

Rule of Law in China: Chinese Law and Business

Competition Policy and Law

Mark Williams

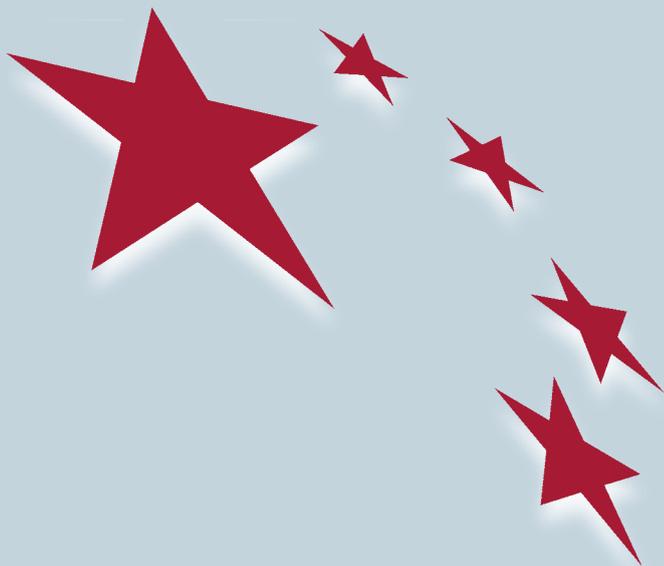
The Foundation for Law, Justice and Society

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The Centre for Socio-Legal Studies,

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Executive Summary

- Competition policy and law are essential to the optimal functioning of a market-orientated economy. The precondition for an effective competition policy is that the national government is ideologically committed to markets as the primary economic regulator, rather than to state-centred planning or excessive public sector intervention.
- However, arguably, Chinese authorities have not yet accepted this ideological position. Accordingly, in present conditions, the adoption of a Chinese competition law would be inappropriate. It might, in fact, impede the creation of a more economically efficient market.
- The real rationale for the increasing political clamour for the rapid adoption of an Anti-Monopoly Law is, paradoxically, not the acceptance of market competition; rather, the government's desire to maintain and extend economic control.
- Competition problems in China generally emanate from sectors where the state is still dominant and from abuse of administrative powers. Competition problems in the private sector appear, at present, to be minimal, though this may change as the sector expands.
- The current draft law lists a number of conflicting objectives that might render coherent application of the law problematic:
 - 'Monopolistic conduct', when undertaken under the aegis of other laws, is exempted, though without indication of the breadth of the exemption provision.
 - The administrative architecture of the enforcement bodies is confused; with the original notion of a single high-level agency apparently abandoned, there is no clear division of responsibilities and powers. Crucially, no indication of the administrative rank of the enforcement agencies, vital for the effectiveness of the competition regime, has been provided.
 - The key provisions on administrative monopoly are weak and likely to be wholly ineffective, as they merely provide for admonition by a superior, rather than for effective enforcement by a competition agency.
- The State Council specified in December 2006 that seven industries were to remain under 'absolute' state control; namely: armaments, electricity, oil, telecommunications, coal, civil aviation and shipping. A second tier of industries would remain under 'relatively strong' state control. These include manufacturing, automobiles, electronics, architecture, steel, metallurgy, chemicals, surveillance, science and technology. The goal was to 'cultivate 30 to 50 enterprise groups with a strong competitive edge in the global market place'.
- An appropriately drafted and implemented competition law would assist in reducing China's trade surplus, by allowing greater market access to imports, and goods and services made or provided in China by foreign investors. On the other hand, a competition law selectively or mendaciously employed as a trade weapon to protect domestic markets or domestic producers would have the opposite effect. This might appeal to those in authority, who view competition law as integral to an overarching industrial policy, which promotes 'national champions' by mercantilist means.

Competition Policy and Law

Introduction

Competition policy and law, appropriately implemented and enforced, are essential to the optimal functioning of a market-orientated economy. International organizations, including the World Bank, the Organization for Economic Cooperation and Development (OECD) and regional groupings such as the European Union (EU), the Association of South East Asian Nations (ASEAN) and Asia-Pacific Economic Cooperation (APEC), all emphasize, to a greater or lesser extent, the need for a pro-competition policy to be adopted, to promote industrial efficiency and economic growth.

