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# Transplanting Antitrust in China: Economic Transition, Market Structure, and State Control

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# TRANSPLANTING ANTITRUST IN CHINA: ECONOMIC TRANSITION, MARKET STRUCTURE, AND STATE CONTROL

WENTONG ZHENG\*

## ABSTRACT

This Article examines the compatibility of Western antitrust models as incorporated in China's first comprehensive antitrust law—the Antimonopoly Law (“AML”)—with China's local conditions. It identifies three forces that shape competition law and policy in China: China's current transitional stage, China's market structures, and pervasive state control in China's economy. This Article discusses how these forces have limited the applicability of Western antitrust models to China in three major areas of antitrust: cartels, abuse of dominant market position, and merger review. Specifically, it details how these forces have prevented China from pursuing a rigorous anti-cartel policy, how they have led to a mismatch between monopoly abuses that are prohibited under the AML and monopoly abuses that are most prevalent in China's economy, and how they have prevented the merger review process under the AML from being meaningfully applied to domestic firms. This Article demonstrates that despite having a Western-style antitrust law, China has not developed and likely will not develop a Western-style antitrust jurisprudence in the near future due to these local conditions. Finally, the Article explains how China developed a consensus on the need for a

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formal antitrust law despite local conditions that were not entirely compatible with such a law.

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## 1. INTRODUCTION

Legal transplants, or “the moving of a rule or system of law from one country to another, or from one people to another,”<sup>1</sup> are commonly observed around the world. Examples of legal transplants can be found on many different levels, from the borrowing of an entire legal system<sup>2</sup> to the borrowing of an entire area of law<sup>3</sup> and to the borrowing of individual legal concepts or practices.<sup>4</sup> Indeed, it has been argued that “at most times, in most

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<sup>1</sup> ALAN WATSON, *LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW* 21 (1974).

<sup>2</sup> See ALAN WATSON, *THE EVOLUTION OF WESTERN PRIVATE LAW* 193 (Expanded ed. 2001) (“From the eleventh century to the eighteenth and even beyond, the main feature of legal change in western continental Europe was the Reception of Roman law.”). Similarly, much of American law was originally borrowed from England. See Alan Watson, *The Importance of “Nutshells,”* 42 AM. J. COMP. L. 1, 14–15 (1994) (arguing that a prominent English law treatise was immensely influential to the development of American common law which was founded largely in English common law).

<sup>3</sup> For an example of the borrowing of an entire area of law, see Hideki Kanda & Curtis J. Milhaupt, *Reexamining Legal Transplants: The Director’s Fiduciary Duty in Japanese Corporate Law*, in *LAW IN JAPAN: A TURNING POINT* 437, 437 (Daniel H. Foote ed., 2007) (discussing the importation by Japan of its original Commercial Code from Germany in 1898 as an element of a fundamental overhaul of its legal systems).

<sup>4</sup> See, e.g., Francesca E. Bignami, *The Democratic Deficit in European Community Rulemaking: A Call for Notice and Comment in Comitology*, 40 HARV. INT’L L.J. 451 (1999) (arguing for EU adoption of American concepts of notice and comment rulemaking); John D. Jackson, *Playing the Culture Card in Resisting Cross-jurisdictional Transplants: A Comment on “Legal Processes and National Culture,”* 5 CARDOZO J. INT’L & COMP. L. 51 (1997) (arguing that the influence of cultural distinctions may not hinder transplantation of law as greatly as some scholars might suspect); Ugo Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economics*, 14 INT’L REV. L. & ECON. 3 (1994) (examining the role of economic efficiency in transnational borrowing of property law doctrines); Julie Mertus & Elizabeth Breier-Sharlow, *Power, Legal Transplants and Harmonization*, 81 U. DET. MERCY L. REV. 477 (2004) (discussing adoption and transplantation of U.S. law concepts and doctrines by NAFTA); James A. F. Nafziger, *International and Foreign Law Right Here in River City*, 34 WILLAMETTE L. REV. 4, 11–12 (1998) (discussing Karl Llewellyn’s borrowing of German doctrines into U.S. contract law); Joel M. Ngugi, *Promissory Estoppel: The Life History of an Ideal Legal Transplant*, 41 U. RICH. L. REV. 425 (2007) (discussing the American concept of promissory estoppel as a transplant from the general English concept of estoppel); Martin Shapiro, *The Giving Reasons Requirements*, 1992 U. CHI. LEGAL F. 179 (1992) (discussing European borrowing of American approaches to administrative law and judicial review); Martin Shapiro, *The Globalization of Law*, 1 IND. J. GLOBAL LEGAL STUD. 37 (1993) (discussing transnational borrowing of administrative law concepts); Jack B. Weinstein & Jonathan B. Wiener, *Of Sailing Ships and Seeking Facts: Brief Reflections on Magistrates and the Federal Rules of Civil Procedure*, 62 ST.

places, borrowing from a different jurisdiction has been the principal way in which law has developed.”<sup>5</sup>

Among all areas of law, antitrust law is arguably “one of the best examples of legal transplants and convergence.”<sup>6</sup> Having its origin in the United States as a response to industrial concentration and social changes during the mid- to late-nineteenth century,<sup>7</sup> antitrust law has now been adopted in more than one hundred jurisdictions.<sup>8</sup> The proliferation of antitrust law has been particularly notable since the early 1980s, when a number of developing countries and former communist countries adopted an antitrust regime.<sup>9</sup>

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JOHN'S L. REV. 429 (1988) (discussing American borrowing of the British approach to court-appointed masters and magistrates).

<sup>5</sup> ALAN WATSON, *SOCIETY AND LEGAL CHANGE* 98 (2d ed. 2001).

<sup>6</sup> JOHN O. HALEY, *ANTITRUST IN GERMANY AND JAPAN: THE FIRST FIFTY YEARS, 1947-1998*, at 172 (2001).

<sup>7</sup> For discussions of the industrial and social conditions that led to the “genesis” of antitrust law in the United States, see Lawrence A. Sullivan & Wolfgang Fikentscher, *On the Growth of the Antitrust Idea*, 16 BERKELEY J. INT'L L. 197, 199-208 (1998).

<sup>8</sup> As of 2004, 102 countries had an antitrust law. Keith N. Hylton & Fei Deng, *Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects*, 74 ANTITRUST L.J. 271, 326-31 tbl.A4 (2007).

<sup>9</sup> See generally JOHN FINGLETON ET AL., *COMPETITION POLICY AND THE TRANSFORMATION OF CENTRAL EUROPE* (1996) (discussing the progress of competition law and policy in four central European countries); Carolyn Brzezinski, *Competition and Antitrust Law in Central Europe: Poland, the Czech Republic, Slovakia, and Hungary*, 15 MICH. J. INT'L L. 1129 (1994) (discussing the role of competition law in post-socialist economic reform in Poland, the Czech Republic, Slovakia, and Hungary); Malcolm B. Coate et al., *Antitrust in Latin America: Regulating Government and Business*, 24 U. MIAMI INTER-AM. L. REV. 37 (1992) (discussing antitrust law in Latin American countries and arguing for the adoption of a hybrid antitrust policy that focuses on monopoly); Sergio Garcia-Rodriguez, *Mexico's New Institutional Framework for Antitrust Enforcement*, 44 DEPAUL L. REV. 1149 (1995) (discussing Mexico's enactment of the Federal Law of Economic Competition, which serves as Mexico's antitrust law); Trudi Hartzenberg, *Competition Policy and Practice in South Africa: Promoting Competition for Development*, 26 NW. J. INT'L L. & BUS. 667 (2006) (discussing the adoption and enforcement of the 1998 Competition Act in South Africa); Youngjin Jung & Seung Wha Chang, *Korea's Competition Law and Policies in Perspective*, 26 NW. J. INT'L L. & BUS. 687 (2006) (discussing Korean competition law and its interaction with economic policies); William E. Kovacic, *Competition Policy, Economic Development, and the Transition to Free Markets in the Third World: The Case of Zimbabwe*, 61 ANTITRUST L.J. 253 (1992) (discussing Zimbabwe's consideration of a new antitrust regime); William E. Kovacic, *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine, and Zimbabwe*, 44 DEPAUL L. REV. 1197 (1995) (discussing efforts to draft or reform competition law in Mongolia, Nepal, Ukraine, and Zimbabwe); William E.

The latest major country to join the expanding antitrust club is China, whose first comprehensive antitrust law, the Antimonopoly Law (“AML”), was adopted on August 30, 2007 and went into effect on August 1, 2008.<sup>10</sup> To a large extent, the AML bears the hallmarks of a legal transplant. Like antitrust laws in most jurisdictions, the AML contains provisions dealing with restraints or potential restraints on competition in areas that are often referred to as the “three pillars” of antitrust: agreements in restraint of trade,<sup>11</sup> abuse of dominant market position,<sup>12</sup> and

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Kovacic, *The Competition Policy Entrepreneur and Law Reform in Formerly Communist and Socialist Countries*, 11 AM. U. J. INT’L L. & POL’Y 437 (1996) (discussing difficulties encountered in the creation and execution of competition policy systems in formerly communist and socialist countries and suggesting ways of overcoming these obstacles); Deunden Nikomborirak, *The Political Economy of Competition Law: The Case of Thailand*, 26 NW. J. INT’L L. & BUS. 597 (2006) (discussing problems with the implementation of competition law in Thailand); Gesner Oliveira & Thomas Fujiwara, *Competition Policy in Developing Economies: The Case of Brazil*, 26 NW. J. INT’L L. & BUS. 619 (2006) (discussing how Brazil has overcome challenges typically encountered when trying to implement competition policy in a developing economy); Alice Pham, *The Development of Competition Law in Vietnam in the Face of Economic Reforms and Global Integration*, 26 NW. J. INT’L L. & BUS. 547 (2006) (discussing competition law in Vietnam in the context of economic reform and globalization).

<sup>10</sup> Fanlongduan Fa [Antimonopoly Law] ch. 1, art. 1 (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 30, 2007, effective Aug. 1, 2008) 2007 STANDING COMM. NAT’L PEOPLE’S CONG. GAZ. 517 (China), available at [http://www.gov.cn/flfg/2007-08/30/content\\_732591.htm](http://www.gov.cn/flfg/2007-08/30/content_732591.htm) [hereinafter AML]. For general discussions of the AML and its major provisions, see Xiaoye Wang, *Highlights of China’s New Anti-Monopoly Law*, 75 ANTITRUST L.J. 133 (2008) and Zhenguo Wu, *Perspectives on the Chinese Anti-Monopoly Law*, 75 ANTITRUST L.J. 73 (2008).

