

manufacturing and service sectors, respectively. This is informative since it tells us how far down the road of economic transformation a society is – from agricultural to manufacturing to service sector dominance in value and workforce. Globalization is measured by reliance on foreign trade and the level of Foreign Direct Investment (FDI). Lastly, increasing private welfare is measured by average disposable incomes and the consumption of non-durable goods and private investment in durable goods.

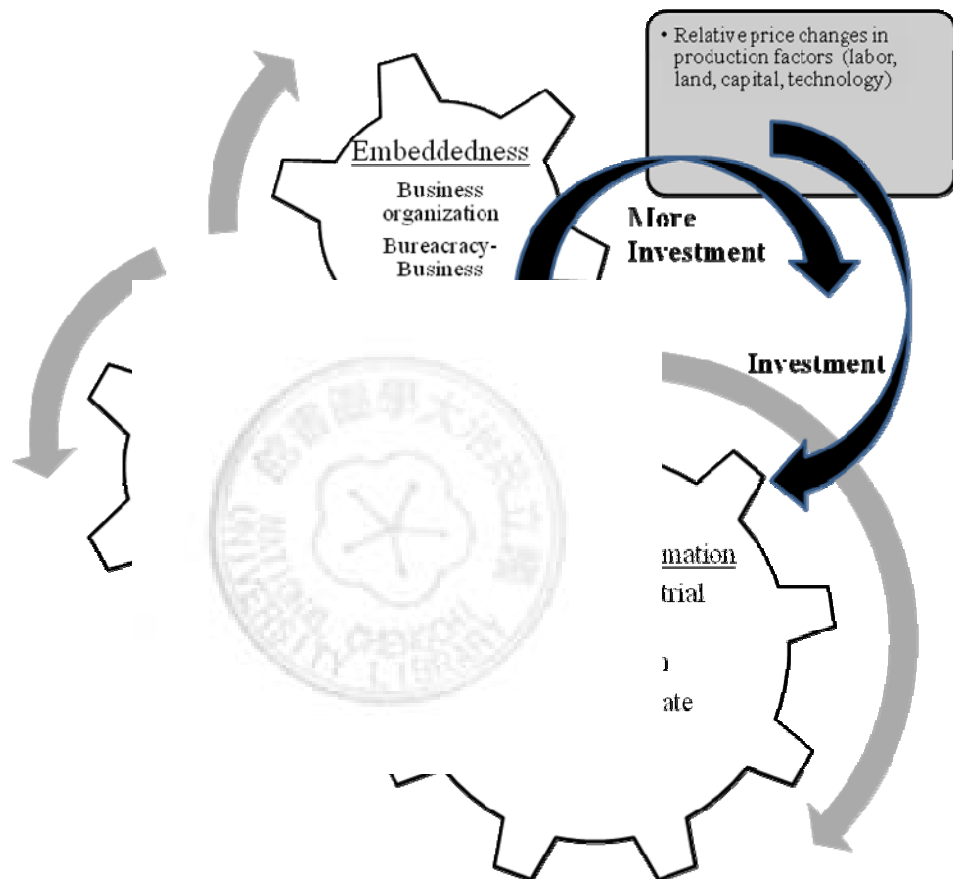


Figure 1. Summary of analytical model/hypothesis. Changes in relative prices make possible initial investment, which starts a process of economic transformation which covaries with strengthening embedded autonomy. Strengthened embedded autonomy then leads to more investment, further reinforcing the process.

Chapter 4: The Kunshan Case

The surveyed literature establishes a clear connection between the performance of economies and the incentives, rules and norms guiding individual behavior (fixed in law

or not). I have narrowed the ‘rules of the game’ we are interested in for our purposes to be autonomy and embeddedness and their relationship of mutual reinforcement with economic transformation. Thus, it boils down to a study of economic transformation, autonomy and embeddedness in and by the state, represented by the city government of Kunshan and society, represented by relevant private-sector providers of FDI (Foreign Direct Investment) since Kunshan is overwhelmingly, as are other of the most developed areas in China, driven by FDI (FDI is defined as including Taiwanese capital).

Economic Transformation in Kunshan

Kunshan’s beginnings in the post 1978-period were humble. As mentioned in the introduction, it was an agricultural marshland and there was no “city” to speak of. Situated on the road between Suzhou and Shanghai, the proximity to these large cities was perhaps its only advantage. In the 1980’s, in Jiangsu and other coastal areas local cadres started their own enterprises - the ‘village and township enterprises’. The state thus assumed the role of entrepreneur and financier. Private capital trickled in, from Taiwanese and to a small extent other foreign sources, but many local governments required joint ventures with local (i.e. state-owned) companies and local majority holding. Kunshan took another path. First, local cadres had new incentives to formulate a project for economic transformation. The central government had changed the rules of promotion of cadres so that economic growth was the key measure of success and the number one ground for promotion, and Chien (2007:274-275) points out the importance of this by pointing to two different quantitative studies. Second, similar to how Weiss-Hobson argue that a perception of weakness created an urgency in a developmental project in Japan, Korea and Taiwan, Keng-Chen (2006:14) propose that Kunshan’s leaders felt left behind when the rest of the delta region was already taking off, and were willing to be unorthodox to ‘get back in the game’. Since capital was extremely scarce, the government could not set up joint ventures with outsiders, but had no choice to rely on fully foreign-owned firms. For, the same reason, they could not afford to wait for land rents to accumulate in order to make infrastructure investments – more secure and more far-reaching land use rights were thus sold out to investors.

The Foundation of the Kunshan story differs from other parts of the delta region – a perception of weakness and falling behind, a leadership with incentives and determination to strive for a developmental project and an institutional environment of what Douglass North would call relatively safe property rights. The liberalization was thus more radical in Kunshan (in terms of more secure property rights) – not out of conviction but as appears to normally be the case in transition economies, out of necessity. The second part of this story – the evolution of embedded autonomy, came later and more gradually, and will be discussed in depth later.

Keng-Chen argued that after 2000, Kunshan was well into accumulating foreign direct investments (when the Taiwanese Business Association was established in 1998 there were already 1500 Taiwanese firms in Kunshan). The sheer cluster mass of certain industries in Kunshan exerted its own gravity on attracting more FDI and constitute a human-devised comparative advantage in these sectors. In analogy to North's emphasis on relative prices for institutional change, capital was no longer as scarce at this point and thus its bargaining position deteriorated, particularly low-tech small and medium firms, as shown by the fieldwork of Keng-Chen (2006:17). Instead, land became the scarce resource. This scarcity combined with an increased understanding on part of the local government on how to plan their economic future by being more selective in inviting and servicing investment means approaching a developmental state model in terms of increased professionalization of the local state and its ability and willingness to be more active in directing the economy (Keng-Chen 2006:18-19).

The KETDZ commenced operation in 1985, and the first major firms (UNI-President, WUS, Shimano, Giant, Foxconn, Verifone etc) started investing heavily in 1993, following the designation by the state council as a national-level development zone in 1992. The impact of the KETDZ on economic and social development has been massive, no matter what statistical indicators we choose to describe the change.