The unspoken, but implicit, precondition for an effective competition policy is that the national government is ideologically committed to markets as the primary economic regulator, rather than to state-centred planning, or excessive public sector intervention to promote 'national champions'. For markets to function, there must be competition. The intriguing question is whether the Chinese authorities now accept this ideological position, and the need for a competition law to enhance domestic competition, after almost 30 years of economic reform. This brief will go on to explore the validity of the assertion that the adoption of a Chinese competition law, in present conditions, may be inappropriate, and might, in fact, impede the creation of a more economically efficient market.

The nature of the problem

Since 1978, China has embarked on an ambitious economic restructuring programme. Orthodox Marxist-Leninist economic prescriptions of state ownership and control of all aspects of economic life demonstrably failed to create wealth. The cautious acceptance of special economic zones along the southern and eastern shores produced profound changes in the economic landscape. These allowed the establishment of capitalist firms, free of

communist controls, initially, to produce mainly export goods; but later to conduct first limited, then unrestricted, internal trade.

The significant reform of state-owned enterprises, their corporatization and listing on the newly established domestic stock exchange, and the dual listing of some of them on overseas exchanges, have complemented the gradual acceptance of privately owned domestic businesses. Foreign multinational corporations, lured by the prospect of a vast market of a billion consumers, have flooded into China at an ever increasing rate, notably since China's accession to the World Trade Organization (WTO) in 2001.

These changes have tempted some observers to conclude that the Chinese authorities now accept markets, not the state, as the primary economic regulator. But this is a profound misunderstanding of the actual situation pertaining in China. The real rationale for the increasing political clamour for the rapid adoption of an Anti-Monopoly Law is, paradoxically, the government's desire to maintain and extend economic control.

Clearly, the nature of the economic settlement that will be reached in China over the next few years is crucial; not only for the economic welfare of Chinese consumers, but also for foreign investors and China's trading partners, most of whom are running high and escalating trade deficits with it.

An appropriately drafted and implemented competition law would assist in reducing China's trade surplus by allowing greater market access to imports and to goods and services made or provided in China by foreign investors. On the other hand, a competition law selectively or mendaciously employed as a trade weapon to protect domestic markets or domestic producers would have the opposite effect.

However, this kind of law might appeal to those in authority who view competition law as integral to an overarching industrial policy to promote 'national champions' through mercantilist means. Thus China's decision to adopt a comprehensive Anti-Monopoly Law is clearly significant, both internally and externally.

The history of competition law in China

The adoption of a comprehensive competition law in China is a convoluted saga that began in the early 1990s. The government appreciated that the nascent market economy could be subject to competition barriers from private firms. It also recognized that there were specific problems relating to public sector enterprises and the misuse of government power: the so-called administrative monopoly problem.

A cursory analysis of the economic inhibitors to competition, evident in the 1990s, reveals that the major impediment to functioning markets was not the existence of private monopolies and cartels; rather the abuse of consumers by public sector enterprises and central or local government departments, that used or abused administrative powers to distort economic activity.

The classic solution to overly powerful public sector firms is first to break up the industry into smaller operating units, and then privatize the sector; at the same time subjecting it either to a regulatory scheme of control, or to a less stringent competition law. China has operated a policy of reorganizing some large-scale industries, such as telecommunications and banking, by converting them along corporate lines, and replacing former state monoliths with smaller operating units. Initial public offerings on the domestic and Hong Kong stock exchanges followed; however the state remained the majority shareholder, usually retaining 70 to 75 per cent of share capital.

Since the later 1990s, following the policy enunciated by the former premier, Zhu Rongji, smaller state-owned enterprises, often controlled at

provincial or city level, have indeed been fully privatized. The process was economically significant, though clouded with controversy and allegations of outright embezzlement, and the substantial undervaluation and 'sale' of state assets.

Following China's accession to the WTO, industries in other sectors of the economy, such as banking, insurance, retail and manufacturing, have been fully or partially opened to foreign participation. However, in general, competition problems in China continue to emanate from sectors where the state is still dominant, and from the abuse of administrative powers. Competition problems in the private sector of the economy appear to be minimal at present, though this may change as the private sector expands.

