from LRC. This is because the former voluntarily self-enforce high labour standard while the latter are manipulative in complying with the labour law. This finding appears to be opposite to the interpretation of the ER Framework in that the firm's compliance with informal rule is not appreciated by the regime. It is reminded that Ximo is actually not selective as it openly claims, exemplified by its admission of low-tech garment producers. Meanwhile, no agency awards well-intentioned and well-complying firms in any substantial way. Bearing in mind the simplicity of the framework, the empirical finding can be said to not be disproving.

The findings from the four case studies showcase different bilateral relations and interactions for different regimes. The regime is represented by that of the general-purpose agency in this regard. Wangda and Gongcheng assure incumbent FOEs power symmetry, typically taking serious consideration of the FOEs' voice in the enforcement process and arrangement. So do Lufei and Tuqing. In contrast, Fujia and Ximo give no regard to incumbent FOEs' interests, but adopt and follow their own rules of the game. Similarly, Anke and Benpo treat incumbent FOEs inferiorly. Besides, the impacts exerted by changes inside the regimes, typically the leadership changes of Wangda and Fujia as well as the strategic changes in RC of Ximo, Lufei, Anke and Benpo, demonstrate different enforcement styles of regimes in the context of RC. We can conclude that different relations and interactions of regime versus firm showcase different regimes' enforcement styles. These different enforcement styles reveal how specific two-sided marriages are looked like. The marriage indicates the match and mismatch of preferences of the two sides as well as helps to explain relevant RC outcomes of the involved jurisdiction.

#### **1.4.4 Summary**

The empirical research findings are that in a prevailing context of RC, regimes demonstrate sharply different matches and marriages with domiciled firms. The domiciled firms' reactions as well as the industrial structure of the regime are indicators of the match and mismatch of their preferences. Apparently the two-sided relations and interactions are not always pleasant. The preferences of the two sides do not always match. The findings in this regard show that corresponding interpretations of the ER Framework are convincing.

## 1.5 RC Outcomes

The two-sided match/mismatch of preferences and marriage of the regime and the firm are considered as relevant to the economic and social effect of specific jurisdiction. The outcomes of business attraction and social effect of specific regimes exemplified in the industrial and firm structure are generally agreeable with the interpretations in the ER Framework. The findings in the Adherent Wangda and Gongcheng as well as the Conciliative Lufei and Tuqing highly agree with the framework. Wangda witnesses a rapid growth of big investment in hi-tech sectors from the EU. Its efficient enforcement is based on both its strict filter of undesired SMEs from LRCs and the chosen firms' faithful self-enforcement. Gongcheng enjoys more than 50% industrial population by HRCs. The rise in labour and land cost has made early-movers exit to partner zones. The upgraded industrial structure enhances efficient enforcement. The TTP-type firms dominate the industrial population of the Conciliative Lufei regime. The enforcement is lax. This finding strongly suggests that it is a regulatory haven for ill-intentioned and well-informed SMEs from LRCs. The FOEs in Conciliative Tuqing are mostly SMEs from both LRCs and HRCs. No heavy industry means Tuqing is a good destination for hi-tech industries with a desirable effect for environmental regulation. But the agency's reactive rather than active stance towards labour dispute, and reluctance to expose its action to the outside, tend to suggest lax enforcement of labour regulation. Based on the limitedly accessible information, the overall enforcement effect can be reasonably said as lax.

Meanwhile, some findings need explanations. The Uncoordinated Fujia and Ximo are found to have big firms and SMEs from LRCs. The ER Framework interprets the Uncoordinated regime as having no attraction to business but burdensome enforcement effect. The empirical findings are explicable both from a temporal perspective and from the reason of the empowered favourable conditions of the two regimes. Fujia has been fully filled by overseas manufacturers under the previous leadership of the general-purpose agency. Thus its industrial structure is not considered as a valid indicator for its current regulatory attraction. Overall enforcement effect tends to be burdensome. This is a conclusion based on the active but varied, often robotic, irresponsive and unnecessary performance of restrictive agencies on the one hand, and the firms' compliance with high standards insisted by the powerful buyers of the HRCs and managerial competence in abiding customs rule on the other. Ximo has abundant land. This puts it in an unrivalled

position to absorb new business, since all its competitors are short of land. Judging by its overall worsening facilitation, the Ximo regime cannot be said as attractive to the desirable type of firm. The restrictive performance is coordinated and reasonable. Yet the agencies do not reward the well-complying domiciled FOEs with noteworthy responsiveness. This implies that formal and informal enforcement structures are not mutually complementary. It hence discounts enforcement effect to burdensome.

The FOEs of the Detached Anke are found to take up less than a quarter of its total industrial population. Likewise, overseas FOEs take up one sixth of the industrial population of the Detached Benpo. Under both regimes, most FOEs are the SMEs from LRCs. The ER Framework instead interprets the Detached regime as of attracting no particular type of firm. The explanations are that, firstly the framework interprets regulatory attraction based on institutions. In reality, the investor's choice is cognitive and bounded by its rationality. This means that the investor is likely to be unaware of the institutional match of his preference and the regime's. Meanwhile, the investor rarely chooses a destination purely based on regulatory considerations. Non-regulatory consideration may be given more weight by some FOEs. Secondly, the information from both regimes confirms that the entry of currently domiciled FOEs was at a time when the regimes favoured them. Lastly, it is noted that many FOEs have exited the regime. The information is that once there were large numbers of undesirable types of firms and that recently they exited or failed to survive because of the regimes' new RC and enforcement strategies. The remaining ones are able to protect themselves via varied means, such as enhancing self-regulation, automating production to replace workforce, hiring the lawyer, inviting the mayor or county governor to intervene and bribing officials. This finding also reveals the extraordinary adaptability of those remaining SMEs. These explanations also underpin the deterrent enforcement effect of both regimes. An abrupt switch to stringent enforcement does not evidently improve ill compliers but rather upsets good compliers. A simple abandonment of both ill-complying and well-complying SMEs implies a dysfunction of formal enforcement mechanism. In spite of being agreeable and seemingly disagreeable, all empirical findings end up supporting the theoretical argument of the ER Framework that no regime is successful in attracting or enforcing compliance of all sorts of firms.

The RC outcome of regulatory advantage of each specific regime is accounted for by the ER Framework. Regulatory advantage is indicated by innovation, legitimacy and instrumentality. Both Wangda and Gongcheng innovated their procedures in

order to improve facilitative and restrictive responsiveness, certainty and efficiency. Their targets and approaches on competing for quality foreign investment conform to the national strategy, involve no instrumentality and hence are legitimate. Therefore both Wangda and Goncheng are characteristic of competitive advantage. On the exact contrary, Anke and Benpo generally make their business environment difficult for the SMEs – the majority of their industrial populations. Their unreasonableness, irresponsiveness and uncertainty are such a big issue that many FOEs have exited the regimes for others and few new overseas investors enter. Their adversarial approaches are unacceptably unfair to the SMEs according to the national government. Their emphasis on domestic investment deviates from the national strategy. Hence the two regimes are characteristic of no innovation but instrumentality and illegitimacy. They demonstrate regulatory disadvantage in competing for quality foreign investment. Fujia and Ximo do not undertake innovation for business attraction or facilitation, but over-emphasise restriction – without responsiveness and flexibility. These two regimes showcase legitimacy but no instrumentality or innovation and hence no regulatory advantage. Lufei and Tuqing are, however, strategic in competing for SMEs and innovative in improving their business facilitation. Their competed-for target is not typical quality foreign investment, and is out of line with the national strategy. Their strategies are characteristic of innovation, instrumentality and illegitimacy. They exemplify comparative advantage.