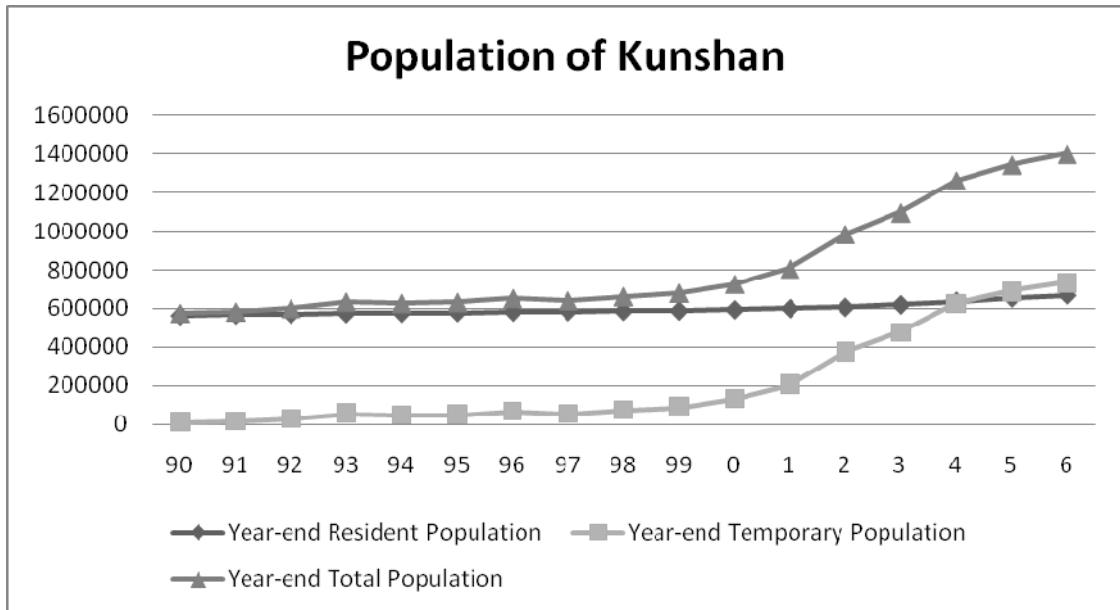


Table 2. population of Kunshan 1990-2006 (Kunshan Statistical Yearbook 2007, hereafter KSY)

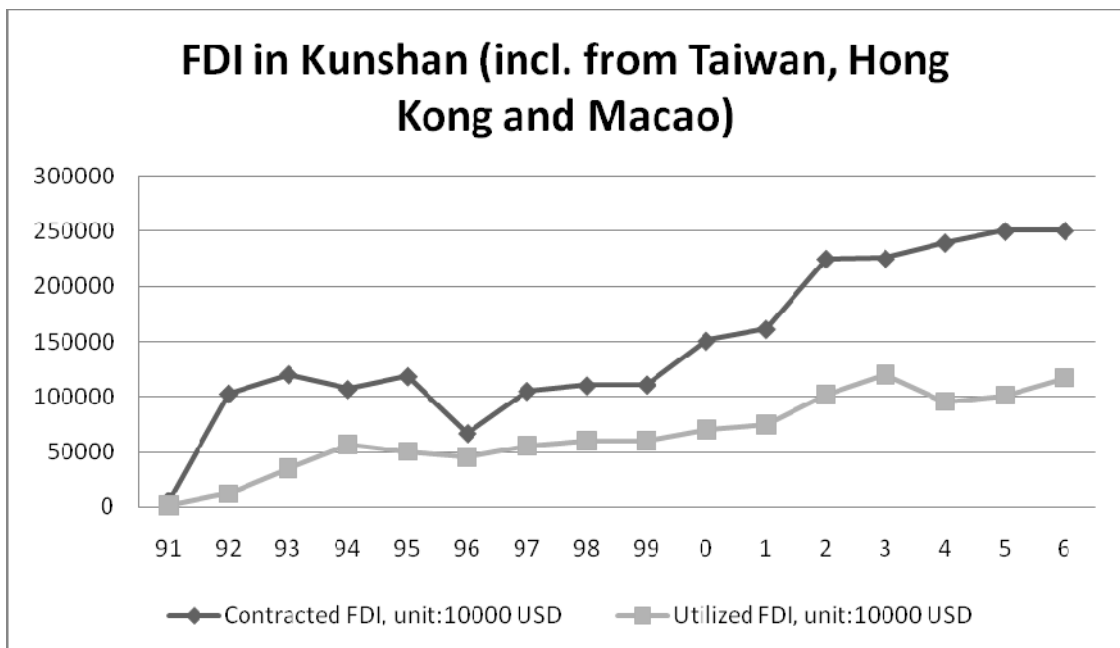


Table 3. Yearly foreign direct investment in Kunshan 1991-2006 (KSY 2007)

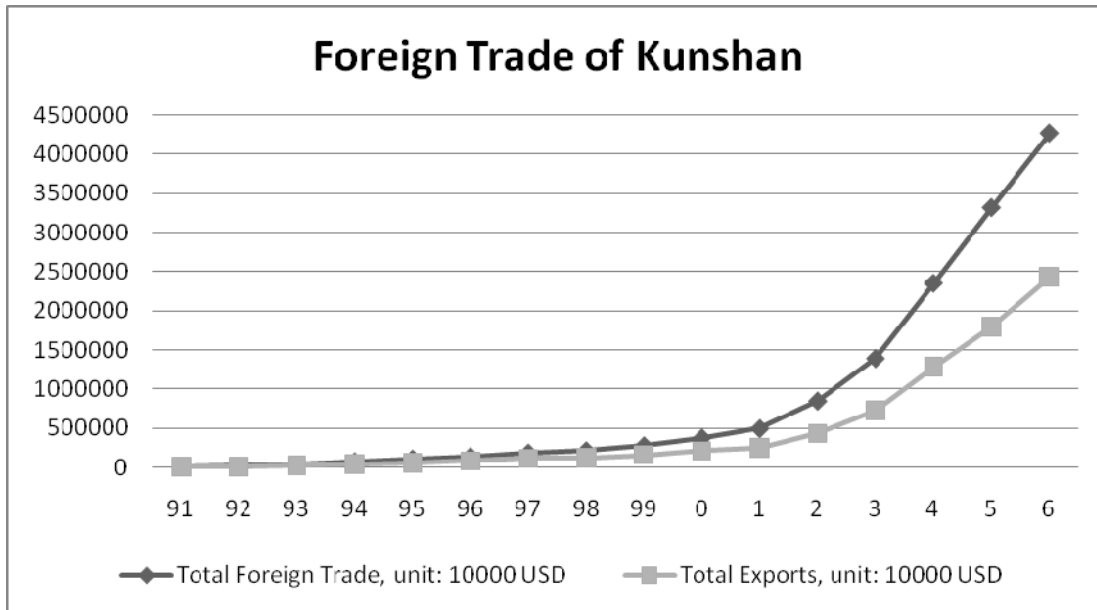


Table 4. Foreign trade of Kunshan 1991-2006(KSY 2007)