Regional and national frameworks

Local and provincial government policies are often at odds with central government objectives. Because there is no independent and transparent mechanism for resolving these policy conflicts, the central government's desire to create a unified national market is often frustrated by local or provincial government action. The system of the People's Court is not sufficiently independent, with the lower level courts in particular being subject to influence by the corresponding level of executive government that provides their funding. Thus reviews of illegitimate government action, using administrative law, is potentially ineffective.

The development of a competition law

Optimistic reformers within government attempted to promote a comprehensive Anti-Monopoly Law, enforced by a single high-level agency, as a single solution to these embedded problems. However, in the 13 years since the central government began the project of constructing a comprehensive competition law, these central objectives have been undermined by bureaucratic rivalry. This has made the establishment of a powerful central agency impossible. Meanwhile, various sectoral interests have attempted to gain exemption from the law.

During the prolonged drafting process, the Anti-Monopoly Law Committee undertook substantial research on foreign competition law regimes, and competition issues under other jurisdictions. It sought assistance from national competition authorities, international organizations, foreign academics and lawyers. However, despite these efforts, the current draft, submitted to the standing committee of the National People's Congress in June 2006, is a disappointing document.

For example, the preamble lists a number of conflicting objectives that might render coherent application of the law problematic. 'Monopolistic conduct', when undertaken under the aegis of other laws, is exempted, though without indication of the breadth of the exemption provision. The administrative architecture of the enforcement bodies is confused. The original notion of a single high-level agency is apparently abandoned, and there is no clear division of responsibilities and powers. Crucially, an indication of the administrative rank of the enforcement agencies, vital for the effectiveness of the competition regime, is not provided.

There are a number of unresolved issues, such as whether the law is aimed at enhancing consumer welfare, or achieving some other goal. The key provisions on administrative monopoly are weak and likely to be wholly ineffective: they merely provide for admonition by a superior, rather than for effective enforcement by the competition agency. Moreover, the law may take up to two years to emerge from behind the closed-door legislative process, and the prospect of a well drafted law, with appropriate enforcement machinery, remains uncertain.

These difficulties notwithstanding, it is clear that foreign practice has had an influence on the substantive provisions of the existing draft bill, which, largely, resemble provisions in European law. However, in key areas, domestic political realities have asserted their primacy, and bureaucratic in-fighting has triumphed over the need for an appropriate statute. This is particularly manifest with respect to the potential clash between the newly enunciated 'national champion policy' (see below)

and the competition law; the confusion over objectives; the ineffective nature of the provisions dealing with 'administrative monopoly'; and the unresolved problem of the enforcement agency. These substantial difficulties are caused by the crosscurrents of bureaucratic politics. Resolving them is a difficult task, ultimately dependent on decisions taken at the highest levels of government as to the respective priority given to competition policy, as compared with industrial policy.

Cynics may speculate as to whether competition policy will in reality be used to reinforce the newly minted 'national champion policy', rather than to open the domestic market to greater competition. Recently, Zhang Guobao, the vice-chair of the National Development and Reform Commission (the successor to the old economic central planning organ), baldly stated that, in the context of the need for the swift enactment of the new Anti-Monopoly Law, 'foreign companies ultimately aim to eliminate competition and monopolize the domestic market'. The balance of advantage between a vigorous competition policy and an ascendant industrial policy will have to be weighed by senior ministers. We may have to wait for a considerable time before their decision becomes clear.

Challenges of adopting competition law

For the moment, let us assume that the Chinese government has a *bona fide* intention to adopt and effectively implement a competition law – which is no easy task. The experience of other developing and transitional countries demonstrates the complexities and difficulties of the process, which is fraught with potential pitfalls. Common problems faced by new competition agencies, especially in developing or transitional countries, include: a lack of clear objectives; resistance from vested commercial or administrative interests; a paucity of resources devoted to the task; little implementation capacity in terms of qualified or experienced personnel; and problems associated with how to focus implementation efforts.

States newly adopting competition laws are either developing countries, with basically market-orientated economies; or they are more developed ex-communist

countries. China is unique, in that it is both a developing world economy, and it is in transition from orthodox socialism to some other economic model.