In comparing the four types of regimes, an additional finding about regulatory advantage can be summarised. It is recognisable that Adherent Gongcheng and Wangda are the most successful regimes in attracting quality foreign investment. Between these two regimes, Gongcheng's success is more likely to endure than Wangda. They demonstrate high regulatory advantage. Conciliative Tuqing and Lufei are most competitive in attracting overseas SMEs. They also show high regulatory advantage. Uncoordinated Fujia and Ximo are less competitive, not only less than themselves previously, but also less than Gongcheng, Wangda, Tuqing and Lufei. Their attractiveness is dependent on their endowed natural and favourable conditions. They do not show regulatory advantage. Detached Anke and Benpo are unattractive to big overseas firms and adverse to foreign SMEs. They are evident of regulatory disadvantage. This finding, based on cross-case comparison, generally supports the interpretation by the ER Framework about RC outcomes of regulatory advantage, including competitive and comparative advantage, for the various types of regimes. A remaining issue is that it is yet to decide whether the Conciliative regimes have more regulatory advantage than the Adherent, as

suggested by the ER Framework. More data and finding need to be collected and analysed to make a conclusion. Notwithstanding this remaining issue, it is tentative to conclude that the empirical finding about regulatory advantages of various regimes is plausibly interpreted by the framework.

## 1.6 Summary

The significant findings of the empirical research about prevailing RC for foreign investment in China can be summarised as follows:

- (1) RC at macro and middle levels typically through drafting and changing formal legal rules is closely linked to enforcement of these rules at micro level. As a matter of fact, the RC effect that is desired by macro-level rule-makers by and large depends on the collective practices of front-line enforcement agencies. It is tentative to conclude that RC through making rules at macro level as well as through implementing rules at middle level are fundamentally affected by enforcement of these rules at micro level.
- (2) Actual enforcement practices at micro level can be so dramatically different that they are beyond our imagination. Even in the context of the same city, not only enforcement agencies and firms think and behave differently, but also they interact with each other differently. Indeed each regime forms a peculiar micro institutional environment, has its own regulatory culture and follows its own rule of the game. What is considered as appropriate inside the boundary of each location is not necessarily appropriate in a larger territory. To be well aware of the differences between enforcement regimes and those between firms are necessary to understand why micro-level practices are so different and why locations are different in economic and social effects.
- (3) Matching of the couple's preferences matters and marriages are different. Both agencies and firms are selective about each other. Locations that are successful in attracting business demonstrate the match of enforcement and business styles, while locations that are not successful indicate the mismatch. Indeed match and mismatch of preferences help to explain why firms conduct business at particular locations and why particular locations attract business as desired or undesired by rule-makers.

Notwithstanding that the ER framework is proposed to interpret the empirical findings, the empirical findings are much richer and more fluid than the ER

Framework is able to apprehend. But in spite of the richness and fluidity of the real world, the empirical findings are generally interpreted by the ER Framework convincingly. The outstanding issues are explicable in terms of the heuristic property of the ER Framework, the contextual peculiarity of the sample, or further finding from other sources. Based on the empirical findings and necessary explanations, it is fair to say the ER Framework is able to give convincing interpretations about the RC for overseas investment in China. Focusing on the dimension of micro-level enforcement, the ER Framework provides a more comprehensive and accurate account for the empirical phenomenon of RC.

## 2. Theory Revisit

In the light of the empirical findings, the ER Framework demonstrates both theoretical strengths and weaknesses. Indeed, the strength and weakness in each theoretical aspect shine side by side. Accordingly, the theory revisit will be carried out by critically analysing one theoretical aspect after another by addressing their respective strengths and weaknesses.

*Interpretive strength* The theoretical interpretation of the agency in cultural institutionalist terms is strong. The empirical findings are, in general, found to be agreeable to the interpretations of the ER Framework. The findings in this regard imply the strength of the fusion of the grid-group typology and historical institutionalism. At the same time, some empirical findings shed light on the weaknesses of the framework. One weakness is found to be the exclusion of the issue of individualisation. This omission is attributable to the use of the grid-group typology as a collective typification of agencies. It is noted that this weakness occurs in spite of the inclusion of historical institutionalism, which is attentive to individualisation versus institutionalisation. Another weakness is that the framework does not show a temporal dimension, which is however typical within historical institutionalism. Not showing the temporal dimension disables the framework from fully capturing the empirical finding of the attraction within the Uncoordinated and Detached regimes. The implication here is that, although the grid-group typology and historical institutionalism are perfectly compatible, their fusion is not totally seamless.

*Theoretical comprehensiveness and accuracy* The ER Framework is more comprehensive and accurate than existing RC theories in answering this question: If rules stay the same, how do different locations compete for business? This

theoretical framework is context free. The general empirical findings support the interpretation of the framework. The theoretical comprehensiveness and accuracy of the ER framework attributes to the involved cultural institutionalist approach. However, a central argument of the framework is concerned about the regulating-regulated marriage and match of their preferences. It is particularly relevant to the enforcement levels that involve the players vis-a-vis each other. Empirically micro-level enforcement is the most precise perspective to use this framework. Generally, the ER framework is applicable to an RC context in which the agency and the firm directly relate and interact each other.

*Archetyped characterisation* The framework is heuristic in typifying the varieties of regimes, agencies and firms into four collectively exhaustive and mutually exclusive archetypes. Consequently the varieties of regimes, agencies and firms are interpreted, and relevant implications for RC are explored coherently and systematically. The down side is that the framework interprets agencies and firms under the same regime uniformly. According to the empirical finding, agencies of the same archetyped regime do not behave in exactly the same way. Meanwhile, just four archetypes fall short of capturing complex and peculiar types of agencies and firms of the real world. This weakness is determined by the cultural categorisation. The framework can be improved by suggesting and exploring hybrid types of regimes, agencies and firms in the future.

*Simplified assumption* Simplified assumptions in terms of the 'grid' and 'group' underpin the ER Framework's strong plausibility. However, simplicity costs elegance. The framework makes simplified assumption about inter-agency cooperation; and the agencies' behavioural tendencies in line with the functions of their regulatory duties. Empirically inter-agency cooperation does not necessarily happen automatically. Restrictive agencies do not enforce restrictive rules in the same way, nor do facilitative agencies support the FOEs evenly. In a similar vein, the ER Framework cannot differentiate nuanced scales of the 'group'. This weakness is traceable to the heurism of the cultural categorisation.

*Theoretical root* The ER Framework borrows the behavioural and interactive dimension from relevant research of regulatory enforcement. The inclusion of this dimension distinguishes the ER Framework from all other RC theories. It illustrates for the first time how enforcement is relevant to RC for attracting business. Nevertheless, since the borrowed dimension is mostly concerned about enforcement style, any implications concerning business facilitation are not all

sufficiently explored. Typically, the concept of relational distance is relevant to enforcement style. Close relational distance implies the enforcer's likely adoption of an informal style and hence infers his likely business facilitation and flexibility. However, enforcement scholars do not determine how 'close' the agency and the firm must be to mean that the players are in close bilateral relation. Nor do the scholars expect that too close a relational distance may bring about undesired burden and distraction to the regulatee. Therefore, the point that close agency-firm relational distance entails business facilitation lacks precision. This weak point showcases that the borrowing of concepts from the enforcement subject to address the topic of RC is not always precise in some contexts.

To summarise, a theoretical revisit in the light of the empirical findings exposes the strengths and weaknesses of the ER Framework. The framework has heuristic and interpretive strengths. Meanwhile, it falls short in capturing the real world on account of the archetyped characterisation and simplified assumption. Both strengths and weaknesses of the framework are underpinned by the cultural institutionalist approach and theoretically rooted subjects used, namely existing studies of RC and enforcement.