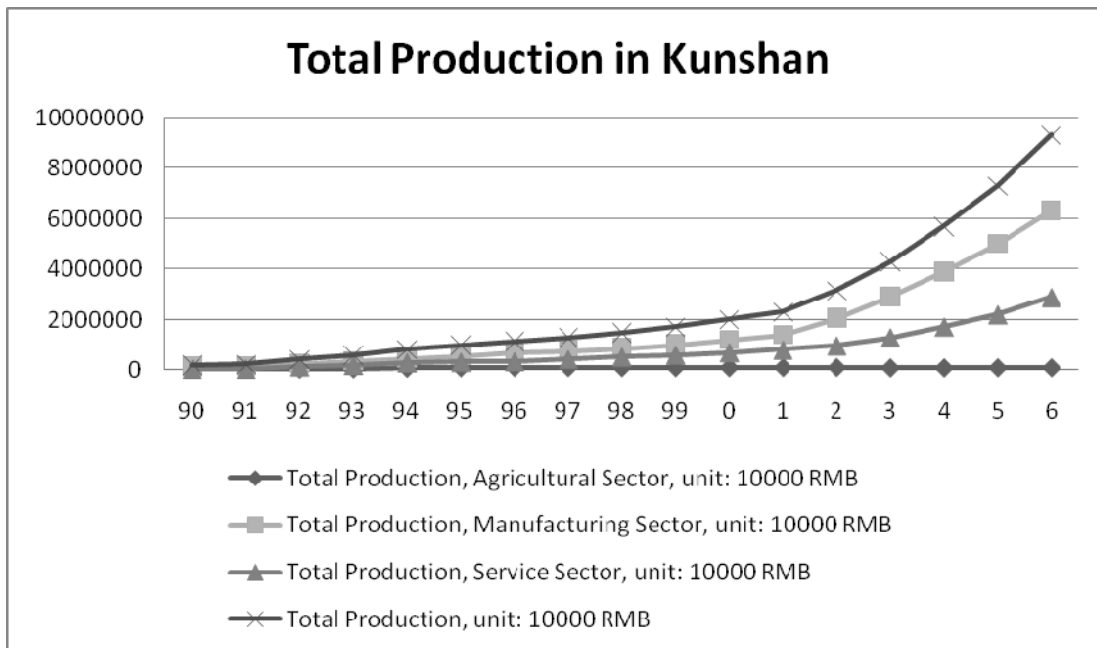


Table 5. Total production in Kunshan 1990-2006(KSY 2007)

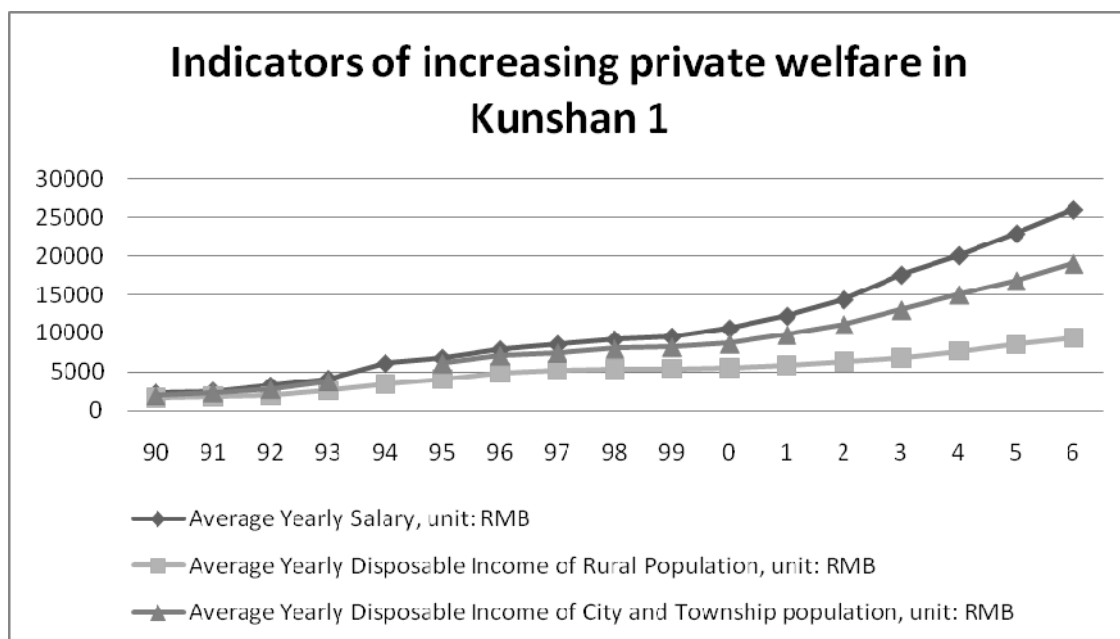


Table 6. Increases in salaries and disposable income in Kunshan 1990-2006. (KSY 2007). Note how disposable incomes amongst farmers increased strongly even though the agricultural production has remained constant since the mid-1990s.

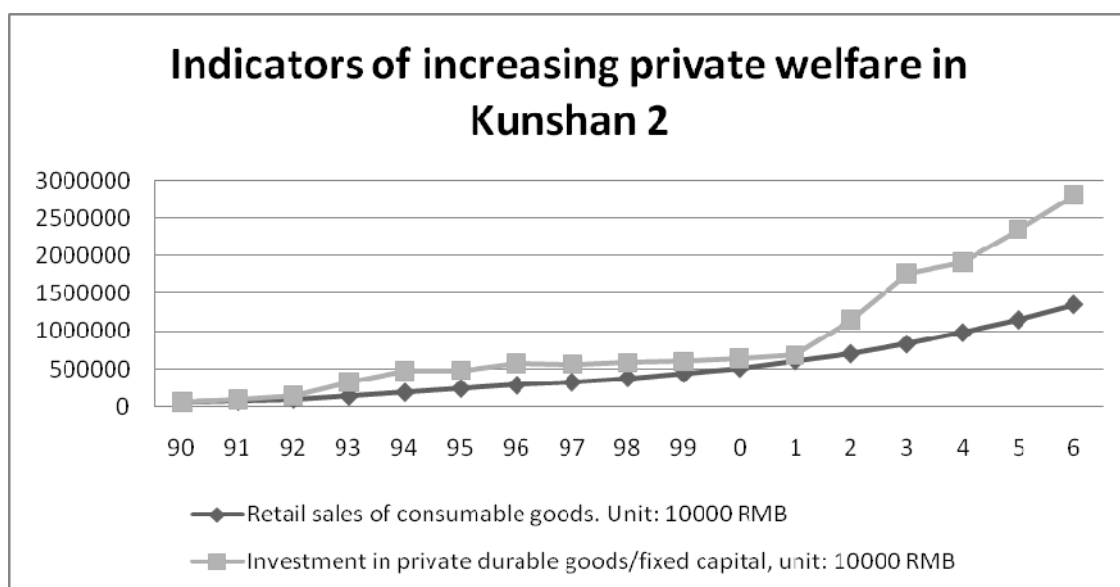


Table 7. Private consumption and private investment in durable goods in Kunshan 1990-2006 (KSY 2007). Note how a more radical growth in durables indicates that basic day-to-day necessities are no longer a pressing need for a growing share of the population.