Whether this model is a traditional capitalist one is, however, by no means certain. For the moment, it appears that China is attempting to copy the state-led models of Japan and South Korea, which suppress competition.

By contrast, most of the former Eastern European nations were relatively economically developed, and underwent an ideological conversion from socialism at the same time as adopting a market-orientated economy. The adoption of comprehensive competition laws was a feature of their economic transformation in readiness, ultimately, for membership of the EU.

International experience shows that successful adoption requires, in the first instance, an ideological commitment to a market-orientated economy. It is questionable whether China has made this ideological jump, the substantial presence of the private sector in the Chinese economy notwithstanding. China's rulers have traditionally emphasized the imperative for strong central political and economic control, so as to prevent the breakup of China into economic or political sub-units. Despite this important factor, in the 1980s, Deng Xiaoping made a bargain with regional cadres, with the implication that they could exercise a certain level of decentralized economic power, in return for political loyalty to the centre. This policy has undoubtedly allowed local initiatives to foster strong local economic growth in the southern and eastern regions. Experimentation in reform policies has also helped establish a strong domestic private sector in these provinces; but it has also led to problems. Allegations of high-level corruption have been common. In the 1990s, in Guangdong, the provincial body responsible for investment fundraising ran up large debts to foreign creditors, and became organizationally insolvent.

This policy may also have reinforced regional barriers to trade, a significant part of the wider 'administrative monopoly' problem. Thus, on the one hand there has been *de facto* economic

decentralization in some sectors; but in others, re-centralization, to create 'national champions'. Given these circumstances, the real motivation of the Chinese authorities to adopt a competition law, and their effectiveness, must be questionable.

Ideology and economic reform

Even if we were to assume that the current government has undergone conversion to a belief in markets, it still faces formidable obstacles in achieving a workable pro-competition system.

The design of an overall competition policy is predicated on an ideological underpinning, provided by the theory of market economics. For a domestic market to evolve, a vital factor is acceptance that government procurement policies, privatization and the deconstruction of state-owned monopolies are needed. The acceptance of a liberal trade policy that facilitates competition of imports with domestic production is another essential pillar of a pro-competitive strategy. Whilst China has joined the WTO and accepted substantial foreign participation in its domestic markets, it still sets clear limits on granting permission for foreign participation, and for the privatization of numerous state-owned firms. For example, the majority of firms listed on the domestic stock exchange remain tightly controlled by the state, which usually retains 70 per cent ownership of shareholder voting capital; though recent reforms have begun to allow the trading of state-owned shares.

This may preempt the next stage of reform, and the state being prepared to cede control of further industries to the private sector. However, it will still retain dominance in a number of industries, deemed necessary to support the 'national champion policy'. In December 2006, the State Council specified that seven industries were to remain under 'absolute' state control; namely: armaments, electricity, oil, telecommunications, coal, civil aviation and shipping. A second tier of industries, which would remain under 'relatively strong' state control include: manufacturing, automobiles, electronics, architecture, steel, metallurgy, chemicals, surveillance, science and

technology. The goal was to 'cultivate 30 to 50 enterprise groups with a strong competitive edge in the global market place'.

Another requirement for the successful adoption of a coherently drafted competition law is that it is sensitive to local idiosyncrasies. Wholesale adoption of a foreign model, without appropriate adaptation, is likely to yield sub-optimal results. Countries that have adopted European or US models, without consideration of the particular competition issues that gave rise to their systems, have found that they face problems that the adopted models may not be adequate to address. For example, in small jurisdictions, there are few problems in creating a single market. This was the case with the original six member states of the European Economic Community (EEC), which required specific measures in competition law to help achieve a single European market.

Competition and enforcement

Once the law is drafted, an even more difficult challenge is the establishment of an appropriate enforcement agency, and of that agency's ability to impartially administer the law. In the Chinese system, the concept of an independent authority is alien. Government is seen as a seamless whole. The executive, legislature and the judiciary are merely branches of a unitary machine. China does not accept the Western notion of the separation of powers. Therefore, an 'independent' enforcement agency is impossible to imagine in the prevailing political conditions in China. Various government departments, as well as the Communist Party itself, would be drawn to interfere in the investigatory and adjudicatory functions of any such competition agency, likely leading to sub-optimal decisions that would have little to do with promoting competition in the market.