### **3. Reflecting Existing RC and Enforcement Literature**

The ER Framework is original to the RC subject. Its theory finds root in the RC and enforcement studies. But exactly how the Framework sit among existing RC theories accounting for the empirical phenomenon of RC?

#### **3.1 Reflecting Existing RC Theories**

The ER Framework is more comprehensive than existing RC theory in interpreting the empirical phenomenon of RC. It distinguishes itself from as well as makes itself to be reconcilable to existing theories of RC in the following ways.

##### **3.1.1 Theories through economic lens**

The ER Framework argues that whether RC is a driving force to satisfy the firm's preference depends on the type of the regime. The agency's incentive, interest and understanding towards the dual duties of facilitation and restriction are determined by the institutions on the regulating side. So is the firm's influence. An across-the-board assertion of the firm's powerful influence by existing theories through economic lens ignores the institutional variety of regime and thus is over-optimistic.

The ER Framework considers that the ‘race’ analogy of RC is inaccurate. The ‘race’ analogy is underpinned by a rational choice or instrumental assumption. This assumption can only capture the features of a certain type of regime but misses out most others. In contrast, the ER Framework highlights the institutionally varied types of regimes. It admits that one type of regime, namely the Detached, is driven purely by rational choice logic. At the same time, it illuminates that other types of regimes are oriented either by instrumentality or social appropriateness or by a mixture of these two logics. In this regard, the framework draws attention to the contrasting functioning of the instrumental and social logics, in terms of being balanced versus unbalanced, and in the interest of constituent versus in that of wider society. The implication of the accommodative assumptions of the ER Framework is that the analogy of the government as a marketplace competitor is neither fully right nor fully wrong. The government’s choice of RC strategies is institutionally bounded. The adjustment of enforcement stringency and the deployment of natural or institutional resources are strategic and instrumental. Making a strategic and instrumental choice is unlikely for all types of regimes, but for the Conciliative and Detached regimes only<sup>2</sup>. Meanwhile strategic and instrumental choices are appealing to SMEs, but not to big and environmentally friendly investors. This explains why neither ‘race to the bottom (RTB)’ nor ‘race to the top (RTT)’ does not always prevail in reality.

### **3.1.2 Theories through sociological lens**

The ER Framework agrees with the intra-governmental contest theory in emphasising the significance of governmental institutional arrangement to RC. However the framework interprets the institutional arrangements in a general rather than contextual fashion. It focuses on scrutinising two particular institutional arrangements in the rule-implementing context, namely vertical top-down oversight (grid) and horizontal inter-agency cooperation (group). Such a focus makes the framework more comprehensive than existing theories. Additionally, the ER Framework gives a more complex account for inter-agency relations by borrowing relevant ideas from the jurisdictional interdependence theory. Interpreting inter-agency relations as being different, the ER framework better captures the real-world phenomenon than existing intra-governmental theories.

The ER Framework agrees with the jurisdictional interdependence theory in appreciating that RC for business attraction is highly likely to function together with

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<sup>2</sup> See Chapter VII and VIII.

social concerns. Yet unlike the interdependence theory that pays primary attention to social concerns, the ER Framework puts the tension of enforcing economic and social regulations at the theoretical centre. Consequently it renders more authentic and sophisticated interpretations about the agency's incentive, inter-agency relations, the firm's preference, and the regime's innovation and legitimacy.

The ER Framework agrees with the theory of RC as a contest of home-based institutions in acknowledging that the regime/agency and the firm are the representatives of their respective institutions and that RC is of an institutional nature. Like the home-based institutions theory, the ER Framework is vague about geographical boundary. But distinctively, it emphasises institutional geography (Hood, Rothstein and Baldwin: 2001), and suggests that the enforcement regime is a plausible unit of analysis where the enforcer and the firm embedded institutions and structures meet, act and react. In this regard, both institutions of the regulating and the regulated sides are considered as being involved in RC. Unlike the home-based institution theory, the ER Framework also makes the RC outcomes visible.

The ER Framework shares with the international rule-setting theory in characterising the dynamics and effects of the interplay of relevant players. Meanwhile, the ER Framework is different in two ways. In one way, it borrows the characterising mechanism from the literature of regulatory enforcement and pays particular attention to enforcement effect. In the other way, its interpretation of the interplay is not multi-lateral but bilateral, highlighting the regulating and regulated sides. Other social structure such as the third party is out of the focus of the ER Framework. This bilateral perspective provides a more balanced viewpoint than the unilateral perspective drawn by most existing theories. At the same time, it is more narrowly focused than the multi-lateral perspective of the international rule-setting theory.

### **3.2 Reflecting Existing Enforcement Literatures**

Relevant existing enforcement theories lend a building block to the ER framework. Broadly speaking, the general structure of the ER Framework borrows that of the enforcement theories about the enforcer's and regulatee's behaviour, relation and interaction. The RC fundamental factors correspond to the focii of relevant enforcement theories. The competing entity of the framework corresponds to the enforcer of the enforcement theories; the competed-for target, the regulated firm; the regulating and regulated sides, the enforcer-firm bilateral relation and interaction in the enforcement process; and the RC outcomes, the enforcement effects. The ER Framework systemises the focii of these enforcement theories in order to create a

coherent analytical framework. In contrast, other enforcement theories form comprehensive but disconnected arguments about the players' action and interaction.

Narrowly speaking, the ER Framework borrows the enforcer-regulatee relational and interactive dimension. Through scrutinising the involved aspects of this dimension, the framework infers the implications for RC characteristics and outcomes. Additionally, the framework clarifies how its typifications of regimes and firms are related to different sets of taxonomies of enforcers and regulatees made by enforcement scholars. Moreover, the framework emphasises enforcement effects other than corporate compliance.

#### **4. Contribution to RC and Enforcement Subjects**

Following the clarification of the linkage between the ER Framework and relevant RC and enforcement literatures, it is to articulate the theoretical originality of the framework. Before that, it is noted that the empirical research contributes to both subjects with original and relevant information from a developing country - China. Even more noteworthy is the theoretical significance of this empirical research. Rather than merely providing contextual information, it demonstrates the plausibility of the ER Framework in both RC and enforcement studies.

##### **4.1 Contribution to RC Study**

This thesis aims at advancing scholarly understanding about the empirical phenomenon of RC through the knowledge of micro-level enforcement regime. It fills the gap of the lack of coherence of RC theories. This theory in the form of the ER Framework demonstrates how to analyse RC based on cultural institutionalism through analysing enforcement dimension. This analysis is carried out by defining RC based on a context-free theoretical framework - the ER framework. Specifically, the ER Framework makes the following contributions to the subject of RC.

*Nature of RC* Defining RC as of an institutional nature, the ER Framework reconciles the logics and emphases of existing economic and sociological institutionalist approaches. It focuses on the micro-level enforcement dimension. It pays an unusual attention to the regulated side, the regulating-regulated marriage and match of their preferences, and the RC outcome of business attraction. This dimension as well as the fundamental factors are ignored in current RC studies. It alerts that RC through micro-level enforcement of rules fundamentally affects that

through macro-level making of rules. It assumes players on both the regulating and regulated sides are of heterogeneous rather than homogeneous types and interests. Such an assumption is more sophisticated and nearer to reality than existing theories based on economic lens. At the same time, the ER framework pays attention to the institutions on the regulating side. It elucidates the institutional implications of the regulating side's interacting with the regulated side and of its winning business attraction. These implications are given insufficient attention in existing RC theories. In general, the ER Framework ameliorates the isolation between various hitherto lenses concerning the nature of RC as well as introducing a new dimension to the debate.