<sup>11</sup> The term used by the AML for agreements in restraint of trade is “monopoly agreements” (*longduan xieyi*). In Chapter 2, the AML prohibits two types of monopoly agreements. Article 13 of the AML prohibits agreements among undertakings that are in a competitive relationship with one another, i.e., “horizontal agreements.” AML, *supra* note 10, art. 13. Article 14 of the AML prohibits agreements among undertakings that are at different stages in the production or sales process, i.e., “vertical agreements.” *Id.* art. 14; see also Wang, *supra* note 10, at 136 (stating that, like its German counterpart, the AML separates horizontal and vertical agreements); Wu, *supra* note 10, at 80–81 (discussing the separate treatment of horizontal and vertical agreements in Articles 13 and 14, respectively, of the AML).

<sup>12</sup> In Chapter 3, the AML prohibits certain practices that are considered abuses of dominant market position, including excessive pricing, predatory pricing, refusal to deal, exclusive dealing, tying, and price discrimination. AML, *supra* note 10, ch. 3; see *infra* note 227 and accompanying text; see also Wang, *supra* note 10, at 137–38 (analyzing Articles 17 to 19 of the AML); Wu, *supra* note 10, at 85 (discussing specific practices of dominant market position contained in the AML).

mergers.<sup>13</sup> Specifically, the AML's provisions on agreements in restraint of trade and abuse of dominant market position borrow heavily from Articles 101 and 102 of the Treaty on the Functioning of the European Union,<sup>14</sup> and the AML's provisions on mergers "appear to be drawn from the European Union Merger Regulation."<sup>15</sup> Some specific provisions of the AML show influences of U.S. and Japanese antitrust laws as well.<sup>16</sup> To be sure, the AML contains provisions addressing issues or considerations peculiar to China,<sup>17</sup> the chief ones being the provisions prohibiting "administrative monopolies," or anticompetitive conduct by government agencies.<sup>18</sup> But given the prominence and salience of the provisions that are borrowed from Western antitrust laws, the AML can be said to be largely a legal transplant shaped in the mold of Western antitrust laws.

But do legal transplants work? This question has been thoroughly debated by generations of scholars, with some taking

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<sup>13</sup> In Chapter 4, the AML provides for a merger notification and review regime. AML, *supra* note 10, ch. 4; *see also* Wang, *supra* note 10, at 139-42 (detailing the AML's treatment of mergers and acquisitions in Articles 20 to 31 of the AML); Wu, *supra* note 10, at 87-88 (stating that the AML has provided for a notification system of "operator concentration").

<sup>14</sup> *See* Susan Beth Farmer, *The Evolution of Chinese Merger Notification Guidelines: A Work in Progress Integrating Global Consensus and Domestic Imperatives*, 18 TUL. J. INT'L & COMP. L. 1, 6 (2009) (noting that the AML's provisions on restraints in trade "borrow heavily from articles 81 and 82 of the Treaty Establishing the European Community").

<sup>15</sup> *Id.* at 9 n.43.

<sup>16</sup> For example, Article 46 of the AML provides that business operators committing a violation may receive a lesser punishment or be exempt from punishment altogether if they voluntarily report the violation to the antimonopoly enforcement agency. *See* Salil K. Mehra & Meng Yanbei, *Against Antitrust Functionalism: Reconsidering China's Antimonopoly Law*, 49 VA. J. INT'L L. 379, 398 n.81 (2009) (noting that this provision draws on the "leniency" policy in the United States). In another example, Article 15(5) exempts agreements reached for solving severe sales declines and excess capacities during economic recessions from the AML's prohibition of agreements in restraint of trade. AML, *supra* note 10, art. 15(5). This approval of "recession cartels" appears to be borrowed from Section 24-3 (now repealed) of the Antimonopoly Law of Japan. *See infra* note 122 and accompanying text.

<sup>17</sup> For detailed discussions of these provisions, *see* Peter J. Wang et al., *New Chinese Anti-Monopoly Law*, JONES DAY (Oct. 2007), <http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=4662>.

<sup>18</sup> AML, *supra* note 10, arts. 32-37. For general discussions of administrative monopolies or government restraints in China, *see* Eleanor M. Fox, *An Anti-Monopoly Law for China – Scaling the Walls of Government Restraints*, 75 ANTITRUST L.J. 173 (2008).

an extremely optimistic view that legal transplants are socially easy because “legal rules are not peculiarly devised for the particular society in which they now operate,”<sup>19</sup> and some taking an extremely pessimistic view that legal transplants are simply “impossible.”<sup>20</sup> When it comes to the transplant of antitrust law, there appear to be different opinions as to its feasibility as well. On one hand, sovereign governments, primarily those of the United States and the European Union, have advocated or even required the adoption of their preferred model of antitrust (which usually means their own) in other economies,<sup>21</sup> and international organizations such as the Organization for Economic Co-Operation and Development (“OECD”) and the International Competition Network (“ICN”) have engaged in efforts to “harmonize” antitrust law across jurisdictions.<sup>22</sup> The implicit assumption in both sets of

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<sup>19</sup> WATSON, *supra* note 1, at 96.

<sup>20</sup> See Pierre Legrand, *The Impossibility of ‘Legal Transplants’*, 4 MAASTRICHT J. EUR. & COMP. L. 111, 113-14 (1997) (disagreeing with Watson’s formalist view of law in regard to legal transplants and thus concluding that because rules are what they are in that they cannot travel, “legal transplants are impossible”).

<sup>21</sup> For example, during the early 1990s, the United States and the European Union were engaged in heated competition to sell their respective version of antitrust law to central and eastern European countries that were moving away from command economies. See Eleanor M. Fox, *The Central European Nations and the EU Waiting Room – Why Must the Central European Nations Adopt the Competition Law of the European Union?*, 23 BROOK. J. INT’L L. 351, 351 (1997) (explaining that when central European countries switched over to democratic systems, “many Americans urged the post-communist nations to adopt U.S. style antitrust rules, while Europeans suggested that the competition law of the European Community (EC) was a better fit.”); Spencer Weber Waller, *Neo-Realism and the International Harmonization of Law: Lessons from Antitrust*, 42 U. KANSAS L. REV. 557, 569-70 (1994) (discussing the initiative of the U.S. government to get post-communist European countries to adopt antitrust laws similar to American ones in opposition to the European Union’s approach). In 1990, as part of an agreement between the United States and Japan aimed at removing structural barriers in the Japanese market, the United States required Japan to move the enforcement of its antimonopoly law in the direction of U.S. antitrust law. *Id.* at 571-72. During the early 1990s, when a number of Latin American countries were revising or considering revising their antitrust policies, economists from the U.S. Federal Trade Commission nominally advocated a hybrid of U.S. and EU approaches for those countries, but urged adoption of a strict law-and-economic version of recent U.S. antitrust policy as the preferred solution for each antitrust issue analyzed. *Id.* at 570 n.76 (citing Malcolm B. Coate et al., *Antitrust in Latin America: Regulating Government and Business*, 24 U. MIAMI INTER-AM. L. REV. 37 (1992)).

<sup>22</sup> Since the late 1990s, OECD has been particularly active in pushing for harmonized antitrust practices among its member countries. AMERICAN BAR ASSOCIATION, ABA SECTION OF ANTITRUST LAW: COMPETITION LAWS OUTSIDE THE UNITED STATES, FIRST SUPPLEMENT 38 (2005). In 1998, OECD issued a recommendation on hard-core cartels. *Id.* In 2001, OECD issued a report



efforts, it seems, is that a particular antitrust rule would function equally well, or at least in an acceptable manner, in different settings. On the other hand, there are frequent views heeding the limitations of conventional antitrust law in particular settings<sup>23</sup> and the need for antitrust to adapt to local circumstances.<sup>24</sup>

The efforts to create a formal antitrust law in the mold of Western antitrust models in China face particular challenges. As Professor John Haley succinctly summarized back in 2004, the antitrust models that originated in the United States and Europe “were designed to deal with problems in advanced capitalist states in which the influence of private actors in national and international markets often seemed to outmatch the role of the state.”<sup>25</sup> None of these models, Professor Haley continued, “were concerned with state power or the need of the state to create conditions for effective market competition.”<sup>26</sup> Because they “do not adequately address the basic underpinnings of monopoly power and barriers to free and competitive markets in East Asia or in most other developing states,”<sup>27</sup> Professor Haley predicted that questions might be raised “whether these models have any applicability to China and other parts of East Asia.”<sup>28</sup>

Has Professor Haley been proven correct? With the benefit of knowing what transpired in the first two years of the AML, this Article sets out to answer this question by examining the compatibility of Western antitrust models as incorporated in the AML with China’s local conditions. In particular, it discusses three forces that shape competition law and policy in China: China’s

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proposing a framework for harmonized merger control procedures. *Id.* Launched in October 2001, the ICN aims to “develop guiding principles and best practice recommendations that . . . could be implemented voluntarily by member agencies.” *Id.* at 40. In 2002, the ICN adopted eight recommended principles for merger notification and review. *See id.* at 41 (listing the Guiding Principles for Merger Notification and Review).

<sup>23</sup> *See, e.g.*, MICHAL S. GAL, COMPETITION POLICY FOR SMALL MARKET ECONOMIES (2003) (arguing that optimal antitrust policy depends on the size of an economy); John O. Haley, *Competition Policy for East Asia*, 3 WASH. U. GLOBAL STUD. L. REV. 277 (2004) (arguing that American and European competition law models may not be applicable to China and East Asia).

<sup>24</sup> *See generally* Waller, *supra* note 21 (discussing the transferability of national law).

<sup>25</sup> Haley, *supra* note 23, at 277.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

current transitional stage, China's market structures, and pervasive state control in China's economy. Furthermore, it explains how these forces, all brought about by the extensive role of the state, have limited the applicability of Western antitrust models to China in three major areas of antitrust: cartels, abuse of dominant market position, and merger review. Specifically, this Article analyzes how these forces have prevented China from pursuing a rigorous anti-cartel policy, how they have led to a mismatch between monopoly abuses that are prohibited under the AML and monopoly abuses that are most prevalent in China's economy, and how they have prevented the merger review process under the AML from being meaningfully applied to domestic firms. It concludes that despite having a Western-style antitrust law, China has not developed and likely will not develop a Western-style antitrust jurisprudence in the near future due to these local conditions. Finally, it discusses how China developed a consensus on the need for a formal antitrust law despite local conditions that were not entirely compatible with such a law.

This Article makes three contributions to the antitrust and legal transplants literature. First, this Article studies China's competition law and policy by going beyond the text of the AML and focusing instead on the broader contexts in which the AML operates. This contextual approach illuminates China's competition law and policy, particularly its ambiguities and inconsistencies, in a way that is impossible under a purely textual approach. Second, this Article analyzes the assumptions and presuppositions of Western antitrust models, and discusses the conceptual challenges Western antitrust models encounter in settings in which those assumptions and presuppositions fail to hold. These inquiries are of far-reaching significance in an era where unprecedented government intervention in the world markets in the wake of the 2008-2009 global financial crisis is threatening to alter the economic models in which antitrust law has traditionally operated. Third, this Article tells a cautionary tale for legal transplants in general and transplants of antitrust law in particular, a tale that need be kept in mind in future transplant efforts.