Kunshan started to register and keep statistics of “temporary” residence in 1990. Under the Hukou (戶口) system for population control, one may not change permanent residency. This means we are able to keep track of all immigrants (assuming all are registered) coming to Kunshan since 1990. As we can see in table 2, the immigrant population now constitutes a majority (in addition, all oral sources indicate the real number is probably even higher). The real increase took place after 2000, when Kunshan had established a reputation as a dynamic city where work opportunities were plenty. It is striking how many are recent arrivals, and from where they come. In 2006, only 200000 immigrated from other areas in Jiangsu while 534000 were from other provinces. 332000 had been in Kunshan for over a year, 398000 for a month to a year, and 5400 for less than a month. Of all 735000, the vast majority, or 520000, was employed in the manufacturing sector. The vast numbers of recently arrived industrial workers is a sign that Kunshan has really taken off in the years after 2000 (KSY 2007:49).

Investment statistics confirm that around 2000, there is a sudden jump in both contracted and actually utilized investment. The foreign-trade profile of this investment is that the main export markets are Europe, North America and Asia in that order. This indicates that the purpose of the investment is to produce higher-end products, especially in the ICT sector. As we have already noted, 100% percent foreign ownership is the dominant form of investment, with nearly 6 times as many such firms compared to joint ventures and with 10 times the capital (KSY 2007:211-214).

Foreign trade, as seen in table 4, has expanded at a steady rate, compounding over time to the extensive and long-term boom especially pronounced after 2000. Roughly 90% of imports come from Asia (and one third of the Asian imports from Taiwan), while for exports the dominant partner is America, followed by Germany, Holland and Japan in that order (KSY 2007:211, figures are for 2006).

The economic growth on average from 1979 to 2006 was a yearly 27.5%, and for 2006 27.7%. The value of agricultural production has remained constant from 1995 to 2006, but only 33000 workers remain in the sector, so productivity growth per worker has been strong. The manufacturing sector, as expected, is dominant in the local economy, not

only in absolute terms but also in relative. In the latest few years however, the service sector has grown at a faster pace (but from a lower base). This is a sign of a maturing industrial economy, as the service sector in all developed economies eventually overtake the manufacturing sector both in value to the economy and employment.

There are other striking signs of a maturing industrial economy, especially indicators of popular welfare. All groups have seen ballooning disposable incomes during 1990-2006 (table 6); salaried workers by about 1100% and peasants by about 600%, interestingly even as agricultural production has remained constant since 1995. The increasing divide between these two groups have naturally motivated large migrations by farm hands to manufacturing jobs. As table 7 shows, the rising incomes of ordinary people have led to increasing consumption of retail goods, but especially pronounced is the increase in fixed capital, durables and capital goods (real estate, vehicles, TV's, computers, etc). A growing number of people can now afford such goods.

Compared to other counties in Jiangsu, Kunshan is far ahead on FDI reception, and the disposable incomes of workers are on par with other top counties in the delta region; significantly above that of Shanghai city. In a comprehensive index of all counties in China ranking them on current development level, developmental dynamic and developmental potential, Kunshan rose to the top in the two latest available figures (KSY 2007:282-292, figures from 2004 and 2005).

The statistical picture in general is hard to describe as anything but a revolutionary change in a short time from a laggard agricultural county with a large majority in absolute poverty around the time the KETDZ was conceived to the top of comprehensive rankings of all China and signs of a industrial economy with a fast-growing middle class. The question that remains to be answered is what role change and development of the local government's capabilities and understandings made this possible.

Autonomy in Kunshan

Autonomy, like Rome, was not built in a day, as the saying goes. It started with the reform era in 1978 through "fiscal reforms" and "devolution of economic decision-

making power” (Keng-Chen 2006:12) which marked the start of any definition of Kunshan as an autonomous entity in the terms of pursuing its own economic development policy. A caveat is due here; Interviewees in general expressed concern and opposition to some decisions and measures set by the Beijing government (especially the value-added tax and new labor regulations). Local economic development is affected by such policies, and it limits Kunshan’s right to fully determine its economic policy.

Bureaucratic capacity is the level of professionalism of the bureaucracy. This regards the education, competence and promotion of local officials. This affects Kunshan’s ability to formulate their own economic development policy and implement it. It affects the speed and quality of public services and the efficiency with which they handle complaints and make adaptations. This of course also relates to embeddedness – but if Kunshan decides to be “embedded” in its relations to business it must have the capacity to play a useful and constructive role in that partnership.

Bureaucratic integrity refers to the level of corruption and how individuals use public office. Are policies implemented as was intended by the decision-maker? Or there abuse of public office for individual gain? If officials are busy chasing rents for their own purposes rather than following up on government policy, it undermines autonomy.

Bureaucratic capacity

Karlsson Spools (hereafter KS), with a plant in Kunshan’s KETDZ since 2005, is a medium-sized firm. The Kunshan plant is one of only two (the other is located in Sweden). As given away by the company name, the only products KS manufacture are spools for hydraulic valves. In their own words “KS is the world’s leading manufacturer of spools for hydraulic valves” (Front page, <http://www.karlssonspools.com>). One of the most important customers is construction machines manufacturer Caterpillar. Anders Thorén until recently served as general manager of the plant. Thorén has 14 years of experience in China, in particular development zones in Jiangsu, Zhejiang and Shanghai. On the question of his experiences with local cadres, specifically in Kunshan, he expresses that

“...I feel personally that..this thing with political contacts and such, there is a lot of talk about that you need to have Guanxi (關係) in China. All westerners learn this. See, you don't need it. If you work in a place like this, in Kunshan, where there is law and order and you work in accordance with the laws and regulations that we have here, you don't need Guanxi. I have felt this since I first came to China.”

Thorén however specifies this to not necessarily be valid for the whole of China

“...However, if you're going down to southern China (referring to the Pearl River delta), and you're going to smuggle some goods, and perhaps, perhaps make changes to your import documents, respecify (the goods), call them something else, and smuggle over the border like what took place in the past.....then, you need your Guanxi. If you need to make people (cadres) close their eyes.”

Thorén explains that during his time in Kunshan (2006-2008), he never felt the need to seek contact with KETDZ or local government officials to rectify serious shortcomings in services, nor did any bribe-hungry officials show up at his doorstep. That does not mean service is entirely satisfactory. The power cuts are what sticks out in this regard.

“..they're going to do grid maintenance tomorrow, or whatever it is they're doing, but in any event 3-4 days (per year) are gone where you can't produce anything. It's not so much power being unavailable or in short supply as it is suddenly shutting it off for a day to work on it.”

Factories are notified a week in advance, but naturally this uneven supply is a concern to companies. Te Ding (特鼎) industries Inc. is a Taiwanese firm on the outskirts of the KETDZ, supplying customized metal frames for IT products. The firm, with 1000 employees in Kunshan, is much larger than KS and as such face higher fixed costs. Since establishment in Kunshan in 2002, argues the site manager Ryo Usuba:

“... we soon realized the unacceptable risk of relying on the power grid. So, we decided to install our own diesel-powered generator and supply for our own needs. Water...has been fine, but relying on the local government to provide power is just too risky.”