*Regulating side* The ER Framework improves the knowledge about the regulating side's understanding and behaviour in an RC context. It suggests such a sophisticated assumption that agencies exercise conflicting duties rather than following a conventional simplistic assumption that agencies share common regulatory goals. Thus it helps to explain why there is always a contention between regulatory competition and enforcement; between instrumentality and social appropriateness; and between economic and social regulations. Also the framework is the first RC research that systematically interprets the competing entity. Although the enforcement regime is a specific competing entity, its interpretation is fundamental and helps ameliorating the contextual relativity of current RC study.

*Regulated side* The framework provides precise knowledge about how the regulated side's characteristics affect RC for business. Unlike existing economic theories, the ER Framework pays primary attention to the regulatory rather than industrial feature of the firm as the competed-for target. To fill the void of all sorts of existing theories, it systematically interprets the firm's understanding and behaviour towards formal and informal controls in the RC context. This interpretation is expected to make any current contention about the firm's role in RC for business less pointless and more sensible.

*Two-sided marriage and match* The analysis of the ER Framework sets an example in terms of how to understand RC from a bilateral, relational and interactive perspective. It clarifies the implications of competitive instrument versus institutions; understanding and behaviour; regulatory inter-dependent modes; formal and informal structures with regard to RC. It offers explicit knowledge about how the regulating and regulated sides affect RC. It is original in suggesting to understand RC with a thinking of the regulating and regulated sides finding a partner to form a

marriage as well as through the match and mismatch of their preferences. The empirical research of Chine shows that such a thinking is helpful to develop a convincing interpretation about the phenomenon of RC.

*RC outcomes* The ER Framework makes progress in developing business attraction as a theme of RC study. It stands as positive qualitative research in this regard. Acknowledging scholarly contentious concerns of economic and social regulations, it addresses business attraction intertwined with enforcement effect and defines both as RC outcomes. Refining the concept of 'regulatory advantage' and its derivatives, it further advocates that positive research about RC for business always involves social concern. The framework demonstrates how to address the contention of economic and social regulations in a positive rather than normative manner. It hopefully inspires more positive studies for RC in the future.

#### **4.2 Contribution to Regulatory Enforcement Study**

*Analytical framework* The ER Framework offers a way to enhance the strength of the socio-legal study about regulatory enforcement. It proposes an analytical framework that coheres and systemises relevant theories about formal and informal enforcement structures in different institutional contexts, interpreted by the enforcer's and the regulatee's behaviours, relation and interaction as well as their affecting factors and effects. For the first time it draws attention to the bilateral preferences of the regulating and regulated sides and likely caused enforcement effects. It demonstrates the strength of cultural institutionalism in forming and structuring a comprehensive theory.

*The enforcer and regulatee* The ER Framework offers a systematic way to typify both the enforcer and the regulatee. Such a simultaneous typification for both players by the same approach is original. It enables us to get a full and contrasting idea about what impacts the two players are subject to vis-a-vis each other as well as how formal and informal enforcement structures function and inter-play. So it does about the varieties of the enforcer and the regulatee with regard to their behaviours, responses and preferences in the enforcement context. The typification approach is applicable to contexts with endogenous and exogenous controls. In addition, the framework clarifies its connection with hitherto sets of taxonomies respectively of the enforcer and the regulatee. Hence it informs how all taxonomies are inter-related to each other.

*Bilateral relation and interaction* The ER Framework develops further implications of the enforcer-regulatee relation and interaction other than enforcing strategy and style. It advances our understanding about the enforcement context in terms of career versus marriage; regularity versus irregularity; and culture versus sub-culture. It clarifies the institutions on the regulating side affects the bilateral relation and interaction. With the use of cultural institutionalism, the framework expands the scope to illuminate the implications of the enforcement process and arrangement, where the two players interplay vis-a-vis each other.

*Enforcement effect* The framework adds value to studying the relevance of enforcement and business attraction. It offers a framework to interpret varied business-attracting effects under varied enforcement contexts. This framework is more sophisticated than the dichotomy of attracting versus deterring business, which is solely underpinned by enforcement stringency. It furthers such an advocacy that enforcement effect is symbiotic rather than extra to business attraction.

### **4.3 Bridging RC and Enforcement Studies**

The ER Framework is original in bridging the gap between the two subjects of RC and enforcement. The choice of the enforcement regime as the RC entity is symbolic as a marriage of the two topics. The framework merges the dynamics of enforcement and RC. It inter-links the corresponding factors, redefines RC in terms of enforcement regime and interprets the empirical phenomenon of RC based on a structure borrowed from enforcement theories. The use of cultural institutionalism structures and cements the merge of the two subjects. Specifically, it connects the two subjects in the following respects:

*Governmental institutions* The framework systemises and interprets exogenous and endogenous control of governmental institutions in vertical and horizontal terms. This brings a perspective to the RC study as well as provides a context-free and coherent framework for scrutinising the affecting factors of the enforcer for the enforcement study. The framework furthers such an advocacy that the institutions on the regulating side are both endowment and restraint (Levy and Spiller: 1994). The institutions are significant to the regime's practice and performance of both RC and enforcement. To put this significance in an alternative way, both RC and enforcement are institutional by nature. The shared institutional nature lays a foundation for future research of these dual themes. Consequently, both RC and

enforcement research have a common framework to analyse governmental institutions.

*Typology of regulatory players* Proposing a collectively exhaustive and mutually exclusive typology of regulatory players, the framework makes original contribution to RC in terms of systematically characterising the regulating and regulated sides, and at the same time, inter-relates different sets of taxonomies of the enforcer and regulatee. This typology provides RC and enforcement scholars a common discourse when addressing the types and behaviours of the enforcer and the regulated firm.

*Behavioural and interactive dimension* The framework borrows the enforcer-regulatee behavioural and interactive dimension from enforcement study to elucidate the implications for RC. This expands the analytic dimension and enhances the strength of current RC study. It interweaves the RC and enforcement themes whenever rule implementation draws attention in a context of RC for business.

*Regulatory effect* The framework uses the same attributes to regulatory effects that are identified both in the RC and enforcement studies to interpret and measure RC outcomes. Linking and using the commonly identified attributes, the framework highlights the significance of enforcement in the dynamics of RC. It offers a solution to such a long-term puzzle as why there seems to be an inevitable tension between business attraction and social enforcement.

## 5. Suggested Future Research

Like all social science research, the ER Framework covers only limited issues. The excluded issues suggest future research on relevant topics. While examining RC at various hierarchical levels in other sample contexts, future researchers may consider the following specific themes.

Based on the four archetypes of the ER Framework, develop hybrid types of regimes and firms. This research will improve the sophistication of RC theory in capturing various regimes and firms in the real world.

Contrasting to the heuristic research of the ER Framework, future research can be specific and in-depth. Rather than covering all four quadrants of the grid-group

typology, future research can focus on one particular quadrant. Correspondingly, scrutinise in-depth a particular type of regime or firm. A comparative study is possible for regimes of the same type. Comparison could be made spatially if attention is paid to varied scales of grid and group, and temporally if encompassing a change in the grid or/and the group. Further research can also determine whether to include individualisation as an institutional factor of RC or not.

Whereas the ER Framework concentrates on answering a 'how' question, future research can answer other questions. For example, 'why' the regime and the firm prefer and attract each other in the way suggested by the ER Framework?

Unlike the two-sided perspective taken by the ER Framework, future research can scrutinise the control and impact exerted by any third party or other societal forces. The research can either focus on addressing one party, or take into consideration the functioning and interplay of multiple forces.

Studying an agency that is embedded not only in local institutions but also in other institutions can be an area of future research. An example is the national agency – the customs of China in the empirical research of this thesis. A suggested theme is to examine how the dually embedded national-local institutions affect the agency's performance at the micro level. Another theme can be a comparative study of national and local agencies that share the same local regime.