## 2. SETTING THE STAGE: ECONOMIC TRANSITION, MARKET STRUCTURE, AND STATE CONTROL IN CHINA

Few would doubt that China did not need an antitrust law under Mao. And few would doubt that China today is much different from the one under Mao. But how did China get from where it was under Mao to where it is today? Understanding China's path of transition towards a market economy is of utmost importance to understanding the economic conditions under which China's antitrust regime is being established. The following discussions provide overviews of certain key aspects of China's transition that have shaped its current economic conditions pertaining to antitrust.

### 2.1. Price Liberalization

The chief mechanism through which a market economy allocates resources is price. In a command economy, however, price is determined by administrative fiat, not by the interaction of market supply and demand. Prior to the launching of economic reforms in 1978, China's economy was a typical command one. "In 1978, [ninety-seven] percent of domestic retail goods and [ninety-three] percent of farm produce was subject to fixed prices."<sup>29</sup> In many cases, prices were set in accordance with the government's artificial preferences for certain sectors or population groups, resulting in serious distortions in the economy.<sup>30</sup>

Beginning in the early 1980s, China gradually moved away from price controls in efforts to expand the role of markets in determining prices. Initially, price reforms took the form of administratively readjusting the relative prices of key sectors and product groups to address structural distortions.<sup>31</sup> Then the

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<sup>29</sup> WORLD BANK, CHINA: INTERNAL MARKET DEVELOPMENT AND REGULATION 20 (1994) [hereinafter INTERNAL MARKET].

<sup>30</sup> For example, prior to 1978, prices of agricultural products, raw materials, and light-industry products were set artificially low in order to support the development of heavy industry. JEAN-JACQUES LAFFONT & CLAUDIA SENIK-LEYGONIE, PRICE CONTROLS AND THE ECONOMICS OF INSTITUTIONS IN CHINA 18 (1997). Another example of price distortions in the command economy era is that the producer prices of many goods were higher than their retail prices. *Id.* This was intended to protect the profitability of the producers, while preserving the ability of the population to purchase basic consumer goods. *Id.*

<sup>31</sup> Between 1979 and 1984, the prices of the main agricultural products were adjusted upwards six times, resulting in a twenty percent price increase for products under compulsory delivery quotas and a fifty percent price increase for

government began gradually introducing market forces into the price formation process, starting with the introduction into many sectors of the so-called “dual pricing system,” under which firms were allowed to sell their production volumes in excess of government-set targets at market prices.<sup>32</sup> First introduced in the petroleum sector in 1981, the dual pricing system had been extended to all sectors of the economy by the end of 1985.<sup>33</sup> Progressive price decontrols in the subsequent years gradually reduced the gaps between state-controlled and market prices. For example, in 1985, the market prices of consumer goods as a whole were twenty-eight percent higher than state-controlled prices;<sup>34</sup> by 1991, this differential declined to only five percent.<sup>35</sup>

The convergence of state-controlled and market prices laid the foundation for a greater degree of price liberalization. The watershed year for China’s price reforms came in 1992, when the government completely abolished price controls for the vast majority of products in certain key sectors such as raw materials, transportation, agricultural, food, and light industry goods.<sup>36</sup> In 1993 and 1994, price liberalization was also accomplished for steel, the majority of machinery products, onshore crude oil, and coal.<sup>37</sup>

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products under voluntary deliveries. *Id.* Raw materials such as coal, iron and steel also increased significantly in price. *Id.* at 18-19.

<sup>32</sup> Note that selling products outside of the government’s plan, though illegal, was already taking place in the planned economy era. In 1975, “for consumer goods as a whole, free market prices were [eighty] percent above state prices.” INTERNAL MARKET, *supra* note 29, at 22.

<sup>33</sup> Laffont & Senik-Leygonie note:

[t]he 1984-88 period was marked by major liberalisation and saw the appearance of a dual pricing system. The latter was introduced in 1981, when the oil companies were authorized to sell their surplus production, after fulfillment of the plan quotas, at market prices. . . . By the end of 1985, the dual pricing system had been extended to all sectors of the economy.

LAFFONT & SENIK-LEYGONIE, *supra* note 30, at 19.

<sup>34</sup> INTERNAL MARKET, *supra* note 29, at 22.

<sup>35</sup> *Id.*

<sup>36</sup> Among 737 raw materials and transportation prices that were controlled by the central government at the end of 1991, 648 were fully liberalized in 1992. The year of 1992 also saw liberalization of fifty out of sixty agricultural prices and of all consumer goods prices except those of salt and certain medicines. By the end of 1992, food prices in 844 counties and cities were also liberalized. See Yang Jisheng, *Jiage Gaige: Jingji Gaige Zhong de Yibu Xianqi* [Price Reform: A Risky Move in Economic Reforms], YANHUANG CHUNQIU [YANHUANG HIST. REV.], Mar. 2009, at 18, 22.

<sup>37</sup> *Id.*

Official statistics indicates that by the end of 2005, the percentage of market-determined prices in China had reached well over ninety percent.<sup>38</sup>

Despite the overall success of price reforms, price controls still play a significant role in certain sectors in China. The Price Law enacted in 1997 explicitly allows the government to control prices in certain important sectors, including natural resources, sectors characterized by natural monopolies, and public utilities.<sup>39</sup> In those sectors the government could either directly set prices,<sup>40</sup> or set "guidance prices" that limit the fluctuation of market prices within a specified band.<sup>41</sup> In 2001, thirteen items appeared on the catalog of products or services whose prices were controlled by the central government.<sup>42</sup> While the number of controlled prices seems small, the significance of price control in China nowadays is definitely greater than that number would suggest, given that many of the controlled prices are for important products or services such as electricity, basic telecommunications, and gasoline.

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<sup>38</sup> The percentage of market-determined prices was 95.6% as measured by consumption goods retail sales amounts, 91.9% as measured by raw materials sales amounts, and 97.7% as measured by agricultural procurement amounts. *Woguo Jiage Shichanghua Chengdu Tigao [Percentage of Market-Determined Prices Increases in China]*, ZHONGGUO ZHENGQUAN BAO [CHINA SECURITIES DAILY], Nov. 18, 2006, available at [http://news.xinhuanet.com/fortune/2006-11/18/content\\_5345664.htm](http://news.xinhuanet.com/fortune/2006-11/18/content_5345664.htm).

<sup>39</sup> See *Jiage Fa [Price Law]* art. 18 (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1997, effective May 1, 1999), available at [http://www.gov.cn/banshi/2005-09/12/content\\_69757.htm](http://www.gov.cn/banshi/2005-09/12/content_69757.htm) [hereinafter *Price Law*] (setting forth the Chinese government's ability to set prices).

<sup>40</sup> See *id.* art. 3, cl. 5 ("Government-set prices refer to prices set by the government's price regulators or other regulatory agencies within the scope of their pricing power, as permitted by this law.").

<sup>41</sup> See *id.* art. 3, cl. 4 ("Government-guidance prices refer to benchmark prices as well as fluctuation bands set by the government's price regulators or other regulatory agencies for purposes of guiding market prices, as permitted by this law.").

<sup>42</sup> The thirteen items were: strategic food and oil reserves, tobacco, salt, explosives for civilian uses, some fertilizers, some important medicines, textbooks, natural gas, water supplied by central government or inter-provincial water projects, electricity, military products, important transportation services, postal services, basic telecommunication services, and important professional services. *Guojia Jiwei he Guowuyuan Youguan Bumen Dingjia Mulu [Catalog of Prices Controlled by the National Development & Planning Commission and Other Central Government Agencies]*, Jul. 4, 2001, available at [http://www.sjzwj.gov.cn/art/2004/09/28/art\\_14038\\_103873.html](http://www.sjzwj.gov.cn/art/2004/09/28/art_14038_103873.html).

## 2.2. Decentralization

Upon the founding of the People's Republic of China in 1949, China adopted the economic model of the former Soviet Union, characterized by state ownership, central planning, and a development strategy heavily focused on industrialization.<sup>43</sup> But unlike the former Soviet Union, where much of the production and distribution was directly controlled by the central government, China structured its industries in a much more decentralized fashion.<sup>44</sup> Consequently, each region in China is relatively self-sufficient and regional governments assume considerable responsibility for coordinating production and distribution within the region, giving rise to what economists call a multilayer, multiregional form (or "M-form") of industrial structure.<sup>45</sup> As a result of China's decentralized industrial structure, by the time China launched economic reforms in the late 1970s, the extent of

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<sup>43</sup> See Dwight H. Perkins, *China's Economic Policy and Performance*, in 15 THE CAMBRIDGE HISTORY OF CHINA: THE PEOPLE'S REPUBLIC, PART 2: REVOLUTIONS WITHIN THE CHINESE REVOLUTION, 1966-1982, at 475 (Roderick MacFarquhar & John K. Fairbank eds., 1991) (discussing the development of China's economic policies).

<sup>44</sup> See YINGYI QIAN & BARRY R. WEINGAST, CHINA'S TRANSITION TO MARKETS: MARKET-PRESERVING FEDERALISM, CHINESE STYLE 10-21 (1995) (explaining the historical process of decentralization in China and the current marketization as a result of decentralization); see also Yingyi Qian & Chenggang Xu, *Why China's Economic Reforms Differ: The M-Form Hierarchy and Entry/Expansion of the Non-State Sector*, 1 ECON. TRANSITION 135, 142-43 (1993) (discussing China's M-form hierarchy and its contribution to China's economic successes); Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 21-24 (1995) (analyzing the factors surrounding economic growth in China). See generally Gabriella Montinola et al., *Federalism, Chinese Style: The Political Basis for Economic Success in China*, 48 WORLD POL. 50 (1995) (discussing how China implemented successful economic reforms).

<sup>45</sup> See Qian & Xu, *supra* note 44, at 144-45 (discussing historical political reasons behind the evolution of China's M-form hierarchical structure). The term "M-form" was first used by economists to describe the organization form of multi-divisional firms organized by product, technology, or geography. See generally ALFRED D. CHANDLER, JR., STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE INDUSTRIAL ENTERPRISE (1962) (examining the prevalence of the "multidivisional" structure in the context of companies such as Sears, Roebuck and Company and General Motors Corporation); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 132-54 (1975) (discussing use of the multidivisional structure to achieve optimal divisionalization and examining the "M-form hypothesis").

central planning was much smaller in China than in the former Soviet Union.<sup>46</sup>

Economic reforms since the late 1970s have further strengthened the trend towards decentralization.<sup>47</sup> One of the most far-reaching reform measures introduced during the reform era is the reform of the fiscal relationship between the central and local governments.<sup>48</sup> Prior to 1980, China had a highly centralized fiscal regime despite its decentralized industrial structure.<sup>49</sup> The Ministry of Finance of the central government set annual revenue and expenditure plans at the provincial level in a consolidated budgetary process.<sup>50</sup> Although local governments were responsible for collecting all revenues and were allowed to retain the bulk of revenues collected, they had little discretion over the use of revenues.<sup>51</sup> Starting in 1980, fiscal reforms granted local governments greater shares of revenues generated by local enterprises, and granted more autonomy to local governments in

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<sup>46</sup> The number of products directly under central planning in China in 1979 was "only 791 . . . as compared to more than twelve million in the former Soviet Union in the late 1970s." Qian & Xu, *supra* note 44, at 144 (citations omitted).