Östberg Fan, another mid-sized Swedish firm, established in Kunshan since 2004 with 17 workers in the production department (the factory floor), produces industrial fans and ventilation systems. According to Anders Jonsson, the production manager, they have opted for a solution akin to that of Te Ding:

“...power disappears now and then, but it doesn't matter since we have our own generator from Altas Copco (Large electric power technology firm, author's remark) standing outside here. When power disappears we simply switch to our own.”

Diab Group, yet another medium-sized Swedish firm, specializes in producing materials (plastic substances) for vehicle use. The boss of the KETDZ plant, General manager Johan Gralén, explains that planning can overcome the local government's service shortcomings.

“... We haven't had any serious such problems (electricity provision), since we examined all such things carefully beforehand. We have special (written) agreements (with the zone) regarding electricity and such and those promises have been kept – they have handled it in a good way. I know, for example, that in Wuxi (another city with a zone, further inland in Jiangsu, author's remark) we had huge problems. We didn't get any early warnings there when they cut power. Here.....we know that there are problems with supply, but they call up to a week in advance and inform you that this and that day and exact time the power will be shut down during this and that time. This enables us to re-plan our production.”

The comparative aspect of autonomy of local governments appears important to understand China's economic development. Kunshan's autonomy is compared by interviewees to alternatives in China, and naturally the competition is the toughest with other zone-possessing cities in the Changjiang delta (defined as the provinces of Jiangsu

and Zhejiang plus the municipality of Shanghai). Even if interviewees criticize the service provision and infrastructure in Kunshan that the local government is expected to provide, Kunshan could still be their best alternative – especially concerning all other factors that affect decisions on production in and management of a private enterprise. In light of the overall situation of power demand, it is not surprising that the supply sometimes falls short. In 2006, According to the city’s statistics department, power consumption for private and industrial applications increased by 27.8% on a year-to-year basis. Roughly 70% of the consumption is heavy industry, which increased by 32.4% in 2006 (KSY 2007:75).

Infrastructure, most importantly roads, have not quite kept up with the expansion of KETDZ, especially when taking into account the number of vehicles. In 2006, the year-to-year increase of roads in Kunshan was only 4.3% while the number of vehicles increased by 10.4%. Heavy vehicles such as freighters, trucks and buses increased by a staggering 108.7%, and the travel times of these types of vehicles have direct economic effects on individual firms (All figures from KSY 2007:183-184). Construction of this vital infrastructure component is perceived as unnecessarily slow. In the words of Anders Thorén of KS:

“...the service is pretty good. But I wish they would rebuild and expand that road down there, the roads here seem like an endless construction zone. They have been at that road (outside the plant) for at least a year now. That is a darn long time.”

Johan Gralén of Diab similarly mentions the road problem

“..one thing that we raised early was the road network in the area. At that time there was no highway exit, as there is now. The quality of the roads around here was very bad as well, so that’s something we have pressed rather urgently....the exit has since been fixed, and Kunjia road (the main road in this section of KETDZ, author’s remark) if also being upgraded, but too slowly.”

The water provision has improved dramatically. Steve Chen of Sanmina-SCI recounts the situation in 1996:

“In the local dormitory which I rented for the firm back then, when I opened the water, the color is yellow. When the power was gone, it became yellow. A few days later, when I opened it again, what came out was a thick black, dirty liquid. No one could take care of it since the piping system was corroded, too old. Now, it’s been taken care of.”

An important sign of efficiency of the local government is the relative speed of which all practical and bureaucratic steps are handled. Johan Gralén compares Kunshan to Diab’s recent efforts in setting up a plant in Mumbai, India.

“When you grow frustrated with China, go to India for a week and you’ll come back and feel that everything is pretty effective here. You can look at how we set up our company here. From signing the property lease to getting started with the production took us five months. In India, I’m working on setting up our new factory, which I have done for a year now without getting started (with production) , with all the permits and everything there...”

American firm Sanmina-SCI (四海電子) is the result of a merger between Printed Circuit Board Sanmina (PCB, key input component in all electronics and IT products) and US military and aerospace component manufacturer SCI and in 2001. The company’s primary role is as a telecom OEM manufacturer with the main customers being Ericson and Nokia. Steve Chen (陳振森) is the company’s Business Development Director at the Kunshan plant, with 4000 employees. Chen has been working continuously in Kunshan since 1994 and is thus in a position to evaluate how the capability of the local government to deliver services has developed over time. Taiwanese PCB firm WUS, a pioneer firm to settle in Kunshan in 1993 (together with Foxconn, Giant, Shimano, President-UNI and of course Sanmina-SCI) convinced Verifone, a customer of WUS, to settle in Kunshan, which had only a few years earlier established KETDZ. Steve Chen, part of that early establishment process working at Verifone, remembers:

“...the Kunshan government was quite good on communication, especially with Taiwanese people. They took feedback from the investors and responded quickly.”

However, efficiently incorporating capitalism in their way of governing meant early pioneers had to take on the initial training costs of local officials, since many of the processes and expectations companies from Taiwan, the US and other capitalist economies were used to regarding local governments were totally unknown to Kunshan when the KETDZ was established. The concept of “management”, including planning, organizing, leading, co-ordinating, controlling and measuring results, was the core deficiency in the local economic competence. Steve Chen recounts these humble beginnings:

“Back to 1994 or 1995 they (here meaning locally hired business majors and local bureaucrats and leaders, author’s remark) have no concept of capitalism. They have no idea, they only see the news, they read the papers, but they don’t know, they have no idea about management, how we do the MBO (management by objectives). Even if we hired college graduates with a business major, we had to provide training on for example the quality control cycle, how to do finance etc. We had to teach not only the local employees, but also the local government. You see, even the customs. When we import machines, they have no idea what SMT is, so we have to show them this “Service Mounting Technology”, just to give you an example. We had to share all our experiences (on how the local government works and how we work with them) from what we have been doing in Taiwan the last 20-30 years. We do this because we need them to provide high-speed service. Stocking materials costs money, product cycles were getting shorter. We face pressure to constantly improve our speed. But somehow, the local government at that time, back to 1994, aw (loud sigh)!. They’re smoking, they’re cooking, and they’re drinking. They don’t care about your speed. Okay, go ahead, they say, do it faster. I told them: you have to care about this! Not only to provide the gas, electricity and water. The rest of the value-added services we wanted are also government responsibilities: Freight, warehouse and custom clearance speeds. We had to kick them in the ass and say: gogogo! Otherwise we can’t compete with manufacturers from Mexico or Malaysia. I said: China

has been open now for more than 10 years, you have to act now, and you cannot wait any longer.”

Strait-talkers like Steve Chen appear to have left a lasting impact on the attitude of the local government as to how they should best convert their fervor for development into practice.