## **6. Conclusion**

In this thesis, I propose the ER Framework in order to provide a key to the puzzle that I had faced for many years: *If rules are the same, how do regulatory authorities compete for business to come to their jurisdictions?* This framework uses the cultural institutionalist approach to develop the following main argument: An important dimension of RC is a *competition of different types of micro-level enforcement regimes for different types of firms. Depending on the match and mismatch of preferences of the regime and the firm, different locations have different regulatory outcomes in business attraction, enforcement effect and regulatory advantage.* The ER framework has been used to interpret the empirical phenomenon of RC for foreign investment in China. Except for a few remaining issues that require further investigations, empirical findings are convincingly interpreted by the ER Framework. This means that the framework is plausible in its empirical interpretation. The framework is heuristic at the expense of its fineness,

because of the used cultural institutionalist approach. It sits among theories about RC with economic and sociological institutionalisms as well as behavioural, relational and interactive literature of regulatory enforcement study. It fills the gaps inside and between the RC and enforcement subjects by providing a context-free and coherent theoretical framework. It also inspires future research about RC and enforcement related issues. Above all, the ER Framework adds value to the positive and socio-legal studies of RC and enforcement. It stands as an original qualitative empirical research in the discipline of regulation.

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## Appendix I Fieldwork Method

### 1. Ethical Issues<sup>1</sup>

The author has fully complied with the LSE's code of ethics for this PhD research. The topic of this thesis is not ethically sensitive. The empirical research does not involve the interests of either organisational or individual funding body, deception, access into confidential information, intrusive intervention, unacceptable psychological problems, vulnerable or gate-keeper groups. When carrying out the field research in China, the author was cautiously abiding by relevant laws and regulations in China and avoiding raising ethical and political issues.

### 2. Fact-Finding Methods

The fact-finding was carried out from randomly available and referred informants, on-line and hard-copy sources and by other various means. These included interviews with informants from the enforcement agencies<sup>2</sup> and the firms; participant-observation of the inspectors' on-site inspections; written documents issued by agencies acquired during visits to the informants; internet survey at official websites of the sample regimes, relevant firms, governments and agencies of various levels, and newspapers between the beginning of 2008 and the end of 2010. The information reported in each sample case is factual and gathered from triangular sources. In particular, the details about the behaviour, relationship and interaction of the agency and the firm were found mostly through structured and semi-structured interviews based on pre-drafted questionnaires.

### 3. Recruitment and Structure of Informants

The interviewees were determined purely based on accessibility. For ethical reasons, the sources are kept anonymous in order to protect the identities of the micro regimes and informants.

To recruit informants for interview the author began by notifying people already known in China that she needed to carry out interviews for the purpose of PhD

<sup>1</sup> For the details, see <LSE Research Ethics Policy> at [http://www2.lse.ac.uk/intranet/researchAndDevelopment/ethicsGuidanceAndForms/Research\\_Ethics\\_Review\\_Policy\\_FINAL.pdf](http://www2.lse.ac.uk/intranet/researchAndDevelopment/ethicsGuidanceAndForms/Research_Ethics_Review_Policy_FINAL.pdf)

<sup>2</sup> Simplified as 'the agency'

research and would appreciate help in this regard. The interviewee must have been personally dealing with regulatory affairs for at least three years. The involved regulatees must be solely foreign owned enterprises (FOEs) in the toy and/or electronics industries based in the cities of Shenzhen and Suzhou. They must have been settled in one of these two cities for at least three years. The interviewee should be able to spare at least an hour for the interview. The notified people worked for the local enforcement agencies<sup>3</sup>, FOEs, ministries, the chamber of commerce, law firm and joint venture. Among them, one official and two businesswomen in Shenzhen came forward to attend individual questionnaire-based interviews. They were the exceptional few informants with no reference and were the most generous in sparing time for interview. Among the others known to the author, some referred people who agreed to be interviewed or who referred on other potential candidates. A few asked for the questionnaire to read before making a decision about the interview. The informants in the toy industries were more difficult to access than those in electronics. For the seven out of ten questionnaire-based interviews with the toy FOEs in Shenzhen, the author was referred four times so as to approach the informants; and for the two interviews in Suzhou, five times. These do not count the unsuccessful referrals. The biggest toy-maker in Shenzhen refused interview. For all interviews through reference, exactly who were asked and who refused or agreed to be informants were only known by the referrers and entirely unknown by the author. The referrers did not have any advance discussion with the author about the informants, but simply notified the accurate contacts' name, companies' name, telephone numbers, meeting dates and times after they had arranged the individual interviews. The above-mentioned way of recruiting informants shows that it was very difficult to gain agreement from people to be interviewed and that the interviews for the empirical research were purely based on the accessibility and willingness of informants. The agencies and FOEs, hence their affiliated and based sub-city jurisdictions (SCJs) including special investment zones (SIZs), involved in the empirical research were randomly cooperative rather than planned or organised by the author. As a result, the acquired findings are suggestive and indicative rather than representative or conclusive. Nevertheless the randomness avoids systematic bias in fact-finding.

Most informants are from the FOEs. Among the 41 structured interviews, 6 were from the agencies, and 35 were carried out with informants from the FOEs – 12 from the toy industry and 23 from electronics. FOEs were chosen because comparing

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<sup>3</sup> Hereinafter simplified as 'agencies'

with Chinese domestic firms, they were subject to less local impact but to more transnational influence. Thus the effect of micro enforcement regime upon them and their embeddedness in informal enforcement structure were relatively convincing. The two industries were chosen because of the sharp contrast in governmental regulations towards them<sup>4</sup>. Toy manufacture was not an encouraged industry but electronics was. In light of the differentiation in their regulations, the scrutiny of the enforcement practised by the agencies would uncover more implications. Additionally, the author was a team member of the China's toy safety regulation research sponsored by the LSE seed fund (2008). Using the toy industry as a sample sector in the empirical research of this thesis took the best advantage of the fund in overcoming financial constraint to acquire first-hand information.

The involved FOEs share the following characteristics: sole overseas ownership; varied sizes;<sup>5</sup> and undertaking toy or electronics manufacturing. All had tangible factories for production and hired Chinese workers. The investment origins of the interviewed FOEs' were Hong Kong, Taiwan, South Korea, Japan, the USA, Samoa and the British Cayman Islands. Their overseas markets included the USA, the EU, Japan, South Korea, Israel and South Africa. The FOEs informants had direct and regular working contacts with local and national agencies. They personally were handling regulatory affairs such as leasing land, constructing factory plants, registering the establishment of companies, recruiting and managing workers, importing raw materials and necessary equipments, exporting the products, transferring half-finished products to business partners for refinement or finish, paying corporate tax, applying for favourable conditions, processing industrial waste, managing currency conversion and cross-border capital flow.