<sup>47</sup> See *id.* at 145-47 (discussing how the reform policy of decentralization was effectuated).

<sup>48</sup> China's government hierarchy consists of five levels. Below the central government, there are four levels of local government:

- (1) thirty-one provincial-level governments, including twenty-two provinces, four municipalities with significant independent power directly under the central government, and five autonomous regions;
- (2) over three hundred and thirty-five prefectures and cities at the prefecture level;
- (3) over two thousand, one hundred and forty-two counties, autonomous counties and cities at the county level;
- (4) about forty-eight thousand towns, townships and city districts.

See OECD, CHINA IN THE WORLD ECONOMY: THE DOMESTIC POLICY CHALLENGES 659-60 (Charles A. Pigott ed., 2002). Unless otherwise noted, the phrase "local governments" in this Article refers to all levels of government below the central level.

<sup>49</sup> See Christine P. W. Wong, *Fiscal Reform and Local Industrialization: The Problematic Sequencing of Reform in Post-Mao China*, 18 MOD. CHINA 197, 205 (1992) (stating that the budgetary process was centralized during the Maoist period).

<sup>50</sup> See *id.* (explaining the budget and revenue transfer policies of the Ministry of Finance).

<sup>51</sup> Fiscal reforms during the 1960s and 1970s provided discretionary funds for local use under the category of "extrabudgetary revenues" (*yusuanwai zijin*). But the amount of the discretionary funds was small, amounting to only 2% of collections in rich provinces and no more than five percent in most provinces. *Id.*

setting budgets and deciding on expenditures.<sup>52</sup> The direct outcome of the fiscal reforms was that the local government budgets became highly dependent on the financial health of local enterprises.<sup>53</sup> Coupled with the further decentralization of the investment control regime in the reform era,<sup>54</sup> the fiscal reforms created enormous incentives, as well as pressures, for local governments to seek more revenues through the creation of new local enterprises.<sup>55</sup>

### 2.3. Market Concentration

Although decentralization has been credited with creating the conditions for China's economic success since the late 1970s,<sup>56</sup> it also led to some less than desirable outcomes, one of which is the lack of regional specialization in China. Unlike the former Soviet Union, where numerous products were produced by single enterprises,<sup>57</sup> China's industries are structured in a cellular manner, with duplication of a single industrial pattern in each

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<sup>52</sup> See generally OECD, *supra* note 48, at 659-77 (examining the current system of "central-local government fiscal relations" and discussing problems encountered within this framework); Jiwei Lou, *The Reform of Intergovernmental Fiscal Relations in China: Lessons Learned*, in PUBLIC FINANCE IN CHINA: REFORM AND GROWTH FOR A HARMONIOUS SOCIETY 155 (Jiwei Lou & Shuilin Wang eds., 2008) (discussing China's fiscal reforms and their implications for the relationships between the central and local governments).

<sup>53</sup> See Wong, *supra* note 49, at 197 (explaining the economic relationship between local government and local enterprises).

<sup>54</sup> See *infra* Part 3.1.2.

<sup>55</sup> See Jean C. Oi, *Fiscal Reform and the Economic Foundations of Local State Corporatism in China*, 45 *WORLD POL.* 99, 102 (1992) (discussing how China's fiscal reforms encouraged local economic development); Christine P. W. Wong, *Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China*, 128 *CHINA Q.* 691, 691 (1991) (chronicling the fiscal changes in Post-Mao China).

<sup>56</sup> For an argument that China's decentralized industrial structure provided flexibility and opportunities for carrying out regional experiments, which led to the emergence of the non-state sector without mass privatization and political tumult, see Qian & Xu, *supra* note 44, at 152-56.

<sup>57</sup> In 1988, in 212 of the main 344 industrial product groups (62%) in the former Soviet Union, the largest single enterprise within the product group accounted for more than half of all the group's output. 2 *INT'L MONETARY FUND ET AL., A STUDY OF THE SOVIET ECONOMY* 39 tbl.IV-2.6 (1991). A World Bank study finds that in 1989, "of the total of 7,664 'product groups' distributed by the former USSR *Gossnab* (Committee of Deliveries and Supplies) . . . 77 percent were produced by single enterprises." *WORLD BANK, RUSSIAN ECONOMIC REFORM: CROSSING THE THRESHOLD OF STRUCTURAL CHANGE* 82 (1992).



province.<sup>58</sup> A World Bank study finds that by the early 1990s the degree of differences in industrial structure across regions in China was much lower than in the United States or the European Community.<sup>59</sup> And each one of the major industrial groups examined by the World Bank was present in virtually all provinces in the early 1990s.<sup>60</sup> This pattern persisted through the 1990s. By 2001, twenty-three provinces manufactured washing machines, twenty-nine made television sets, twenty-three produced refrigerators, and twenty-seven assembled automobiles.<sup>61</sup> Apparently, China has not taken advantage of the opportunities for regional specialization that its large internal market would permit.

The duplication of industries at the local level also led to loss of economies of scale. Particularly, beginning in the early 1980s, fiscal incentives led to a boom of investment by local governments, resulting in a massive number of duplicate, small-scale local enterprises.<sup>62</sup> Take automobile assembly plants for example: in 1996, China had 116 such plants, of which only eighteen were making more than 10,000 automobiles per year.<sup>63</sup> While it is typically believed that 250,000 units is a "minimum efficient scale" for automobile assembly plants,<sup>64</sup> the average output volume of China's automobile assembly plants in 1998 was only 14,165 units.<sup>65</sup> Similar examples of low economies of scale abound in China's economy.<sup>66</sup>

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<sup>58</sup> See Audrey Donnithorne, *China's Cellular Economy: Some Economic Trends Since the Cultural Revolution*, 52 CHINA Q. 605 (1972) (discussing the development and implications of China's cellular economy).

<sup>59</sup> See INTERNAL MARKET, *supra* note 29, at 18-19 (comparing average coefficients of structural difference in different countries).

<sup>60</sup> See *id.* at 13 (stating that "each major industrial group is located in virtually all provinces").

<sup>61</sup> MINXIN PEI, CHINA'S TRAPPED TRANSITION: THE LIMITS OF DEVELOPMENTAL AUTOCRACY 129 (2006).

<sup>62</sup> See ANWAR SHAH & CHUNLI SHEN, DIFANG ZHENGFU HE DIFANG CAIZHENG JIANSHE [LOCAL PUBLIC FINANCE AND GOVERNANCE] 475 (2005) (discussing "economic conflicts" among different regions in China).

<sup>63</sup> PEI, *supra* note 61, at 130.

<sup>64</sup> ERIC THUN, CHANGING LANES IN CHINA: FOREIGN DIRECT INVESTMENT, LOCAL GOVERNMENTS, AND AUTO SECTOR DEVELOPMENT 59 (2006).

<sup>65</sup> YASHENG HUANG, SELLING CHINA: FOREIGN DIRECT INVESTMENT DURING THE REFORM ERA 260 (2003).

<sup>66</sup> For example, in the late 1990s, there were about 6000 paper mills in China, with an average capacity of 4000 tons per mill, less than one tenth of the international average. PEI, *supra* note 61, at 130. "Of China's 800 beer breweries,

The duplication of industries at the provincial level and the resulting low economies of scale led to generally low market concentration ratios in China. Official statistics indicate that market concentration ratios in China have been unusually low when compared to both developed and developing economies.<sup>67</sup> Between the mid-1980s and the mid-1990s, the average market concentration ratio for the largest one hundred firms in various sectors hovered between ten and sixteen percent.<sup>68</sup> In the mid-1990s, in eighteen out of thirty-nine major sectors, the largest eight firms in each sector accounted for less than ten percent of the market share.<sup>69</sup>

#### 2.4. Market Entry Restrictions

Since the start of economic reform, China has seen a great expansion of private and foreign enterprises in its economy.<sup>70</sup> In

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only one-tenth reached the minimum capacity of 50,000 tons." *Id.* China's machine tool sector is also characterized by the dispersion of a large number of manufacturers in all but one province. While the top five machine tool manufacturers account for 42% of the national production in Japan and 69% in the United States, in China the figure is only 20%. See INTERNAL MARKET, *supra* note 29, at 134 ("[C]lose communication between enterprises in the same industrial sector could lead to more cartel-like output restriction over the longer term.").

<sup>67</sup> In China, the concentration ratio of the largest four producers ("CR4") in 1984 was 17% for automobiles, 15% for cigarettes, 17% for plate glass, and 2% for cement. PEI, *supra* note 61, at 258 n.148 (citing QI LÜDONG, ZHONGGUO XIANDAI LONGDUAN JINGJI YANJIU [ECONOMIC STUDIES ON MONOPOLIES IN CONTEMPORARY CHINA] 146-48 (1999)). By contrast, in the United States, the CR4 in 1982 was 97% for automobiles, 90% for cigarettes, 78% for plate glass, and 31% for cement. *Id.* In India, the CR4 in 1968 was 57% for automobiles, 64% for plate glass, and 60% for cement. *Id.*

<sup>68</sup> *Id.* at 130.

<sup>69</sup> See *id.* (noting that Chinese researchers attribute this low concentration to slow technological progress within the firms).

<sup>70</sup> In 1997, the non-state sector's share in China's industrial output and industrial employment reached more than thirty-four percent and more than eighteen percent, respectively. INT'L FIN. CORP., CHINA'S EMERGING PRIVATE ENTERPRISES: PROSPECTS FOR THE NEW CENTURY 16 (2000). In 1998, the non-state sector's share of GDP was approximately 33%. *Id.* Less than ten years later, in 2005, the non-state sector's share of GDP had almost doubled, reaching 65%. See *Minying jingji 2010 nian ke chuang qicheng GDP; siqi zengsu Beijing diyi* [Private Enterprises May Account for Seventy-Percent of GDP; Beijing Ranks Top for Private Enterprises Growth Rate], XIN JING BAO [NEW BEIJING DAILY] (July 15, 2007), [http://www.crifs.org.cn/crifs/html/default/\\_history/37213130.html](http://www.crifs.org.cn/crifs/html/default/_history/37213130.html) (quoting official statistics released by All China Federation of Industry & Commerce, National Bureau of Statistics, and National Development and Reforms Commission).

certain sectors, however, private and foreign enterprises still face substantial government-imposed barriers to market entry. In the case of foreign enterprises, the government periodically publishes a guidance catalog on the sectors and industries in which entry is prohibited or restricted.<sup>71</sup> In the case of private enterprises, market entry restrictions are imposed mainly through stringent licensing and minimum capital requirements, and the sectors or industries that carry market entry restrictions tend not to be clearly spelled out.<sup>72</sup> Government-imposed market entry restrictions have been cited by private enterprises in China as one of the major constraints on their growth.<sup>73</sup>

In recent years, China has shown willingness to lessen the market entry restrictions against domestic private enterprises. In 2005, China's State Council issued a guidance opinion that became popularly known as "Thirty-Six Measures on Non-Public Economy" because it contained thirty-six measures aimed at promoting the development of the non-state economic sector.<sup>74</sup> The 2005 document stated that the government intended to relax the market entry restrictions currently in place against private enterprises in a number of sectors or industries, including public utilities and infrastructure, social services, financial services, national defense, electricity, telecommunications, railroads,

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<sup>71</sup> The catalog also contains sectors and industries in which the entry of foreign enterprises is encouraged. For the most recent edition (2007) of the guidance catalog, see NATIONAL DEVELOPMENT AND REFORMS COMMISSION & MINISTRY OF COMMERCE, WAISHANG TOUZI CHANYE ZHIDAO MULU [GUIDANCE CATALOG ON FOREIGN INVESTMENT], available at <http://www.sdpc.gov.cn/zcfb/zcfbl/2007ling/W020071107537750156652.pdf>.

