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Rent-seeking at Home, Capturing Market Share Abroad: The Domestic Determinants of the Transnationalization of China State Construction Engineering Corporation

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Summary. — How do the Chinese central state and central state-owned construction enterprises interact with one another as China's overseas contracting unfolds in the post-corporatization period? Building upon a neo-institutional analysis of the principal–agent relationship, this article finds that contrary to most of the accusations leveled against the global outreach of Chinese SOEs, state-backed transnationalization is by no means state-dominated. SOE managers' continuous bureaucratic ties enable the firm to navigate through China's gigantic but fragmented bureaucracy in favor of corporate commercial interests, which reflects the negotiated nature of the state–SOE relationship in the course of transnationalization.

Key words — rent-seeking, state-owned enterprise, economic transition, managerial behavior, Asia, China

1. INTRODUCTION

How do the Chinese central state and central state-owned construction enterprises interact with one another as China's overseas contracting evolves during the reform era? As China plays a more active role in great power politics, the central state is motivated to exert more control over its construction state-owned enterprises (SOEs) to serve as agents for the delivery of foreign aid. Ideally, policy-oriented construction SOEs rather than market-oriented construction SOEs would be more conducive to a rising China's expansion of its sphere of influence worldwide. Yet China's construction industry is one of the most liberalized sectors in the national economy. [1] The operation of construction SOEs has long been subject to market forces and open competition. Does the juxtaposition of burdensome state-mandated tasks and fierce market-driven competition shape the transnationalization of China's construction SOEs? If so, how?

Without referring to the liberalization of China's construction industry, the prevailing view argues that the transnationalization of construction SOEs is mainly shaped by the Chinese state's diplomatic strategy, which aims to secure energy resources and alliances. According to this view, overseas contracting by Chinese construction SOEs is motivated by government policies and their associated financial supports. [2] These construction SOEs rely on not only official financial backing but also political resources such as diplomatic connections with host countries. [3] However, a few scholarly works find that the preceding view oversimplifies the situation. The agency problem often frustrates the state's intention of having construction SOEs serve as instruments of economic diplomacy (Gill & Reilly, 2007). Meanwhile, contrary to the conventional wisdom, Chinese construction SOEs engage more in international bidding for projects financed by international funding agencies than in bidding among Chinese contractors for projects financed by the Chinese government (Chen, Goldstein, & Orr, 2009). In addition to academic studies, recent trends have seen cut-throat competition among these Chinese contractors, and some of the contractors have shifted their attention to developed areas such as the United States and Europe that are irrelevant to Chinese aid programs. [4]

While each of the previous accounts touches on some key points of overseas operations by Chinese builders, further demystification of the black box of the decision-making process would enable researchers to understand the contradictions among existing studies. Two reasons justify this research specification. First, almost all of the existing literature on the transnationalization of Chinese construction SOEs focuses on the same region, Africa. The bias in the choice of empirical observations reflects the fact that Africa has been the top destination for Chinese foreign aid since 2006. However, studying Chinese contractors' activities in one particular region may confound the interactions between the state and its construction firms in general with the state's policies toward the area. Together with the fact that Asia, not Africa, occupies the lead position in terms of Chinese international contracting projects (see Figure 1), the existing studies cannot truly provide a comprehensive view on the transnationalization of Chinese construction SOEs. As such, drawing our attention back to the domestic policy-making process that involves all interested parties can provide a better understanding. Second, although a number of academic works explore Chinese SOEs' global outreach by examining domestic policy-making processes, most of them choose the state-monopolized sectors as their case studies. [5] However, the construction industry is one of the most liberalized sectors in China and has a very different market structure from that of state-monopolized sectors.

Based on these two concerns, I suggest that to assess the role of construction SOEs in China's foreign-aid program and its implications for the international-aid regime, it is a

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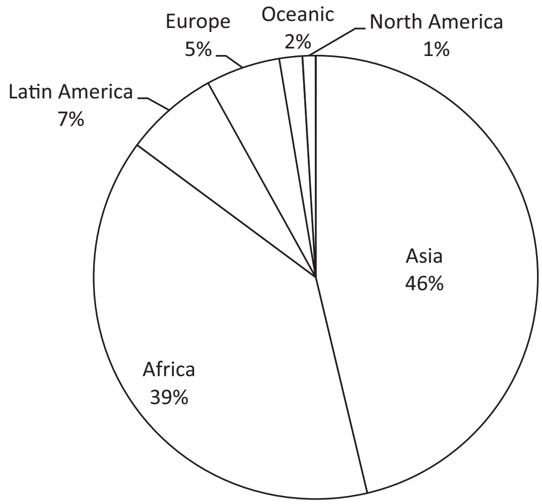

Figure 1. *Geographical distribution of turnover from completed Chinese contracted projects in 2010. Source: China Statistical Yearbook 2011.*

prerequisite to understand the domestic background against which the reform of these firms has evolved. This article thus adopts a neo-institutional analysis of the principal–agent relationship between the Chinese central state and its construction firms to explain Chinese construction SOEs' corporate strategy during the period of transnationalization—rent-seeking at home while capturing market share abroad.