It is noted that the majority of informants are from the FOEs and the minority from the agencies. This informant structure is deliberately planned so as to offset systematic bias. Typical systematic bias was that the Chinese governmental officials and official websites generally give positive stories<sup>6</sup>. The officials were generally reluctant to be interviewed by a research student. When interviewed, the officials tended to give diplomatic and politically correct answers. Their answers were, by

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<sup>4</sup> See <Catalogue Guiding Industries for Foreign Investment>. The name in Chinese is <WaiShang Touzi Changye Zhidao Mulu>, promulgated by the national government on 1<sup>st</sup> April, 2002 ([http://www.fdi.gov.cn/pub/FDI/zcfg/law\\_ch\\_info.jsp?docid=55073](http://www.fdi.gov.cn/pub/FDI/zcfg/law_ch_info.jsp?docid=55073)). Hereinafter simplified as 'the Catalogue'

<sup>5</sup> Referring to <Interim Specifications of Small and Medium Sized Enterprises> (<Zhong Xiao Qiye Biaozhun ZanXing Guiding> in Chinese) promulgated by the national government on 19th February 2003 ([http://www.gx.xinhuanet.com/zxqy/2007-10/23/content\\_11477255.htm](http://www.gx.xinhuanet.com/zxqy/2007-10/23/content_11477255.htm))

<sup>6</sup> For details, see Chapter IV.

and large, a repetition of the content shown at official governmental websites. Therefore, the information sourced from interviewing the agencies was replaceable by the one that was more easily available at the internet. In contrast, the opinions of the FOEs as the party affected by enforcement practice were inadequately covered in the public media in China. The FOE informants were lively in telling stories, particularly when reassured that the author was an independent researcher who had nothing to do with the government. The FOEs domiciling at the same locality were independent from each other. Their interviews were carried out individually. Most interviews were carried out at the sites of the informants' companies. The author's on-site presence made it possible to verify the informants' identities and if possible, to witness first hand their relevant activities. The authenticity of each FOE's story was verified through acquiring the information from at least two additional independent sources. This implies that the information was gathered from triangular sources for every case study. The interviews with the firm and the agency were supplemented by research through a third party, the internet, written documents and/or the author's direct observation. With triangular fact-finding sources, any bias of the information was likely to be balanced in reliability.

#### **4. Codes of Interviews**

Different interviews are labelled by different codes (see the list in the following Section 4). For the codes used to refer to the interviews, the first letter refers to the industry, i.e. 'E' for electronics FOEs and 'T' for toy FOEs. The second letter, and sometimes with the third, refers to the investment origin, e.g. 'H' for Hong Kong, 'T' for Taiwan and 'SM' for Samoa. The next one, or two, refers to SCJ, e.g. 'S' for a special investment zone (SIZ) such as a free trade zone or an industrial park. When there is 'I' followed by a number, it means that the interview was participated by more than one interviewee from the same agency or FOE. For example, 'I4' means that four persons participated in the same interview and answered the questionnaires together. The last letter refers to the location of the city, i.e. 'E' for east China, namely Suzhou; and 'S' for south China, namely Shenzhen. Sometimes the code is ended with a number. It means that there are three to four interviews with the FOEs with similar backgrounds carried out on the same day, and hence a number for their sequence is given in order to distinguish between them.

#### **5. List of Interviews and Informants for Case Studies**

Most interviews were carried out based on relevant questionnaires, depending on the interviewees being the agency or the FOE<sup>7</sup>. The interviews were conducted without questionnaires on only four occasions: (1) when the informants were not directly involved in micro-enforcement, typically those worked at the ministerial agencies in Beijing; (2); when the informants were viewed as additional information sources, because they were the third party, for example the lawyer, the officer of municipal chamber of commerce, and the general manager of a joint-venture of China and Hong Kong; and (3) when the informants were unable to spare sufficient time for a questionnaire-based interview but were able to give specific details, typically a factory director of a TTP-type FOE, and a former director-general of an SIZ. On this last occasion, the details addressed in the questionnaire-free interview were specific issues as included in the relevant questionnaire. This shows that the information gathered from questionnaire-free interviews was relevant; and that the questionnaire-free interviews were based on a semi-structured approach, although not a fully structured linear fashion following the questionnaire.

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<sup>7</sup> For specific questionnaires, see Appendix II.

City	Interview Code	Sub-City Regime	Sector	Country of Origin (if applicable)	Market (if applicable)	Registered Investment Volume (if applicable)	Number of Involved Informant	Organisational Position Held by Informant	Date of Interview (in 2008)	Length of Interview
Beijing	CADZ	n/a	ER	n/a	n/a	n/a	1	Director-general	17 Sept.	2h
	AQSIQ		ER				1	Deputy section chief	16 Sept.	1h
Shenzhen	GIDG	Wangda	ER				1	Director-general	30 Jan.	1h42 min
	GISC	Wangda	ER				1	Section chief	19 Feb.	2h
	FTFDG	Fujia	ER				1	Former Director-general	1 Feb	20min
	ACSC	Anke	ER				1	Section chief	25 Feb.	1h30 min
	CGSC1	Anke	ER				1	Section chief	25 Feb.	1h30 min
	CGAD	Anke	ER				2	Administrators	26-28 Feb.	1h20 min
	CGSC2	Anke	ER				1	Section chief	29 Feb.	1h
	BOSVDG	n/a	ER				1	Deputy director-general	4 Mar.	30min
	LWY	n/a	Law firm				2	Lawyer and client general manager of Sino-Hong Kong joint venture	7 Mar.	2h

	COC	n/a	Chamber of Commerce				1	Section chief	22 Feb.	1h
	EHSS2	Wangda	Electronics	Hong Kong	USA & EU	HKD 110 million	1	Governmental coordination manager	6 Mar	2h
	EHSS1	Wangda	Electronics	Hong Kong	North America, EU & Japan	USD 50 million	1	Manager of governmental coordination, HR & customs affairs	30 Jan.	1h25 min
	EJSS2	Wangda	Electronics	Japan & Hong Kong	60% overseas & 40% domestic	HKD 38.73 million	1	Section chief of legal and tax affairs	6 Mar	1h
	EJSS1	Wangda	Electronics	Japan	Downstream locally domiciled Japanese Companies, i.e. Sony & Hitachi	USD 16 million	1	Chief of governmental coordination, industrial safety & environmental issues	30 Jan.	1h
	ETSS	Fujia	Electronics	Taiwan	USA & EU	USD 45 million	1	Vice president	1 Feb.	2h30 min
	THLG1	Lufei	Toy	Hong Kong	USA, EU & Israel	HKD 1 million	1	Member of board & Governmental coordinator	27 Feb.	4h
	THLG1A	Lufei	Toy	Hong Kong	USA, EU & Israel	HKD 1 million	1	Factory chief	3 Mar.	30min
	THLG2	Benpo	Toy	Hong Kong	USA & EU	HKD 50 million	1	Section chief of human and production resources	6 Mar.	1h

	EHLG2	Benpo	Electronics	Hong Kong	USA & EU	USD 1950 million	1	Factory chief	7 Mar.	1h
	THLG3	Benpo	Toy	Hong Kong	USA & EU	HKD 3 million	1	Factory chief	7 Mar.	1h
	EHLG1	Benpo	Electronics	Hong Kong	USA	HKD 4 million	1	Factory chief	5 Mar.	1h30min
	TJLG	Benpo	Toy	Japan	Japan	USD 400,000	1	Factory chief	3 Mar.	1h20min
	THLG4	Benpo	Toy	Hong Kong	USA, EU, South America & middle east	USD 1.6 million	1	Investor	3 Mar.	1h
	EHBA1	Anke	Electronics	Hong Kong	USA, UK & Japan	HKD 32.28 million	1	Customs declarer	26 Feb.2008	30min
	ESMBA	Anke	Electronics	Samoa	Taiwan	HKD 3 million	1	Factory chief	26 Feb. 2008	35min
	EABA	Anke	Electronics	The USA	USA, Canada, South America (80%) & domestic (20%)	USD 2.5 million	1	Manager of customs declaration	27 Feb. 2008	40min
	EKBA	Anke	Electronics	South Korea	South Korea	UKD 580,000	1	Manager of customs affairs	28 Feb. 2008	30min
	ETBA	Anke	Electronics	Taiwan	USA	USD 9.17 million	1	Vice general manager	27 Feb. 2008	35min
	EHBA2	Anke	Electronics	Hong Kong	Worldwide (50%) & domestic (50%)	USD 5 million	1	Director	27 Feb. 2008	2h