<sup>72</sup> In 2003, the Administrative Licensing Law (*Xingzheng Xuke Fa*) authorized the government to impose market entry restrictions in sectors or industries that are "directly related to public interest." See *Zhonghua Renmin Gongheguo Xingzheng Xuke Fa* [The Administrative Licensing Law of the People's Republic of China], art. 12 § 2 (2003), [http://news.xinhuanet.com/zhengfu/2003-08/28/content\\_1048844.htm](http://news.xinhuanet.com/zhengfu/2003-08/28/content_1048844.htm) (outlining China's market entry restrictions). The law, however, does not define what constitutes "public interest," and therefore the government still enjoys wide discretion in selecting the sectors or industries for which market entry restrictions are to be imposed.

<sup>73</sup> See GARNAUT ET AL., PRIVATE ENTERPRISE IN CHINA 45 (2001) (surveying CEOs of Chinese firms about different types of entry barriers).

<sup>74</sup> See State Council, *Guowuyuan Guanyu Guli Zhichi He Yindao Geti Siying Deng Fei Gongyoushi Jingji Fazhan De Ruogan Yijian* [State Council's Opinions on encouraging, supporting, and guiding the development of individual, private, and other non-public sectors], State Council Doc. No. [2005] 3 (Feb. 19, 2005), [http://www.gov.cn/zwggk/2005-08/12/content\\_21691.htm](http://www.gov.cn/zwggk/2005-08/12/content_21691.htm) (outlining China's measures to develop the non-state economic sector).

airlines, and petroleum.<sup>75</sup> In an effort to reduce the level of uncertainty surrounding market entry by private enterprises, the 2005 document also ordered central government agencies and local governments to reduce various market entry restrictions against private enterprises to explicit legal rules. Further, it stipulated that market entry would be permitted in sectors or industries where the law does not explicitly prohibit entry.<sup>76</sup>

However, efforts to open up State-Owned Enterprise ("SOE")-dominated sectors to private enterprises since 2005 have generally fallen short. The quick rise and, subsequently, quick fall, of China's private airline companies provides a good example of the failed efforts. Shortly after the issuance of the Thirty-Six Measures on Non-Public Economy in 2005, the government approved more than twenty privately owned airline companies, and six began operating.<sup>77</sup> But the private airline companies quickly discovered that sectoral barriers in China meant more than entry prohibition, as discrimination in route allocations<sup>78</sup> and government subsidies to SOE airlines<sup>79</sup> made it very difficult for private airline companies

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<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> The six private airline companies that came into operation were: Aokai, Chunqiu, Yinglian, Dongxing, Jixiang, and Kunpeng. See Jinling Li, *Guohang Minqi Mingzhe "Qianguize:" Baiju Beihou De Zhidu Jiban* [Private Airline Companies Destroyed by Hidden Rules: Systemic Hurdles Behind Failures], PEOPLE'S NETWORK (Jul. 8, 2010), <http://caac.people.com.cn/GB/114104/12089179.html> (discussing the problems private airlines face and providing possible solutions to them); Xiaohong Cui, *Minying Hangkong: You Chi Nan Fei* [Limited by Scarce Routes, Private Airlines Forced to Focus on Second-Tier Cities], AIR NEWS (Dec. 26, 2006), <http://www.airnews.cn/hotel/23228.shtml>.

<sup>78</sup> The allocation of air routes in China heavily favors state-owned airlines, which are allocated most of the routes to and from China's largest cities, such as Beijing and Shanghai. Private airlines have to focus on second-tier cities, such as Harbin, Haikou, Sanya, Hangzhou, and Kunming. Chunqiu Airline, whose main hub is in Shanghai, was forced to reassign its airplanes to Hainan province because it was unable to obtain more routes in Shanghai. See *Hangban Shike Shouxian; Minying Hangkong Bei Tuiju "Erxian"* [Limited By Scarce Routes, Private Airlines Forced to Focus on Second-Tier Cities], AIR NEWS (Dec. 26, 2006), <http://airnews.cn/consultation/23228.shtml>.

<sup>79</sup> For example, the 2008-2009 global financial crisis and plummeting crude oil prices led to huge losses on the fuel hedging contracts entered into by China's major state-owned airlines. The losses on fuel hedging contracts at Air China, China's largest airline, reached ¥6.8 billion in 2008, almost eclipsing its profits in 2006 and 2007 combined. *Guohang Taobao Kui 68 Yi Chaoguo Donghang; Shue Jiejun Liangnian Yingli Zonghe* [Air China's Loss on Fuel Hedging Contracts Larger Than Eastern Airline's; ¥6.8 Billion Loss Almost Eclipses Two Years' Profits], SOHU, Jan. 19, 2009, <http://news.sohu.com/20090119/n261823132.shtml>. In response, the

to compete. Within a short period, most of the private airline companies that came into operation were either liquidated or acquired by SOE airline companies, or found themselves in serious financial troubles.<sup>80</sup> In May 2010, the State Council made new efforts to relax market entry restrictions against private enterprises by issuing another guidance opinion known as “New Thirty-Six Measures on Non-Public Economy.”<sup>81</sup> But whether the new guidance opinion will achieve what the 2005 guidance opinion failed to achieve remains to be seen.

### 2.5. *The Transformation of State Owned Enterprises*

In the official lexicon of the Chinese political economy, “State-Owned Enterprises” refer to enterprises owned by the “whole people” whose ownership rights are exercised by governments at various levels, from the central government down to county governments.<sup>82</sup> During the planned economy era, SOEs were little more than productive units of the state: managers (or, more accurately, government officials) at SOEs simply followed government orders regarding what to produce, how much to produce, and the prices at which the products would be sold, and then turned all resulting profits (or losses) over to the government.<sup>83</sup>

The reform of China’s SOEs during the reform era proceeded along three lines: commercialization, corporatization, and consolidation. Initially, between the late 1970s and the early 1990s,

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government injected huge amounts of equity into major state-owned airlines. See *Dongfang Hangkong Huode 30 Yi Yuan Zhengfu Zhuzi* [Eastern Airline to Receive ¥3 Billion Equity Injection from the Government], XINHUA FINANCE (Dec. 11, 2008), [http://news.xinhuanet.com/fortune/2008-12/11/content\\_10486200.htm](http://news.xinhuanet.com/fortune/2008-12/11/content_10486200.htm) (noting that the government hopes to ease the working capital pressures of the airline with the investment).

<sup>80</sup> See Li, *supra* note 77 (providing examples of airlines that were either liquidated or merged with another airline).

<sup>81</sup> See State Council, *Guowuyuan Guanyu Guli He Yindao Minjian Touzi Jiankang Fazhan De Ruogan Yijian* [State Council Opinions on Encouraging and Guiding the Health Development of Private Investment], State Council Doc. No. [2010] 13 (May 13, 2010), [http://www.gov.cn/zwggk/2010-05/13/content\\_1605218.htm](http://www.gov.cn/zwggk/2010-05/13/content_1605218.htm) (outlining ways of encouraging private investment in China).

<sup>82</sup> See Qian & Xu, *supra* note 44, at 138 (defining SOEs); see also OECD, *supra* note 48, at 659–60 (describing China’s fiscal structure).

<sup>83</sup> See generally Lixin Colin Xu, *Control, Incentives, and Competition: The Impact of Reform on Chinese State-Owned Enterprises*, 8 ECON. TRANSITION 151 (2000) (discussing how various reforms benefitted China’s SOEs).

China's SOE strategy focused on managing SOEs more like commercial entities without altering the SOEs' governance structures. In connection with the price reforms discussed above, the government delegated to SOEs the power to make managerial decisions on a variety of issues, including choice of products, production volumes, pricing, technology adoption, production scheduling, exports, and employee wages.<sup>84</sup> The government also allowed SOEs to retain a portion of profits through the use of a profit contract system.<sup>85</sup> The commercialization of SOEs without governance reforms, however, failed to revitalize the stagnant SOE sector. Between 1980 and 1992, although the gross output of SOEs more than quadrupled, SOE losses increased more than tenfold.<sup>86</sup>

Beginning with the enactment of the Company Law in 1993,<sup>87</sup> China started experimenting with "corporatizing" SOEs, i.e., converting SOEs into corporations. Under the Company Law, SOEs can be converted to "wholly state-owned companies"<sup>88</sup> where the state owns all stakes, or "limited liability companies"<sup>89</sup> and "joint stock limited companies"<sup>90</sup> where the state owns partial stakes. SOEs converted to joint stock limited companies can be listed on China's stock markets if listing requirements are met.<sup>91</sup>

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<sup>84</sup> *Id.* at 154–55.

<sup>85</sup> Between 1981 and 1983, the government introduced different versions of profit contracting among SOEs. However, the SOEs responded by demanding a larger share of profits, while still insisting that any losses remain with the state. This resulted in shrinking state revenues. In 1983, the government introduced a tax-for-profit system, substituting income taxes for remission of profits. But the tax-for-profit system only prompted SOEs to bargain for lower tax rates. In 1986, the government returned to the profit contract system. See SHU-YUN MA, SHAREHOLDING SYSTEM REFORM IN CHINA: PRIVATIZING BY GROUPING FOR STONES 9 (2010); see also Xu, *supra* note 83, at 154 ("The average marginal retention rate [of SOEs] rose from 11 per cent in 1980 to 17 per cent in 1984, ending up at 25 per cent in 1989").

<sup>86</sup> MA, *supra* note 85, at 9–10.

<sup>87</sup> *Zhonghua Renmin Gongheguo Gongsifa* [Company Law of the People's Republic of China] (promulgated by the Tenth Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective Jan. 1, 2006), [http://www.gov.cn/flfg/2005-10/28/content\\_85478.htm](http://www.gov.cn/flfg/2005-10/28/content_85478.htm) [hereinafter "Company Law"].

<sup>88</sup> See *id.* arts. 65–71 (listing special provisions relating to wholly state-owned companies).