“At that time, at the first stage, they have a lot of old officials; they cannot meet this kind of speed. And then, the government side changed officials – from old men to young people. And they not only select the people from Kunshan or Suzhou – they pick up the best ones from Beijing, from any area to serve the top 500 manufacturing firms in Kunshan. Just like us at Sanmina-SCI, the government here now seeks the best personnel from all over China. The message in our (“us” referring to the above mentioned early, mostly Taiwanese, investors) educational efforts towards the local government was that there is a trend of stiffening competition: Do you want to survive? You do not only compete within the Chinese market. For example, Kunshan is competing with Shenzhen, Tianjin, Ningbo and Hangzhou – all areas within China. But if you want to be one of the best, and right now Kunshan is the best, you have to show us the best efficiency you can muster. One thing that Giant (the early-investing Taiwanese bicycle manufacturer) did was offer the local leaders a trip to Taiwan. They wanted to show them how quick and competent the local authorities in Taiwan are in this regard. They took them to Xinzhu (The main IT science park in Taiwan), to Yuanshan, to Zhongli, to relevant areas – to show them how the people in the island prosper. We all wanted to make them understand how to compete not only with other locations in China but on a global level. The bottom line was that they learn how to add value to the production (rather than take it away).”

Integrating in a global production chain in the case of Kunshan – like all cases of economic development in Asia since Japan’s Meiji Restoration in 1868 – is a process of skill and attitude transfer from those that are part of the chain to those that want in. It involved making changes that required political leadership and challenging the “old ways” to instead adopt large chunks of Taiwanese business culture and over the years

construct an increasingly service-oriented bureaucracy for the single purpose of ensuring Kunshan a profitable place in the global production chain.

A look at the organizational division of the local authorities that are tasked with foreign investment-related services bears witness to the ambition of providing services demanded by the “early pioneers”. The city government has set up 4 bureaus to deal with different aspects of investor services and relies to a great extent on services provided privately by a civil society organization, the Taiwanese Business Association (TBA, 台商協會) to handle a growing and evolving set of services for Taishang and their families. The TBA will be discussed at greater length under the “embeddedness” heading.

The Merchants Council of KETDZ is the bureau guiding investment in the contact, negotiation and establishment phases. The Planning and Construction Council is responsible for infrastructure maintenance and expansion inside KETDZ. The Economic Development Council and Personnel and Labor Council are tasked with overseeing and enforcing environmental and labor regulation compliance, respectively. This organizational division is an expression of how the local state has adopted according to the needs of development (http://www.ketd.gov.cn/english/index_17.asp).

Some of the interviewees provide examples of infrastructure deficiencies that do threaten Kunshan’s competitiveness on a theoretical level, but the comparison companies are likely to make when selecting locations for investment is more likely what public service provision standard prevails in Kunshan compared to other counties and cities in China in general, and the Changjiang delta region in particular. The interviewees with experience of other zones and cities in China place Kunshan on par with the Singapore Industrial Zone (which has a very good reputation) in Suzhou or slightly below it in terms of service provision. This amounts to a significant improvement in bureaucratic capacity in comparison to Steve Chen’s early-90s “Smoking, cooking, and drinking” communist officials, and has thus boosted Kunshan’s ability to implement economic policies and provide services expected of states in market economies. Without this bureaucratic capacity there can be no autonomy.

Bureaucratic integrity

The integrity problem (also known as the agent-principal problem) is the problem of the principal's (local government's) agents (individual bureaucrats) not acting in good faith to implement policy adopted by the principal, but rather acting out of motivation for private interests (most likely financial gain). Apart from illicit financial gain, integrity is compromised by heavy-handed regulation enforcement without warning that disrupts business and cause costs to the industry out of proportion to the purpose it serves. Arbitrary, disruptive and corrupt behavior on behalf of local government agents or government agents on higher administrative levels naturally undermines the Kunshan governments' autonomy in the sense that its policies are not implemented as intended, or, in the case of authorities on provincial or national levels, disrupted.

Several interviewees brought up the problems of obtaining payment from Chinese firms, especially state-owned firms. State firms are agents of the state and are thus of interest to us here, whereas corruption amongst private Chinese companies is an agent-principal problem strictly between private owners and agents.

Johan Gralén of Diab group explains the company's strategy for customer credit:

“We have the policy that we don't ship until after getting payed – for local customers. As competition in this country is becoming tougher and tougher, payment terms becomes one of the means of competition. But still, this is one of the criteria that we have been quite stringent about. When working with European or American firms in China, we have softened the policy and give some credit, but as regards Chinese and especially state owned firms – that would be like throwing money in the sea. It's better to not do business with them at all.”

As we have seen, an important part of Kunshan's development strategy was to allow more reliance on single-owner foreign enterprises (duzi qiye, 獨資企業) as opposed to joint ventures with local (mostly state) state firms (hezi qiye, 合資企業). This makes property rights more secure in Kunshan compared to other locations, partially by

reducing the potential for agent-principal problems that are more common in joint ventures. Johan Gralén compares Diab's single-ownership operation in Kunshan with a previous experience of running a joint venture for rubber company Trelleborg in Wuxi (無錫), a strong competitor to KETDZ:

“We have entered here (Kunshan) in a totally different situation than in Wuxi. Here, we entered as a new, single-ownership firm...we have been aware of the pitfalls along the way as we sat down and negotiated with the different parties, so I believe we have been able to avoid many of the problems here. While I was in Wuxi, I ran a company that Trelleborg had owned for a number of years and we were unable to guide and govern the firm. We owned 49% and the counterpart 51%, and we had left it up to the local management to run the operation, and since they posted a profit each year Trelleborg didn't care too much about how it was run. Our goal was to take over the firm and make it 100% Trelleborg-owned, and move the factory from central Wuxi to an industrial zone. There you'll notice what kind of corruption...corruption is the best word. There was only one goal for our counterpart and the local government, and that was to extract as much money as possible from us, no matter what the means of achieving that were.”

Gavin Xu of Kyoden, a Japanese PCB-manufacturer with many customers in mainland China, including big Japanese firms Sony, Panasonic, Hitachi and Toshiba, makes a similar comparison:

“From my time in Shenzhen (just north of Hong Kong, author's remark) and Dongguan (famous zone in Guangdong province, author's remark) I can say that yes, doing business here also requires spending a lot of time on relations with customers and suppliers. But we are also more secure since we avoid a lot of the problems related to joint ventures here in Kunshan.”

Incidences of current corruption by local government agents in Kunshan are largely absent from the anecdotes and impressions of the interviewees, and even if the number of interviewees are not large enough to draw general conclusions of agent-principal problems in the local government, it is however safe to argue that the problem is less

serious than it once was. Steve Chen recounts an example from 1995 to underscore the past seriousness of this problem, when what is today the Sanmina-SCI plant was run by Verifone and a power generator had just been installed by the company seeing as how local power production was unreliable:

“The noise from the generator apparently was higher than what the regulations allowed. So, an official came to the plant. This guy, this gentleman – he was drunk. I told him that showing up in short sleeves and slippers and being drunk is a bad attitude, I wanted him to leave. He wanted me to shut down the plant due to what he claimed was public complaints about the noise, he had no idea about the losses incurred from one day of inactivity. I called his superior at the environmental bureau and told him that you have to give us a chance to live up to the regulations within some time limit, but you can’t just show up like this and demand we shut down. It was the old-fashioned communist style of barking orders to me.”

It also seems that behavior on behalf of companies differs depending on corporate governance of the firms. Steve Chen, who represents a US firm, faces stricter limits to his financial authority than for example a Taiwanese manager, not normally subject to as strict corporate governance.