	THBA1	Anke	Toy	Hong Kong	Overseas	HKD 30 million	1	Factory chief	26 Feb. 2008	30min
	THBA2	Anke	Toy	Hong Kong	USA & EU	HKD 20 million	1	Administration manager	26 Feb. 2008	1h15min
	TTBA	Anke	Toy	Taiwan	USA & EU	USD 7.9 million	1	Vice manager of public relations	29 Feb. 2008	1h
	THBA2	Anke	Toy	Hong Kong	USA & EU	HKD 23 million	1	Manager of administration and HR	29 Feb. 2008	1h
	TH2BA	Anke	Toy	Hong Kong	EU & USA	HKD 3 million	2	Factory chief; customs & commodity inspection administrator	29 Feb. 2008	1h
	Suzhou	SIDG	Gongcheng	ER	n/a			Vice director-general	24 Jul.	1h
		LZSC	Tuqing	ER	1	Section chief	26 Jul	1h10min		
		ETSIE1	Gongcheng	Electronics	Taiwan	Domestic	USD 2.3 million	HR specialist	21 Jul	1h
		ETSI4E	Gongcheng	Electronics	Taiwan	Downstream manufacturers	USD 4 million	4 Sales specialist; customs specialist; HR manager; accountant	21 Jul.	1h40min

	EJSIE2	Gongcheng	Electronics	Japan	Downstream locally domiciled manufacturers, e.g. Asus	USD 9 million	2	Accounting manager; Sales manager	21 Jul.	1h
	ETS3I3E	Ximo	Electronics	Taiwan	Downstream manufactures	USD 25 million	3	Sales specialist; custom declarer; HR chief	23 Jul.	1h20min
	ECS3I2E	Ximo	Electronics	British Cayman Island	USA, Taiwan & domestic market	USD 5 million	2	Administration manager; sales manager	23 Jul.	1h30min
	ETS3E3	Ximo	Electronics	Taiwan	USA	Untold	2	Sale specialist; purchasing specialist	23 Jul.	1h
	TKLZ1	Tuqing	Toy	South Korea	USA & EU	USD 1.1 million	1	Deputy chief of accounting	26 Jul	1h
	TKLZ2	Tuqing	Toy	South Korea	EU & USA	USD 6 million	1	Assistant chief of administration department	26 Jul.	1h

List of Interviews and Informants for Case Studies

## Appendix II Questionnaires

The questionnaires are designed for fact-finding purpose. Their design is in accordance with the quality requirements and criteria for multiple case studies<sup>1</sup>. They are not planned to be pre-posted or filled out alone by the informants, but to be used by the author to structure the interviews and field investigations. The use of the questionnaires in this way ensures the field research to be relevant, purposeful and fruitful, bearing in mind the limited timeframe and budget as well as difficulty of recruiting informants. All answers to the questionnaires were acquired through face-to-face interviews. Although the questionnaires are long, in practice this was not found to pose difficulties and all issues covered by the questionnaire were discussed. All informants were aware in advance that the interviews would take about an hour. In practice, most questionnaire-based interviews took at least an hour, with a comfortable pace for the informants to give complete information. The exception was those taken on the same days as the author's participant observations. Because of the inspectors' tight daily schedules to visit multiple FOEs, the interviews were taken at a quicker pace in order to cover all questions<sup>2</sup>. However, the author complemented the interview-acquired information by inquiring of the inspectors. While the informants gave answers to the questions one by one, the author simultaneously and faithfully recorded their answers. The informants' answers are complemented by the information acquired from other sources and methods, which ensures that the fact-finding results are reliable. The questionnaires answers and other sourced information are then synthesised and analysed. The findings of the analyses are reported faithfully in the case studies.

In order to gather useful and sufficient information from the interviews, two sets of questionnaire were formulated, one for the firm and one for the agency. Although the questionnaires were long, the informants were given early notice about the length of interview and willing to answer all questions in the interviews. All the questions listed in the questionnaires were carefully chosen in order to acquire all necessary information concerning the agency, the firm, their bilateral relation and interaction as well as preference, the regime's profile and established industrial structure<sup>3</sup>. For the questionnaire for the FOE, Questions 1-13 are for gathering background information about the firm. Questions 14-47 are about the agency-firm

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<sup>1</sup> For details, see Yin (2003) pp19-56

<sup>2</sup> See the list of interviews in Appendix I.

<sup>3</sup> For relevant aspects and focuses of field investigation, see the section about the method in Chapter IV.

relation and interaction. Questions 48-55 concern inter-agency cooperation and the agency's business-competing and enforcement strategies. The last few questions are for additional information-gathering and further necessary clarification of details. For the agency questionnaire, Questions 1-12 are about the organisational background of the general-purpose agency as well as the profile and industrial structure of the regime. Questions 13-27a concern the agency's stance and strategy towards attracting business and enforcing rules. Questions 28-48a are about the agency-firm relation and interaction, and Questions 49-55 the inter-agency cooperation. The last questions are for additional information gathering or clarification.

### **Questionnaire for Foreign Owned Enterprise**

Company's Name:

Interviewee's Name, Position and Working Years for the Company:

Contact Details (Name-card):

Place of Interview:

Time and Date of Interview:

Would like the author to acknowledge you with your name: Yes/ No

Year of Setup in Current Location:

Registered Investment Amount:

Actual Investment Amount:

Workforce:

Main Products:

Main Markets:

Investment Destinations in Mainland China Apart From Current Location:

Company Brochure: Yes/ No

Customs Category:

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1. What is the country / region of origin of your company?
2. When did your company start production in this location?
3. Is this the first production plant that your company has set up in mainland China? Yes/ No
- 3a. If no, where were earlier production plants set up?
4. Why did your company choose this location?
5. Has the size of your work-force changed compared to three years ago?

Yes/No

- 5a. If so, how?
6. In the past three years, have you made additional investment? Yes /No
7. If so, did you make the additional investment here or somewhere else?
8. Do you often work with the following agencies?
  - a. Local council: Yes/ No
  - b. Labour: Yes/ No
  - c. Commodity inspection: Yes/ No
  - d. Customs: Yes/ No
  - e. Others – please specify:
9. Based on the past three years, how do you generally rank the treatment by the agencies? Very good, good, satisfactory, poor, very poor
10. Based on interaction with whom do you make above-mentioned ranking?
11. Based on your treatment, would you like to recommend another investor to set up his business in the current location? Yes/ Maybe/ No/ Don't know
12. If you would like to recommend another location in China, which location would it be?
13. Could you explain the main reasons for recommending this location?
14. Do you have any arrangements with the agencies about the way you work with each other?
15. If yes, what are the forms and main content of the arrangements?
16. If yes, when did the arrangements start?
17. If yes, in your opinion, how well do the agencies follow these arrangements?
18. Do you have problems in following the arrangements?
19. How much do you think the arrangements are helpful to your company?
- 19a. Could you explain the reasons and give examples for your answer?
20. What are the main forms of communication the agencies use to contact you?
  - a. Telephone
  - b. Fax/ mail (including email)
  - c. Meeting
  - d. Visit
21. Why do the agencies invite you to have meetings?
22. On most occasions, which members of the agencies attend the meetings?
23. On most occasions, which members of your company attend the meetings?
24. Do you think the agencies' meetings are worthwhile?
- 24a. If yes, why do you think some agencies' meetings are worthwhile?
25. If the agencies' meetings are not worthwhile, why do you think so?
26. Why do the agencies visit you?