<sup>89</sup> *Id.* art. 23 (stating the conditions limited liability companies must satisfy).

<sup>90</sup> *Id.* art. 77 (stating conditions joint stock limited companies must satisfy).

<sup>91</sup> Initially, only subsidiaries of large SOEs were listed on the stock markets, and only a portion of the shares of the listed companies were tradable. Usually, a wholly state-owned SOE would spin off some assets into a subsidiary, sell a portion (typically one-third) of the shares of the subsidiary to institutional and

Corporatized SOEs are required by the Company Law to improve their internal governance mechanisms by establishing boards of directors, boards of supervisors, and shareholders' general meetings.<sup>92</sup>

In addition to commercialization and corporatization, another important component of China's SOE reforms is consolidation. Since the early 1990s, China has embarked on a "grasp the large, and let go of the small" (*Zhua Da Fang Xiao*) strategy, under which the government aims to control only large-sized SOEs in strategic sectors, while relinquishing the control of small and medium-sized SOEs.<sup>93</sup> Under this strategy, many of the small and medium-sized SOEs were privatized,<sup>94</sup> while large SOEs were consolidated into even larger SOE groups.<sup>95</sup> In 2003, the central government created the State-Owned Assets Supervision and Administration

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private investors, and then apply to have the subsidiary listed on the stock exchanges. This allowed the government to introduce corporate governance reforms without relinquishing control of SOEs. STEPHEN GREEN, 'TWO-THIRDS PRIVATIZATION': HOW CHINA'S LISTED COMPANIES ARE – FINALLY – PRIVATIZING, THE ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS BRIEFING NOTE 1 (2003), available at <http://www.isn.ethz.ch/isn/Current-Affairs/Policy-Briefs/Detail/?lng=en&id=23024>; see Chenxia Shi, *Recent Ownership Reform and Control of Central State-Owned Enterprises in China: Taking One Step at a Time*, 30 U. NEW S. WALES L. J. 855, 858 n.11 (2007), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1121255](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121255) (describing how the restructuring of the SOEs allowed them to be listed on the stock market).

<sup>92</sup> See Company Law, *supra* note 87, art. 11 (noting that the Company Law is binding on company shareholders, directors, supervisors and senior managers). For an overview of China's corporate governance structures under the Company Law, see Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 494 (2003) ("A fundamental dilemma of Chinese [corporate governance laws and institutions] stems from the state policy of maintaining a full or controlling ownership interest in enterprises in several sectors.").

<sup>93</sup> OECD, CHINA IN THE GLOBAL ECONOMY: REFORMING CHINA'S ENTERPRISES 52 (2000).

<sup>94</sup> See *id.* at 56–58 (explaining that the justification for privatizing small firms is "to reduce government burdens and responsibilities for public enterprises, while improving their capabilities to successfully compete in a market environment"). Although the exact number of SOEs being privatized is not known, the general consensus among economists is that China's SOE reforms did not result in mass privatization. Cf. Qian & Xu, *supra* note 44, at 156 (noting methods that would accelerate China's privatization). This is in contrast to the rapid, mass privatization in Russia and Eastern European countries in the post-communist era. See Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1731, 1739–40 (2000) (stating that privatization in Russia began in 1992 and was "largely complete" by 1994).

<sup>95</sup> For discussion on the rationales for the consolidation of SOEs, see *infra* Part 3.3.3.

Commission (“SASAC”) to supervise most of the SOEs controlled by the central government (or “central SOEs”).<sup>96</sup> SASAC’s stated goal is to reduce, through consolidation, the number of SOEs within its jurisdiction from 196 in 2003 to between 80 and 100 by the end of 2010.<sup>97</sup> Local-level SASACs were also created and charged with consolidating SOEs controlled by local governments (“local SOEs”).<sup>98</sup> The consolidation of SOEs, which is still going on, has already resulted in the formation of a group of behemoth SOEs. In 2009, 331 of China’s 500 largest companies by revenues were SOEs.<sup>99</sup> In 2010, thirty-eight of China’s largest SOEs appeared in the Fortune Global 500, with three of them appearing on the top ten list.<sup>100</sup> Today, almost all of the most important industries in China—such as national defense, electricity, petroleum and petrochemicals, telecommunications, coal, civil aviation, waterway transportation, banking, and insurance—are dominated by SOEs. In 2006, SOEs accounted for almost all of the

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<sup>96</sup> For a complete listing of current central SOEs, see *Directory of Central SOEs*, STATE-OWNED ASSET SUPERVISION AND ADMINISTRATION COMMISSION OF THE STATE COUNCIL (“SASAC”), <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html> (last visited Nov. 22, 2010). Note that not all SOEs controlled by the central government are within SASAC’s jurisdiction. For historical reasons, SASAC only supervises “industrial” SOEs. The largest SOEs in the financial sector (such as the four state-owned commercial banks) are supervised by Central Huijin Investment Ltd. (*zhongyang huijin touzi youxian zeren gongsi*), a holding company that reports directly to the State Council.

<sup>97</sup> See Shuhong Chen Xiaohong, *Jinnian di zhongyang qiye jiang jianshao dao 80-100 hu* [Number of Central SOEs to Shrink to 80-100 by End of Year], BEIJING QINGNIAN BAO [BEIJING YOUTH DAILY] (Apr. 7, 2010), [http://www.ce.cn/cysc/newmain/jdpd/zjxw/201004/07/t20100407\\_20360865.shtml](http://www.ce.cn/cysc/newmain/jdpd/zjxw/201004/07/t20100407_20360865.shtml) (stating the total number of SOEs to be consolidated by the end of 2010).

<sup>98</sup> See *Guoziwei Jiang She Xianji Guozi Jianguan Jigou; Difang Guozi Chongzu Jiang Ai* [SASAC to Establish County-Level State Assets Management Offices; Consolidation of Local SOEs Imminent], MEIRI JINGJI XINWEN [DAILY ECONOMIC NEWS] (May 4, 2010), [http://www.ce.cn/macro/more/201005/04/t20100504\\_21352873.shtml](http://www.ce.cn/macro/more/201005/04/t20100504_21352873.shtml) (noting the consolidation of SOEs at the county level is ongoing).

<sup>99</sup> See 2009 *Zhongguo da Qiye Fazhan de Qushi, Wenti he Jianshi* [The Development of China’s Large Enterprises: Trend, Problems, and Suggestions], CHINA ENTERPRISE CONFEDERATION & CHINA ENTERPRISE DIRECTORS ASSOCIATION, [http://www.ccceda.org.cn/c500/chinese/content.php?id=100&t\\_id=1](http://www.ccceda.org.cn/c500/chinese/content.php?id=100&t_id=1) (last visited Nov. 22, 2010) (noting that the majority of the top 500 Chinese enterprises are SOEs).

<sup>100</sup> For a complete list of the companies comprising the Fortune Global 500, see Fortune, *Global 500: Our Annual Ranking of the World’s Largest Corporations*, CNN MONEY (July 26, 2010), [http://money.cnn.com/magazines/fortune/global500/2010/full\\_list/index.html](http://money.cnn.com/magazines/fortune/global500/2010/full_list/index.html). Among the forty-two companies on the list from mainland China, only three are privately owned: Ping An Insurance (#383), Huawei Technologies (#397), and Jianguo Shagang Group (#415).



production of petroleum, natural gas, and ethylene, provided all of the basic telecommunication services, generated approximately 55% of electricity, and flew about 82% of passengers and cargo through the country's air transportation system.<sup>101</sup> Because of the dominance of large SOEs in those industries and the market entry restrictions against non-SOEs in those industries,<sup>102</sup> those industries are often referred to as "monopoly industries" in China and the SOEs in them are often referred to as "SOE monopolies."

All of these reforms notwithstanding, China's SOEs still differ in material respects from profit-maximizing firms in market economies. Although most SOEs now are generally responsive to market signals, profit maximization is not the sole objective of SOEs and often gives way to other objectives such as the provision of employment and social services and the generation of tax revenues.<sup>103</sup> Every SOE in China still carries a political rank, and many of the largest SOEs, such as the central SOEs supervised by SASAC, are very politically powerful.<sup>104</sup> Finally, China's SOEs still have implicit, and sometimes even explicit, financial backing from the government. The "soft budget constraints" of SOEs—i.e.,

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<sup>101</sup> Tuijin Guoyou Jingji Buju Zhanlue Tiaozheng: Pochu Longduan Rengshi Jiaodian [Tackling SOE Monopolies Key to the Restructuring of State-Owned Sectors], LIAOWANG, (Dec. 13, 2006), [http://news.xinhuanet.com/politics/2006-12/13/content\\_5480196.htm](http://news.xinhuanet.com/politics/2006-12/13/content_5480196.htm). Recall that most of those sectors or industries are those in which stringent market entry restrictions are maintained against private enterprises. See *supra* notes 72-73 and accompanying text (detailing these barriers to entry).

<sup>102</sup> See *supra* Part 2.4.

<sup>103</sup> See D. Daniel Sokol, *Competition Policy and Comparative Corporate Governance of State-Owned Enterprises*, 2009 BYU L. REV. 1713, 1727-28 (2009) (noting that SOE's are not "necessarily profit-maximizers" and that some of their "functions are based on non-financial goals").

<sup>104</sup> Many of the central SOEs were actually created from government ministries. For example, China Petrochemical Corporation ("Sinopec") and China National Petroleum Corporation ("CNPC"), China's largest two petroleum companies, were created in the 1980s from the downstream (refining and marketing) and upstream (exploration and production) assets of the then Ministry of Petroleum Industry. See Erica S. Downs, *Business Interest Groups in Chinese Politics: The Case of the Oil Companies*, in CHINA'S CHANGING POLITICAL LANDSCAPE: PROSPECTS FOR DEMOCRACY 121, 122 (Cheng Li ed., 2008). The assignment of a political rank to Sinopec and CNPC caused many controversies. The founders of Sinopec and CNPC wanted a ministry rank (*bu*) for the new companies, while the existing ministries were willing to assign only a general bureau (*zongju*, one half-level below ministry) or bureau (*ju*, one level below ministry) rank. See SUSAN L. SHIRK, *THE POLITICAL LOGIC OF ECONOMIC REFORM IN CHINA* 94 (1993) (discussing the importance of agencies' official rank). The founders of Sinopec and CNPC prevailed, with both companies assigned a ministry rank.

SOEs' abilities to turn losses over to the government—give rise to the moral hazard problems typically associated with not having to be fully responsible for operating failures.<sup>105</sup>

### 2.6. *The Changing Regulatory Landscape*

In the planned economy era, government ministries directly managed China's major industries,<sup>106</sup> obviating the need for government regulation as it is known in market economies. As China makes its transition towards a market economy, the question arises as to how to redefine the nature and extent of state involvement in the economy.