If then, in the Chinese system, the authority cannot be independent, a ministerial authority is essential to ensure that other government departments pay adequate attention to it. Current proposals do not allow for a single regulator, but rather for a division of authority between at least two administrative organs. This arrangement virtually guarantees that the new authority will be ineffective.

Capacity for implementation

Even if these institutional arrangements are not as important as has been found to be the case in other jurisdictions, further difficulties must be overcome. The implementation of a competition law is a complex and technical undertaking. The availability of accurate statistical information about market size and market share is one such challenge. Accurate official statistics are important, as is the ability of independent market research to verify official data. Neither of these requirements can be met in China. Official statistics are generally thought to be unreliable, though there is some indication that the situation might be improving. Accurate independent market assessment is in its infancy.

Even with valid data, a competition authority needs highly trained and skillful personnel, both in law and economics. Most multinational corporations have found that about only one in ten domestic graduates are suitable for employment with them. Given the low official salary levels prevalent in the public sector, it is unlikely that sufficient numbers of competent personnel can be recruited to staff a competition agency.

In addition to staff, the new authority will also need an appropriate budget. This might be difficult for mainland authorities to justify or procure. One of the most important functions of a competition agency is to undertake competition advocacy. This involves educating both private and business consumers as to their rights and obligations under the law, as well as to advocate pro-competitive policies by government in the promulgation of administrative rules, the regulation of 'natural monopolies' and in public sector procurement. This alone will be a Herculean task in China, given the myriad layers of government and their overlapping jurisdictions.

Thus, even if China has good faith about the adoption of a competition policy law, very formidable obstacles will have to be overcome to make it be effective. The evidence shows that many developing countries that adopt a competition law have extreme difficulties in implementing it appropriately; in this respect, China will be no different.

Government commitment and control

In the case of China's adoption, it would be dangerous to assume that government is committed to a wholesale market-economy model. In the last year, it has become increasingly apparent that senior Chinese officials see the adoption of a competition law as part of a strategy to retain or even extend control over the economy. Competition law will form part of an economic policy designed to limit the impact of foreign business on Chinese domestic markets. In September 2006, China re-enacted a set of discriminatory merger control rules that provide for administrative review of foreign-related mergers; but which did not apply to domestic concentrations.

'National champion' policy

In December 2006, a new 'national champion' policy was enunciated. The enunciation of this industrial policy at the same time as the promulgation of a competition law is no coincidence. The adoption of a competition law should be seen as part of this same strategy, rather than as one aimed at creating an effective market.

Conclusion and recommendations

That China needs to improve the efficiency of its domestic enterprises is not in doubt. This is especially so in the case of the semi-privatized industrial behemoths that still dominate much of China's capital-intensive industrial sectors, just as with the telecommunication and financial services sectors. It seems that China has decided to attempt to emulate post-war Japanese and South Korean quasi-mercantilist industrial policies of nurturing national champions and attempting to shield them, to a significant extent, from competition from multinational corporations.

This task will be very difficult for China. The geopolitical environment, which allowed Japan and South Korea to exploit their favoured economic relationship with the US and Europe in return for political loyalty to Western interests in the Cold War era, clearly does not apply to China's situation today. Added to this difficulty is the fact that the WTO now has enforceable international rules on external trade.

It is arguable that any discriminatory use of a competition law to disadvantage foreign produced goods or services, subject to WTO protection, might lead to cases being brought against China under the dispute settlement regimes.

China, it seems, is wedded to the idea of an industrial policy, promoted by the state, that ensures that the commanding heights of the economy are still in the hands of the state, or at least protected against foreign incursions or acquisitions. Therefore, it appears that China is not ideologically committed to markets as a solution to all of its economic development problems.

The adoption of an Anti-Monopoly Law is likely to be ineffective against the misuse of administrative power, or against the anti-competitive conduct of dominant state-owned domestic firms. It seems likely that foreign multinationals that have, or appear to have, a substantial share of a domestic market may well be the primary target of such enforcement activity launched by any new competition agency.