27. On most occasions, which members of the agencies visit your company?
28. On most occasions, which members of your company receive the agencies?
29. Do you think the agencies' visits worthwhile?
30. If yes, why do you think some agencies' visits are worthwhile?
31. Do the agencies tell you in advance about their visits?
32. What are the main forms you use to contact the agencies?
  - a. Telephone
  - b. Fax/mail (including email)
  - c. Meeting
  - d. Visit
33. On average, each year, how many times do you visit the following agencies?
34. Why do you visit them?
35. Which members of your company visit the agencies mostly?
36. Which members of the agencies does your company mostly visit?
37. Generally, how well do you rank the help the agencies offer you when you visit them?
38. Why do you think the agencies helpful or not helpful? Any examples?
39. In the past three years, on average, how many incidents do you encounter?
40. Generally, what are the main areas of incidents you encounter? Any examples?
41. Who do you mostly approach to seek solutions when encountering incidents in the mentioned aspects?
42. Which members of your company contact the agencies mostly on these occasions?
43. Which members of the agencies does your company mostly approach in these circumstances?
44. How easy are they easy to be found?
45. How do you rank the speed and effectiveness of the help provided by the agencies when you have incidents?
46. Do you make suggestions or comments to the agencies to help improve their work?
- 46a. If yes, what suggestions or comments do you make?
47. How seriously do you think the agencies consider your opinions or comments? Example(s)?
48. Do the agencies coordinate their work routinely in order to treat you well?
- 48a. If yes, could you give some examples of their routine coordination?
49. How well do you rank the effect of the agencies' coordination in this circumstance? Very Good, Good, Moderate, Poor, Very Poor

50. Do the agencies coordinate their work to help you when you have incidents?
- 50a. If yes, could you give some examples in these circumstances?
51. How well do you rank the effect of the agencies' coordination when you have incidents? Very Good, Good, Moderate, Poor, Very Poor
52. Do agencies work with investors differently according to their different registered/ actual investment volume?
53. Do agencies work with investors differently according to their different industries?
54. Do agencies work with investors differently according to their different countries of origin?
55. Do agencies work with investors differently according to their different compliance?
56. Is there any other information that you think would help me to know more about the interactions between you and the agencies? Yes/ No
57. Do you mind if I come back to clarify some issues later?
58. Would you like to recommend another company / other companies for me to interview in Suzhou?

Thank you!

### **Questionnaire for Enforcement Agency**

Agency's Name:

Interviewee's Name, Position and Working Years for the agency:

Contact Details:

Place of Interview:

Time and Date of Interview:

Would like the author to acknowledge you with your name: Yes/ No

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1. When was your organisation set up?
2. What are the main duties of your organisation?
3. What sections are there in your organization?
4. Which sections have routine and direct contact with FOEs?
5. How many staff members in each of these sections?
6. Who are your superiors?
7. What regulations does your organisation follow?
8. How many FOEs are there in this location?

9. Which countries do they come from? (From most to least countries of origin)
10. What industries do they undertake? (From major to minor industries)
11. On average, how much is amount of investment of each FOE?
12. How many years have most FOEs been in production?
13. Do you think that there are competitions between different locations in attracting foreign investment? Yes / No / Don't Know
- 13a. Why do you think so?
14. If there are competitions, who do you think are your main competitors?
  - a. An SIZ/SIZs of the same city
  - b. A location/locations of the same city excluding SIZs
  - c. A neighbour city excluding its SIZs
  - d. An SIZ/SIZs of a neighbour city
  - e. Others, please specify
  - f. Few competitor
- 14a. Why do you think they are your competitors?
15. How do you rank the current attraction of your location?  
Very attractive, attractive, moderate, limitedly attractive, not attractive
- 15a. Could you explain why you rank so?
16. Compared with three years ago, how has the attraction of your location changed?
  - a. From little to some
  - b. From some to more
  - c. Maintain strong attraction
  - d. Reverse to a
  - e. Reverse to b
  - f. Attraction becomes less strong
  - g. Others, please specify
- 16a. Could you show examples for this change in attraction?
17. What are the most important measures you have taken for attracting investors?
18. In general, how effective do you think these measures are?  
Very effective, effective, moderate, limitedly effective, not effective, not sure
19. How important do you think favourable conditions are to the attraction of your location? Very important, important, moderate, limitedly important, not important
- 19a. Could you explain the reasons?
20. How important do you think lax regulation is to attraction of your location?  
Very important, important, moderate, limitedly important, not important

20a. Could you explain the reasons?

21. How important do you think the roles play director-generals of the agencies of your location to the attraction?

21a. Could you explain the reasons?

22. How important do you think changes in director-generals of the agencies of your location to the attraction?

22a. Could you explain the reasons?

23. What are your main incentives for attracting investors?

- a. Municipal government / organisational target of winning competition
- b. Material rewards, e.g. bonus, promotion
- c. Professionalism
- d. Some of them, please specify
- e. Others

24. Do you work with investors in different ways according to their registered/actual investment volume? Yes / No

24a. Why so?

25. Do you work with investors in different ways according to their industries? Yes / No

25a. Why so?

26. Do you work with investors in different ways according to their countries of origin? Yes / No

26a. Why so?

27. Do you work with investors in different ways according to their compliance with regulation? Yes / No

27a. Why so?

28. Does your organisation have any arrangement with investors about the ways you work with each other? Yes / No

28a. If yes, when did the arrangement start?

28b. Could you tell the content and form of the arrangement? (e.g. what you are to do, what investors are to do, etc.)

29. In general, how well do you think your organisation follows the arrangement? Very well, well, moderate, poorly, very poorly

29a. What are the main reasons for your rank in this regards?

30. How well do investors follow the arrangement? Very well, well, moderate, poorly, very poorly

31. What are the main forms for you to contact investors? (From most to least used)

32. In the past three years, on average, how often do you contact them each year? (In main forms)
33. What are the main occasions do you visit investors?
34. Which members of investors' companies do you visit mostly?
35. What are the main occasions do you invite investors to have meetings?
36. Generally, do you inform investors about changes in policies? Yes/ No
37. What are the main occasions when investors visit you?
38. On average, each year, how frequently do investors have incidents?
39. Which are the main areas of their incidents?
40. Whom do they mostly ask for help from when in incidents?
  - a. You
  - b. Other members of your organisation (please specify)
  - c. The relevant agency
  - d. Other agencies
  - e. None
41. If they come to you, what measures do you usually take to help investors?
42. Are investors informed your mobile number? Yes/ No
43. Are investors informed of the mobile numbers of other members of your organisation? Yes/ No
44. How quickly do you reply to investors' call for help?
45. How effective is your help when investors are in incidents?
46. Do you invite investors to give their comments and opinions for improving your work? Yes / No
- 46a. If so, why do you invite investors to give their comments and opinions?
47. What are investors' comments and opinions mainly about?
48. Have you made improvements in your work according to their comments and opinions? Yes / no
- 48a. Could you give examples of these improvements?
49. Which agencies do you work mostly with for the purpose of facilitating the FOEs?
50. Do you routinely contact these agencies? Yes / No
51. Do you contact other agencies for help when investors are in incidents? Yes / No / It depends.
52. Is it easy for you to reach the right persons of relevant agencies in this circumstance?
53. Generally, how well do you think their response to your contact in this circumstance? Very well, well, moderate, poorly, very poorly

54. Do other agencies invite investors to give comments and opinions to improve their work? Yes/ No / Perhaps/ Don't know
- 54a. If yes, do you think other agencies consider investors' comments and opinions seriously? Yes/ No/ Perhaps/ Don't Know
- 54b. Could you give some examples?
55. How much do you think other agencies care about attracting business?  
More than you do/ As much as you do/ Not as much as you do / Not care at all/ Don't Know
56. Is there any other information that you think would help me to know more about the interactions between you, investors and other agencies?
57. Do you mind if I come back to clarify some issues later?
58. Would you like to recommend agencies/ companies for me to interview?  
(Contact details)

Thank you!