“The rest of the (Taiwanese) firms preferred to pay the fines meted out by the Environmental Bureau. Even if they have good Guanxi with them they still preferred to pay 100,000 yuan in fines to solve the noise problem. As a US company – no way! I can’t pay that kind of money. It could be that these companies make it easier for the local bureaucrats to be corrupt. Because, some of them did pay the 100,000 fine but cannot get a formal receipt. Then when they got the receipt, it said it was 100,000 for “fruit”. The firms were asking: how come I cannot get a formal receipt from the government?”

Another case was the local military asking for “contributions”. In 1996, tension ran high in the Taiwan Strait as President Lee Deng-Hui of Taiwan had called the cross-strait relationship a “state-to-state” relationship – a serious contradiction of the one-China principle of which the military has traditionally been a type of vanguard. During the

missile crisis, apparently a group of 5 People's Liberation Army (PLA) generals decided to pay a visit to Taiwanese manufacturers in the KETDZ to solicit "contributions" for the police and military in order to show their "love for the motherland".

"The five generals, at least 1-2 star generals, show up, each in his own Audi car. I was surprised: How come you don't make a phonecall, but just come without a previous arrangement? They were asking for donations. When they came to the plant, they said that the plant is very great, good! They said: You spent a lot of money on this, how about you donate 200,000 Rmb to the military, the police? I answered politely but in my heart I said: fuck you! You target your missiles at Taiwan, and now you want me to donate? The money, I think they wanted to use it for their own benefit. The attitude was very much what you would imagine from a pre-war Japanese general. I said, of course, I am Taiwanese, but I was hired by a US firm, I have no such authority. Everything comes from a budget that you have to apply and get passed in advance. They didn't seem to understand the idea with a budget. But, the other firms, Taiwanese firms, they were wise. For example, UNI-president decided to donate their instant noodles. They didn't give up on me, they tried to sell military decoration items for 3-5 thousand Rmb. I didn't give them anything."

This story demonstrates the importance of corporate governance regulations for making corruption more difficult. Western legal systems and accounting standards place strict limits on firm managers and local bureaucrats soon learned that Taiwanese firms were easier targets since managers in those firms were in general not subject to the same strict legal requirements. For several years since opening the Verifone plant in 1994, Steve Chen was also unable to secure a license for installing an imported sprinkler system. When the Verifone plant was already 75% equipped with sprinklers, the Kunshan fire department would not issue a license since the sprinkler system was more modern and unknown, hence not allowed according to what the fire department claimed to be local regulations.

"I went to the fire bureau, again and again. They wouldn't budge, I still had to uninstall my system and use an older model, otherwise they mentioned I had to pay 200,000 Rmb

for “investigation and checking” the system. They said 200,000 is actually very cheap, that if I wanted to follow a regular application they would have to send the application through Suzhou, and then to Nanjing for approval. I was told it would take longer and cost around 500,000 Rmb. I told him the same thing I told the generals. The fire captain then showed me a list of things he wanted from me – 5 notebook computers for the fire departments office. I thought that if I had to ask my superiors for more money, now that the regular budget is already spent, I would lose face, I would be a bad worker here in China. A friend advised me to try to buy the fire department representatives dinner instead. I bought them dinner and then there was no problem with obtaining the license after that.”

This “clash of cultures” extended to relatives of high cadres, such as the mayor, approaching Chen inquiring about what he refers to as “easy and high-paying jobs”. These relatives were directed to formal channels of seeking employment – without special treatment. This did not lead to significant negative consequences for the Verifone plant. Instead, Chen argues that around 1997 the “cultural clash” between new and old management and the learning process promoted by the “early pioneers” had started to produce change in the behavior of bureaucrats.

“Before 1997, it was quite hard for them (the local government) to understand how we worked. After that, they became more professional. For example, I had a customs representative come over, unannounced, to inspect our warehouse. Suddenly, he didn’t want to inspect anymore and just left. I called his boss and he told me it would be dealt with. Interestingly, the inspector was transferred and received no bonus that year. This kind of thing would not have happened when I first came here to Kunshan. All the top level officials....they do listen. If there is any problem or any issue coming up which you cannot solve, they will listen to you and take quick action. Like the bureaucrat complaining about the noise from the generator (see previous example), he is already gone. They will replace such bureaucrats with those who can provide service, if you make a phone call and specify your complaints.”

The many examples of principal-agent problems in various government bureaus described are indicative of what Weiss-Hobson (1995) and Evans (1995) described as a “predatory” state in which the state has little control over its agents. As a result of a learning process in which investors have played an active part, Kunshan has professionalized its bureaucracy since this is a necessary condition for providing fast service vital to the foreign investors’ competitiveness. A positive side effect of this is lower tolerance to corruption. The impetus for this change also has a background; the competition between local governments, all eager to grow their economies (as we have seen growth is the determinant of promotion of officials, Chien 2007:16-17) is increasingly fierce. Kunshan, having learned about the roles and functions the state takes on in advanced economies, also learned that surrounding counties are all playing the same game. The author personally observed how the vice president and accompanying officials from a newly opened zone in Jiangsu’s Huai-An (淮安) solicited investment from Taishang by coming to Kunshan (Dinner with Sanmina-SCI, Foxconn, various Taiwanese and Japanese investors and consultants, 20080225). Some firms, such as the world’s largest ICT industry supplier (OEM) and Sanmina-SCI competitor Foxconn, already moved many low-value added manufacturing jobs to Huai-An, while more qualified jobs remain in Kunshan for the time being.

Not counting the new Huai-An zone, the Changjiang delta region has at least 26 other zones in operation (For a list see Appendix B). The terms for a “developmental state” in today’s Changjiang delta is thus different from what Japan and to a lesser extent the four little dragons went through; the competitive environment between such “states” (actually counties and cities in China with significant fiscal self-determination) is much more pronounced and fierce than before. This is not only due to the sheer number of competitors, but also the lowered costs for information and transactions and the accompanying explosion of transactions and communication we know as ‘globalization’. Both the local bureaucracy being involved in a learning process and the surrounding environment of institutional changes in other counties put pressure on Kunshan to increase its bureaucratic integrity, which is stronger, in particular since the transition phase around the late 1990’s.

Embeddedness in Kunshan

Embedding itself with investors and potential investors happens in symbiosis with growing autonomy. Planning and implementing policies clearly must be based on accurate knowledge and information about trends in industry, culture and world trade. Thus, the trend towards stronger autonomy in the later part of the 1990's went hand in hand with a gradual shift in the nature of state-business relations. The prerequisite for embedding itself in ties with business was for the local government to first allow the business to network and organize amongst themselves to be a useful and coherent partner for the government. This is not a trivial prerequisite since China is a one-party state and civil society almost per definition is a threat to that order.