China has responded by using different strategies for different industries. In industries that the government believes should be opened up to market competition and that state capital should eventually exit, China has gradually reduced the role of the government through numerous rounds of government restructuring.<sup>107</sup> Those industries, known as "competitive industries" in China, generally include the coal, machinery, metallurgy, chemical, light, textile, building materials, and nonferrous metal industries. The central government ministries overseeing those industries were first downgraded in 1998 before being abolished altogether in 2001.<sup>108</sup>

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<sup>105</sup> See WILLIAM L. MEGGINSON, *THE FINANCIAL ECONOMICS OF PRIVATIZATION* 40 (2005) (stating that the SOEs do not bear the risk of financial collapse).

<sup>106</sup> In the planned economy era, there was a ministry within the central government for almost every major sector or industry, such as agriculture, coal, and machinery. "The economic sectoral ministries can be thought of as divisions in a huge conglomerate called 'China, Incorporated' . . ." SHIRK, *supra* note 104, at 93.

<sup>107</sup> For a detailed discussion of China's governmental reforms from 1978 to 2008, see OECD, *CHINA: DEFINING THE BOUNDARY BETWEEN THE MARKET AND THE STATE* 92–95 (2009).

<sup>108</sup> In the massive restructuring of the central government agencies in 1998, the overseeing ministries for those competitive industries were downgraded to "national bureaus" under the State Economic and Trade Commission. In 2001, the national bureaus were abolished. See *Jingmaowei Chexiao Guojia Guonei Maoyi ju Deng Jiu Ge Guojia Ju [State Economic & Trade Commission Abolishes Nine National Bureaus Including Domestic Distribution Bureau]*, SINA (Feb. 19, 2001), <http://finance.sina.com.cn/g/37340.html>. The administrative functions of those national bureaus were assumed by SASAC. See OECD, *supra* note 107, at 94 (describing how the State Economic and Trade Commission's bureaus on state enterprises were transferred to SASAC). This is an implicit recognition that the government's interest in those sectors is no more than its ownership interest in the SOEs in those sectors.

In industries in which the government decides to retain control of state capital—i.e., “monopoly industries” such as electricity, banking, insurance, telecommunications, petroleum, civil aviation, and railroads—government reforms have generally focused on separating the government’s role as regulator from its role as owner of the major enterprises. In some of the monopoly industries, China established new “independent” regulatory bodies that assumed the regulatory functions of the government, including: the China Insurance Regulatory Commission (established in 1998), the General Administration of Civil Aviation (established in 2002), the State Electricity Regulatory Commission (established in 2003), and the China Banking Regulatory Commission (established in 2003).<sup>109</sup> In the petroleum industry, regulatory power was stripped from the SOE duopoly, China National Petroleum Corporation and China Petrochemical Corporation, and was reassigned to other government agencies.<sup>110</sup> In the telecommunications industry, the SOE monopoly, China Telecom, was separated from its affiliated ministry, the Ministry of Post and Telecommunication, which itself was merged with another government ministry to form a new—supposedly more independent industry regulator—the Ministry of Information Industry in 1998.<sup>111</sup> The telecommunications industry

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<sup>109</sup> OECD, *supra* note 107, at 94.

<sup>110</sup> CNPC and Sinopec were granted regulatory power when they were first created in the 1980s. In 2000, the regulatory and policy functions of CNPC and Sinopec were transferred to the State Economic and Trade Commission. With the abolition of the State Economic and Trade Commission in 2003, the National Development and Reforms Commission assumed regulatory functions for the petroleum industry. See OECD, *CHINA IN THE GLOBAL ECONOMY: GOVERNANCE IN CHINA* 292 (2005).

<sup>111</sup> Until 1994, the Ministry of Post and Telecommunication (“MPT”) was both the regulator and the dominant operator of China’s telecommunications network. Through China Telecom, the MPT provided landline, mobile, data transmission, and satellite services. In 1988, three other ministries—the Ministry of Electronic Industry (“MEI”), the Ministry of Electric Power (“MEP”), and the Ministry of Railroads (“MR”)—started lobbying the State Council for a rival telecommunications operator. In 1993, the State Council authorized MEI, MEP, and MR to form China United Telecommunications Corporation, or China Unicom, which came into operation in 1994. However, MPT used its regulatory power to hold back the initial growth of China Unicom; it was denied entry into certain markets and access to China Telecom’s vast landline network. In 1998, MPT was merged with MEI to form MII, and China Telecom was separated from the new regulator. See PEI, *supra* note 61, at 103–05 (discussing the history and politics of the reorganization). The reform of the regulatory structure for the telecommunications industry is part of the overall restructuring of the

subsequently underwent three more rounds of restructuring and one more round of regulatory reform, and now the Ministry of Industry and Information Technology—a new industry regulator created in 2008—oversees three telecommunications carriers.<sup>112</sup> The last major monopoly industry that has not undertaken regulatory reform is the railroad industry, where the Ministry of Railroads is still both the regulator and the owner of all major enterprises in the industry.<sup>113</sup> However, reform of the railroad industry in the form of separating the government's regulatory functions from its operating functions is reportedly on the agenda, with the Ministry of Railroads slated to be merged into the Ministry of Transportation by the end of 2010.<sup>114</sup>

Regulatory reforms in China, however, are by no means complete. In industries where the government has abolished its formal regulatory roles, the informal roles of the government are still preserved—to varying degrees—through the so-called “industrial associations.” In the wake of the government reforms of the 1990s, a number of industrial associations were established in various industries to provide industrial coordination and self-regulation. Many of those newly established industrial associations, however, are essentially quasi-governmental entities: they are staffed by former government officials from the industries' former supervising ministries, and have the same organizational structures and functions as the defunct supervising ministries. Many of the industrial associations are officially “affiliated” (*guakao*) with various government agencies.<sup>115</sup>

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telecommunications industry. For further discussions of the restructuring of the telecommunications industry, see *infra* note 251 and accompanying text.

<sup>112</sup> See *infra* note 251 and accompanying text (discussing China's restructuring of its telecommunications industry after 1998).

<sup>113</sup> See OECD, *supra* note 110, at 292 (noting that the Ministry of Railway serves as the “owner, operator and regulator” of the railroad industry in China).

<sup>114</sup> Tiedaobu Gaige Xin Xinhao; Liangnian Hou Bingru Jiaotongbu [New Signals on Railroad Reforms; Ministry of Railroads to be Merged into Ministry of Transportation in Two Years], CHINAREVIEWNEWS.COM (Mar. 25, 2008), <http://gb.chinareviewnews.com/doc/1006/0/4/2/100604265.html?coluid=7&kindid=0&docid=100604265>.

<sup>115</sup> For example, the industrial associations that were converted from former national bureaus under the State Economic and Trade Commission are now officially affiliated with SASAC. Those associations include: China Iron & Steel Association, China Machinery Industry Federation, China Petroleum and Chemical Industry Federation, China Light Industry Federation, China Textile Industry Association, China Coal Industry Association, China Federation of Logistics & Purchasing, and China Non-Ferrous Metals Industry Association. A number of industrial associations in the export and import sector are affiliated

Furthermore, in many of the industries where the government has retained its regulatory presence, the impartiality of the regulators remains questionable. Although the original intent of regulatory reforms in those industries was to separate the government's regulatory functions from its operating functions, politically powerful SOEs still regularly receive favorable regulatory treatment, an example of which is the preferences routinely given to state-owned airlines in route allocations in the airline industry.<sup>116</sup> In addition, it is still not uncommon for a government agency to either directly own or otherwise have financial deals with "affiliate companies" that are subject to its regulation.<sup>117</sup> With financial interests at stake, the partiality—rather than impartiality—of the regulators is all but assured.

### 2.7. *Setting the Stage: Conclusions*

As discussed above, three decades of economic reforms have fundamentally transformed China. Long gone are the days when the state controlled almost every aspect of China's economy. China's economic transition, however, is by no means complete. Despite the increasingly important role of the market, many aspects of China's economy are still transitional in nature. Most importantly, although most prices have been liberalized, the government still maintains price controls over certain key products. The SOEs, although now generally responsive to market signals, are still not true profit-maximizing commercial entities. In terms of market structure, China's decentralized industrial structure prior to the start of economic reforms and the further

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with the Ministry of Commerce ("MOFCOM"). Officially called "chambers of commerce," those associations include China Chamber of Commerce for Import and Export of Textiles, China Chamber of Commerce for Import and Export of Light Industrial Products and Arts-Crafts, China Chamber of Commerce of Metals, Minerals & Chemicals Importers & Exporters, China Chamber of Commerce for Import and Export of Foodstuffs, Native Produce & Animal By-Products, China Chamber of Commerce for Import and Export of Machinery & Electronic Products, and China Chamber of Commerce for Import and Export of Medicines & Health Products. See JIANHUA LIU, ZHONGGUO SHICHANG XIN ZHIXU [CHINA'S NEW MARKET ORDER] 178 & n.1 (2006).

<sup>116</sup> See *supra* note 78 and accompanying text.

<sup>117</sup> This stems in large part from the fact that before the enactment of the Company Law in 1993, China "vested the power of approving the establishment of companies in various functional administrative agencies." See Bing Song, *Competition Policy in a Transitional Economy: The Case of China*, 31 STAN. J. INT'L L. 387, 407 (1995).

decentralization of China's industries in the reform era have led to generally low market concentration ratios in China. Finally, China's economy is still subject to extensive state control. In addition to the government's control over prices and SOEs, the government still imposes market entry restrictions against non-SOE firms in certain important industries. The government also exercises control in those industries through the regulatory process, which has been streamlined but still lacks the institutional guarantee of impartiality.

### 3. THE AML AS A LEGAL TRANSPLANT

The key elements of China's economic conditions summarized in the Part 2 have a great impact on the viability of the AML as a legal transplant. The act of transplanting the AML is relatively simple; the more challenging question is whether the transplant will "grow in its new body, and become part of that body just as the rule or institution would have continued to develop in its parent system."<sup>118</sup> In order for a legal transplant to be successful, the local conditions of the host country should not reject the transplant or render the transplant irrelevant. The discussion below will explore how China's local conditions have affected the effectiveness and relevance of the Western antitrust models as incorporated in the AML. It demonstrates that in all three major areas of antitrust—cartels, abuse of dominant market position, and merger review—China's local conditions have prevented the AML from becoming an integral part of China's competition policy.