However, if the new law is faithfully implemented by a competent agency, private domestic and foreign-invested firms may be able to avail themselves of its protective effect against the abuse of administrative powers by government or dominant state enterprises. The state might also argue that some protection of 'infant' enterprise groups is a defensible strategy at this stage of China's economic development. Economists will disagree as to whether some protection or rather the harsh discipline of competition is the best way to foster economic strength.

However, China must weigh very carefully the reaction of foreign-invested enterprises and their home governments to a competition law that is not used appropriately. China clearly benefits from current trade policies that give it huge foreign trade surpluses in relation to many developed economies. It also receives very substantial levels of foreign direct investment that have helped create a world class manufacturing power. Misuse of domestic competition laws to attack foreign entrants might

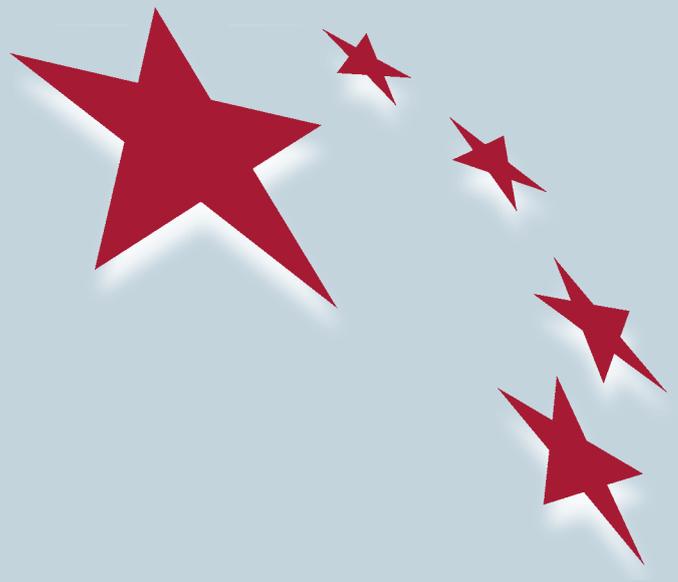
provoke a political backlash from disgruntled developed states. It could also lead to the foreign direct investment bubble being pricked, as alarmed foreign investors reconsider their expansion plans into the Chinese domestic market.

If the analysis provided here is correct, China might be best served by not enacting an Anti-Monopoly Law until such a time as it has decided to wholeheartedly accept a market-based economic system with a limited economic role for the state; and has the ability to administer and enforce its domestic laws appropriately. Adopting and enforcing a new competition law in current circumstances might well lead to less competition in some markets, delay the disposal of state-owned enterprises, entrench existing economic structures, reinforce barriers to entry, and provoke unwanted and damaging political and economic reactions from trading partners.

In the current situation, if the government accepts that a more competitive regime is the best solution to inefficiency in the state sector, an appropriate and

well administered sector-specific regulatory regime for 'natural monopolies' might be a better solution. Administrative monopoly is primarily a question of the rule of law, which, fundamentally, requires a political solution. When the private sector has developed to the extent that real competition problems are encountered, for example substantial consolidations or the achievement of significant market shares, or where privately sponsored cartels are demonstrably causing harm, a properly tailored law, with the prerequisites of an appropriate enforcement structure, might be considered. This scenario is still some way off in most sectors of the economy.

Contemporary China needs to consider very carefully the probable consequences of the adoption of its proposed Anti-Monopoly Law in the current economic, political and legal conditions, where botched adoption and discriminatory enforcement might provoke unintended and harmful consequences.



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Rule of Law in China: Chinese Law and Business

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Mark Williams has a good knowledge of competition law in the EU and has striven to publicize and further the developing competition law and policy in both China and Hong Kong. He has promoted competition law and policy in Hong Kong by organizing academic events, publications and also by acting as an honorary legal adviser to members of the Legislative Council and assisting in the drafting of an outline competition ordinance. He has taught competition law at Fudan University, Shanghai; Nanjing University; and East China University of Politics and Law, Shanghai; and presently is teaching at the Hong Kong Polytech University.

For further information please visit
our website at www.fljs.org
or contact us at:

The Foundation for **Law, Justice and Society**

Wolfson College
Linton Road
Oxford OX2 6UD
T · +44 (0)1865 284433
F · +44 (0)1865 284434
E · info@fljs.org
W · www.fljs.org