By studying the China State Construction Engineering Corporation (CSCEC), this article argues that the transnationalization of Chinese construction SOEs during the post-corporatization period reflects more the firms' corporate strategy than the state's policy objectives. It is the domestic market structure, not national foreign-aid programs, which drives construction SOEs' transnationalization. Contrary to Chinese reformers' expectations, pro-competition reforms actually made Chinese construction SOEs more inclined to utilize non-market leverage to compete in an increasingly open market. After all, political influence is a firm-specific competitive advantage for bureaucracy-connected construction SOEs. Habitual rent-seeking behavior together with the pressure to meet financial standards set by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) motivate construction SOEs to negotiate with a fragmented bureaucracy in favor of corporate interests.

A case study on CSCEC can be used for understanding Chinese construction SOEs because of its top position in the industry. In addition to its status as the largest construction SOE in the domestic market, CSCEC is the first among five Chinese vertically integrated construction companies that entered the list of the top 225 international contractors, which is compiled by the *Engineering New-Record* (*ENR*).[6] This is the result of CSCEC's leading role in carrying out China's foreign-aid program. Examining the transformation of CSCEC's operation strategy from a "diplomatic arrangement" (*waijiao buju*) to a "commercial arrangement" (*shangye buju*) will contribute to a more comprehensive grasp of China's foreign behavior in the realm of political economy.

This article begins with the reform measures of China's construction industry, which created the institutional environment that shapes the incentive structures of the actors involved. It then examines firm-level behavior in response to institutional changes brought about by the reform. Special attention is given to CSCEC managers' conduct in their effort to balance their political and economic interests within a transition economy in which the Chinese Communist Party (CCP) still dominates their career prospects. The next section analyzes how this interaction between the party-state and managers determined the transnationalization of the CSCEC. The article concludes with the issue of incompatibility between managerial political and economic roles and the implications for the political economy of development.

2. THE REFORM OF CHINA'S CONSTRUCTION INDUSTRY

With the SOE sector regaining its strength in China's transitional economy, there is a growing body of research on the changing state–market interaction as a result of the corporatization reform agenda. Focusing on two theoretical themes — state–SOE relations and regulator–business relations — the existing literature notes the increasing SOE autonomy vis-È-vis the state. On the issue of state–SOE relations, a number of studies find that the emergence of SOEs' commercial interests from the process of corporatization has transformed the firms into market players (Lin, 2008; Steinfeld, 2010; Tsai, 2011). Although SOEs' corporate interests do not necessarily contradict the state's interests, SOEs have the leverage to bypass the state mandates as they pursue their own goals (Naughton, 2008). Moreover, similar to Hellman's (1998) observation of partial reform in transitional economies, Chinese SOEs as early winners of China's gradual reform strategy are capable of altering the industrial reform agenda in favor of their own operations and resisting full-fledged liberalization (Eaton, 2013). Corporate autonomy vis-È-vis the state is further facilitated by China's fragmented bureaucratic governance, which is especially apparent in the sphere of SOEs' offshore ventures (Downs, 2008; Liou, 2009).

On the issue of regulator–business relations, the predominate scholarly view is that Chinese reformers create a new set of economic governance structures in response to the changing state–market relations brought about by the economic reform; the result however is mixed. The design of the new economic governance institutions reflects Chinese reformers' views of long-term development, i.e., strategic industries such as telecommunications adopt re-regulation while non-strategic ones such as textiles adopt liberalization (Hsueh, 2011). Nonetheless, in embracing the "independent regulator model" recommended by most international organizations, China's regulatory agencies in strategic industries fail to deliver effective governance due to various institutional constraints (Pearson, 2005, 2007; Yeo, 2009). As a result, when facing powerful SOEs that are good at maneuvering China's fragmented bureaucracy with conflicting departmental interests, the newly established agencies that lack bureaucratic resources fall into the trap of regulatory capture (Pearson, 2005).

Although the preceding literature make their argument by examining state firms operating in the state-monopolized industries such as airline, electric power, oil, and telecommunications, the dynamics of the changing state–market interactions and ensuing state firms' corporate autonomy also occur in China's construction industry, which operates in a relatively liberalized market environment. China's construction industry is one of a few "pillar" industries (*zhizhu chanye*) in which both state firms and non-state firms are governed by a competitive market. The reform started from the adoption of a national tendering system in 1984, which was designed to govern the bidding process for construction projects. The introduction of the tendering system represents a significant