Business organization

Parallel to the transition period in bureaucratic integrity during the late 1990's, there was a transition in the Kunshan government's acceptance of the idea of business actors organizing privately amongst themselves. Steve Chen recounts how before that transition, the early pioneers had to make do when they needed information and relations were far from close and smooth:

"In 1997-98, they (the Kunshan government) would say that we Taiwanese were not allowed to have a meeting by our own. We were not allowed to. At that time, (socializing and exchanging advice and business information) it was quite hard. Back in 1995-96, I had to set up human resource management and learn what regulations to follow in running the plant. I had to set up the salary structure, how to pay operator 1 and 2...I had no idea. So, first, I had to check with the local government. They, very simply, said that any salary between 300-380 Rmb per month (for all jobs) is fine. They had no idea about different pay scales. We have to have different pay grades, even within subgroups of engineers. So I wanted to talk to other foreign businessmen and see how they handled this. The only foreigners at this time are a few Taiwanese. A group of us decided to go out and drink and talk about these things. All restaurants were government owned, so we had to pick a dormitory in a dark area, 5-6 of us from President-UNI, Shimano, Foxconn, Giant etc. We talked about salary levels, custom clearance procedures and cost, land cost

payment and levels, regulations and meetings with local government cadres etc. We needed to share information and discuss these things. In 1998, we formed the Taiwanese business association and after that they became more helpful.”

A 1997 fact-finding mission conducted by the Kunshan government to Shenzhen, the very first open-door zone in China, revealed that the Shenzhen government not only allowed but also encouraged the formation of the Shenzhen TBA for Taiwanese there, and that this was good not only for the businessmen who could raise their bargaining power but also for the government as the TBA could help in lobbying more firms to move in. Also, the local government realized that they had possible enormous benefits to reap from sidestepping the strict controls on civil society and allowing the Taiwanese to start a TBA in Kunshan – the IT supply chain. 8 major Taiwanese notebook manufacturers all established in Kunshan and Suzhou and each brought with them about 100 supplying firms (Interview with Steve Chen 20080304). This cluster represented 90% of global notebook production, so securing it was of huge strategic significance to Kunshan – in effect creating a “comparative advantage” for producing notebooks in Kunshan. As these firms moved in, it added a certain weight to the interests of Taiwanese firms to organize. From the point of view of the Taishang, establishing a civil organization was imperative both to maximize bargaining power vis-à-vis the local government, but also for solving certain problems through scale – providing primary education to children of investors, negotiating setting up a hospital to provide good care, socializing and activities for families of investors, to name a few. In 2008, the TBA is located in the same building as the KETDZ administration units - a sign in itself of its importance, but also of how the government wants to keep it on a short leash.

Business-government connectedness

Following the observations of Kunshan cadres of how the TBA of Shenzhen contributed to development there, The Kunshan TBA was thus established in 1998, and by that time the number of Taiwanese firms had reached 1500. The embeddedness here consists of what contributions this relationships brought towards effective policymaking in Kunshan. To attract more investors and satisfy those already there, Kunshan had to know what

needs investors had in terms of fast and high-quality public services. Steve Chen mentions some examples:

“One of the first things to see an improvement was fast custom clearance. We need to ship our goods from the plant within 2 days after production. Our regular communication and conversations with the local government on how to provide fast service pushed them to achieve this. This in turn allowed them to increase their tax incomes and formulate the city’s future, the “Garden City”.”

Recruiting local officials from all over China on meritocratic grounds and promoting them based on clear standards enabled the local government to play this “partnership” role competently. New foreign investors did not have to go through a jungle of negotiations, terms and procedures but could obtain information on rules and procedures for setting up and running a business from the TBA. Allowing the TBA to establish health care and education services for its constituents was another pragmatic move that might lead to spill-over effects for the education and health care local citizens receive.

From a previous situation where all investors were welcome in Kunshan, the city now has the capacity to define its own future economic plan. Relative prices have changed as well since the KETDZ was started, as land is now scarce and capital more abundant. This in combination with a clear ambition of attracting high-value added, environmentally clean and technology-intensive companies leads to some low-value added firms being turned away or receiving less favorable deals than what would originally have been the case. Steve Chen emphasizes that this is a natural consequence of Kunshan’s economic development strategy:

“Of course, now they only focus on the big firms – high-value added, high profit, high-tech firms to establish in Kunshan. If the Taiwanese firms are low-end and polluting, they don’t like it. We (the TBA) cannot put this up as an item of negotiation, because the local government has the right to choose what business to allow in.”

For the firms that establish today, the new, relatively “embedded” relations mean predictability to investors and cheaper means of obtaining information and dealing with small issues – far from the illegal meetings in dark dormitories recounted by Steve Chen. Liao Wan-Guo is the 2008 chairman of the TBA’s common affairs department (常務會長), responsible for dealing with smaller complaints, disturbances and unclarity that arise in each firm during everyday work. All-in-all there is 12 sub departments. Liao came to Kunshan in 1998.

“We (the TBA) quickly became a type of window for them to understand the requirements that exist to take part in and do well in global business. We helped them to understand what we expected from them, what we needed from them to operate successfully from Kunshan. We started to play a part in their economic planning, and provided them with help in lobbying key industries and firms to locate to Kunshan. They have set up vocational schools to train the workforce, partly because of our input”

Liao argues that there has been a process of institutionalization; best explained as more predictable standard procedures that firms can follow at different levels of state-business relations. The TBA is playing a large role in upholding that order. Today, sub-chapters of the Kunshan TBA have been established in all districts of the city.

So as to underscore how the local government is suspicious of organized interests and their activities; for outsiders to interview representatives of the TBA, it was necessary to go through the local government to obtain permission – the TBA itself insisted on following this procedure. In other words, allowing for civil society and relating to it in the close way Kunshan has is an exception that proves the rule of generally tough restrictions that is true of China in general.

Embeddedness with private business organizations was deemed so successful it was replicated for other foreign capital. The initiative here was not by business, but a state initiative. Specialized units conduct relations with foreign firms and even set them up with local service providers such as freighters and construction agents

(<http://www.ksinvest.com/english/Service.htm>. Also Interview with Steve Chen 20080304).

Johan Gralén of Diab points out how Kunshan's behavior struck them as more professional and interested than the alternatives when the firm was in the process of opening a plant in China:

"I can't say the different zones fought for our investment. On the contrary, I felt as if the zone people in other zones in general were too busy, so we didn't obtain high-quality service. When we conducted our primary investigation – only here in Kunshan did we get really good feedback and the impression that they really wanted us to settle. In Suzhou and Shanghai, the message was that the zones are full and we had to do with 'take it or leave it' offers."

The pursuit of embeddedness goes further than just being responsive and effective in Kunshan itself. The local government actively tries to lobby desired firms to settle in Kunshan. Besides public relations offices in Beijing and Shenzhen, study trips were organized to as far away as New York. Steve Chen:

"Around 1997, the city started to organize study trips of 4-8 people. Two places they visited were New York and Taipei. When returning to Kunshan, they had to write a report. However, these traditional officials complained about poor and beggars in the streets of New York and too many temples in Taipei, and so on. They didn't get promoted. The major (1997-2001 Kunshan Major Ji Jianye, author's remark) was disappointed that they complained. He wanted a constructive report, with observations of what was working well in those places so Kunshan could copy it"

The importance of acquiring detailed knowledge applies not only to city planning on the macro-level, but also for targeting specific companies in key industries that bring with them specific innovations and suppliers when settling in Kunshan. Keystone Electronics, a large US electronic instrument manufacturing firm, tried to establish in 1997 but gave up since then the city didn't set him up with a vice mayor or other high-ranking official