#### 3.1. *Cartels, Chinese Style*

One of the central goals of antitrust is to maintain a competitive market through which society's economic resources are allocated among competing uses. In a perfectly competitive market, firms make production and sale decisions independently of—and in competition with—one another, driving prices down and volumes of production up to socially optimal levels. However, if competitors could reach, and enforce, an agreement among themselves—i.e., form a "cartel"—regarding certain areas of competition such as price, the resulting constraints on competition will disrupt market discipline and cause losses to consumer and

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<sup>118</sup> WATSON, *supra* note 1, at 27.

social welfare.<sup>119</sup> Due to the perceived threat of cartels to the functioning of the market mechanism that is considered so essential to resource allocation, antitrust law in most countries is particularly harsh on cartels, subjecting many of them to a *per se* illegality standard.<sup>120</sup>

Cartels, however, have not always been treated consistently under antitrust law. Despite the generally rigorous antitrust enforcement against cartels in Western countries, cartels have historically been tolerated or even actively encouraged by governments during times of depressed business conditions as a means of dealing with excess capacity and falling prices.<sup>121</sup> As it

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<sup>119</sup> Adam Smith, who first articulated the *laissez-faire* economic theory, characterized cartels as “a conspiracy against the public.” See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 84 (Jonathan Wright ed., 2007) (“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”). But see Jeffrey Fear, *Cartels*, in THE OXFORD HANDBOOK OF BUSINESS HISTORY 268 (Geoffrey Jones & Jonathan Zeitlin eds., 2007) for an alternative characterization of cartels. Under Fear’s characterization, cartels historically provided participating firms with a range of market-ordering options and were not formed to eliminate competition, but to regulate competition. *Id.* at 269.

<sup>120</sup> In the United States, for example, cartels (or “horizontal constraints”) are condemned under Section 1 of the Sherman Act and Section 5 of the Federal Trade Commission Act. Agreements by rival firms to fix prices, a core element of cartel conduct, have received high levels of scrutiny from the courts. In *United States v. Socony-Vacuum Oil Co.*, the U.S. Supreme Court declared that price-fixing agreements violated the Sherman Act regardless of the reasonableness of the price fixed and regardless of whether the conspirators possessed the power to affect prices in the market. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940) (“Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.”). In modern times U.S. antitrust jurisprudence has moved away from this “*per se* rule” in the horizontal constraints area in favor of a truncated “rule of reason” analysis. See *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 23 (1979) (“Not all arrangements among actual or potential competitors that have an impact on price are *per se* violations of the Sherman Act.”). However, courts still apply the classic *per se* rule to the most egregious forms of price fixing. See, e.g., *FTC v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411, 433 (1990) (“The *per se* rules also reflect a longstanding judgment that the prohibited practices by their nature have a substantial potential for impact on competition.”) (internal quotation omitted).

<sup>121</sup> In the United States, for example, the National Industry Recovery Act (“NIRA”) was enacted in 1933 as a response to the Great Depression. See 15 U.S.C. § 703 (2006) (allowing the President to approve “codes of fair competition” for various trades and industries.). The NIRA “authorized trade associations or industrial groups to establish codes of fair conduct, subject to the approval of the president.” MARC ALLEN EISNER, REGULATORY POLITICS IN TRANSITION 83 (2d ed. 2000). Failures to adopt codes of fair conduct “could result in the imposition of

stands now, antitrust law appears to have developed different approaches to cartels during times of excess capacity, depending on the nature of the excess capacity to which cartels are intended as a response. If the excess capacity is the result of sluggish market demand during a business cycle downturn, antitrust law—primarily that of the United States—has, after some periods of wavering, come to the conclusion that cartels should not be condoned under such conditions, even if the downturn is a very severe one.<sup>122</sup> From a normative point of view, this refusal to allow cartels during business cycle downturns is arguably defensible, as business cycle downturns do not typically involve the malfunction of the market mechanism itself, and reduced profits or losses incurred in such downturns are likely to be offset by profits enjoyed in business cycle upswings.<sup>123</sup>

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codes by the president or direct [government] regulation.” *Id.* The codes were exempt from antitrust law, and, as a result, agreements to fix prices were allowed. *Id.* The U.S. Supreme Court struck down part of the NIRA that permitted cartels in 1935 on grounds unrelated to antitrust. See *Schechter Poultry Corp. v. United States*, 295 U.S. 495, 550 (1935) (noting that the U.S. Constitution did not provide authority to “destroy the distinction . . . between commerce ‘among the several States’ and the internal concerns of a State”).

<sup>122</sup> The U.S. Supreme Court declared in *United States v. Socony-Vacuum Oil Co.*, a case concerning the depressed oil refining industry during the Great Depression, that an industry crisis was not relevant to antitrust analysis and that cartels could not be justified on the ground that they diminished “competitive evils.” *Socony-Vacuum*, 310 U.S. at 221. The Supreme Court’s holding in *Socony-Vacuum* was in stark contrast to its holding seven years earlier in *Appalachian Coal*, where it validated concerted industry action in the similarly depressed coal mining industry during the Great Depression. See *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 377 (1933) (“[T]he question under the Act is not simply whether the parties have restrained competition between themselves but as to the nature and effect of that restraint.”). In Japan, between 1953 and 1999, Section 24-3 of the Antimonopoly Law explicitly allowed the so-called “depression cartels” or “recession cartels” to fix prices in the event of imminent bankruptcy of firms in an industry. DAVID FLATH, *THE JAPANESE ECONOMY* 205 (2d ed. 2005). Section 24-3 of the Antimonopoly Law was widely used in the 1950s and 1960s, and the “number of government-sanctioned cartels peaked at 1,079 in 1971.” But “[s]ince that time the number [of government-sanctioned cartels] has steadily declined, dipping only to twelve by 1997.” EDWARD J. LINCOLN, *ARTHRITIC JAPAN: THE SLOW PACE OF ECONOMIC REFORM* 34 (2001). Section 24-3 of the Antimonopoly Law was eventually repealed in 1999. Catherine M. Bejerana, *Capitalist Manifesto: The Inadequacy of Antitrust Laws in Preventing the Cannibalism of Competition*, 2 *ASIAN-PAC. L. & POL’Y J.* 143, 159 n.103 (2001).

<sup>123</sup> See MANFRED NEUMANN, *COMPETITION POLICY: HISTORY, THEORY AND PRACTICE* 103 (2001) (“Cartels are frequently defended as being indispensable for coping with declining demand.”).



Where, however, the excess capacity is the result of a structural crisis—i.e., a crisis stemming from structural problems in the economy that prevent the “creative destruction,” to use Schumpeter’s term,<sup>124</sup> of the excess capacity through the market mechanism, antitrust law—primarily that of the European Union—has been more sympathetic to the needs for government-sanctioned cartels as part of non-market solutions to the excess capacity. The best examples of such “structural crisis cartels” are perhaps the cartels organized in the European synthetic fiber and steel industries in the late 1970s and early 1980s. In both cases, the industry crisis in question was first triggered by a business cycle downturn, but structural problems, caused largely by distortive state aid provided by member states of the European Communities as part of their national industrial policy, prevented the elimination of the excess capacity through the market mechanism.<sup>125</sup> From a normative point of view, this accommodation of cartels is arguably justifiable because the prevailing market conditions in a structural crisis are typically distorted by government intervention and do not necessarily reflect optimal resource allocations in the first place. The normative case for rigorous antitrust enforcement against cartels, therefore, is much weakened under such conditions.

The fundamental challenge China faces in devising a coherent cartel policy is that the structural problems that once beset the European synthetic fiber and steel industries are present in the

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<sup>124</sup> See JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM, AND DEMOCRACY* 83 (3d ed. 1950) (“Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in.”).

<sup>125</sup> In the European synthetic fiber industry, the 1973 oil crisis and the ensuing global recession caused demand to slow down significantly around 1973, but capacity continued to expand until 1978, as some member countries of the European Communities continued granting state aid to national firms in order to preserve existing capacity and develop new capacity. This aid prolonged huge losses to the industry. In 1978, the European Commission approved the D’Avignon Agreement, a cartel agreement in essence, signed by eleven major producers of European synthetic fiber for purposes of reducing their combined capacity for the main fiber types. See P. Simpson, *Response to Decline in the Western European Synthetic Fibre Industry: An Investigation of a Crisis Cartel*, in *HOW CARTELS ENDURE AND HOW THEY FAIL: STUDIES OF INDUSTRIAL COLLUSION* 254, 258 (Peter Z. Grossman ed., 2004) (noting that the D’Avignon Agreement was an effort to decrease capacity). Similarly, structural crisis cartels were permitted in the European steel industry in the late 1970s and early 1980s as a response to excessive capacities caused by distortive state aid given by member states of the European Communities to national steel firms. NEUMANN, *supra* note 123, at 103.

Chinese economy on a more massive scale. As discussed below, in many—if not most—of China’s industries, structural problems caused by the government’s distortive roles in both capacity formation and capacity elimination have led to chronic excess capacity. The tremendous competitive pressures resulting from excess capacity in those industries have, in turn, largely tied China’s hands in formulating its cartel policy.

### 3.1.1. *China’s Excess Capacity Problem*

By all indications, China’s economy has evolved from its socialist past where chronic shortage of products and services was the norm.<sup>126</sup> In many of China’s industries, chronic excess capacity, rather than shortage, has become the defining feature. In the mid 1990s, there was excess capacity in sixty-one of China’s ninety-four major categories of industrial products and the capacity utilization rate was below fifty percent in thirty-five of them.<sup>127</sup> The capacity utilization rate, for example, was seventy percent in the textile and oil refining industries, sixty percent in the machine tool, copper processing, tobacco, and alcohol spirits industries, and thirty to fifty percent in the home appliances industry.<sup>128</sup>

The excess capacity in many of China’s industries has persisted through today, and in some industries, the amount of excess capacity has reached staggering levels. In September 2009, China’s State Council approved and circulated a document drafted by the National Development and Reform Commission (“NDRC”) and nine other ministries on excess capacity in a number of industries.<sup>129</sup> According to the NDRC document, the capacity

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<sup>126</sup> The Hungarian economist Janos Kornai characterizes the typical centrally planned economy as a “shortage economy.” According to Kornai, the chronic shortages throughout Eastern Europe in the late 1970s were not the result of planners’ errors, but systemic flaws in the socialist system. See generally JÁNOS KORNAI, *ECONOMICS OF SHORTAGE* (D. W. Jorgenson & J. Waelbroeck eds., 1980).

<sup>127</sup> PEI, *supra* note 61, at 129.

<sup>128</sup> *Id.*

<sup>129</sup> The ministries involved in the drafting were: National Development and Reform Commission, Ministry of Industry and Information Technology, Ministry of Supervision, Ministry of Finance, Ministry of Land and Resources, Ministry of Environmental Protection, People’s Bank of China, General Administration of Quality Supervision, Inspection, and Quarantine, China Banking Regulatory Commission, and China Securities Regulatory Commission. *Guanyu Yizhi Bufen Hangye Channeng Guosheng he Chongfu Jianshe yindao Chanye Jiankang Fazhan de Ruogan Yijian* [Notice on Opinions Concerning Inhibiting Excess Capacity and

utilization rate in 2008 was only 76% for steel, 75% for cement, 73% for aluminum electrode, 88% for flat glass, 40% for methanol, and 20% for poly-crystalline silicon (a key raw material for solar cells).<sup>130</sup> If the new capacity currently in the project pipeline were to be included, the capacity utilization rate in those industries would be even lower: it would be 71% for steel, 59% for cement, 72% for plate glass and, breathtakingly, 4% for poly-crystalline silicon.<sup>131</sup> In August 2010, the Ministry of Industry and Information Technology ("MIIT") published a detailed list of 2,087 firms that were slated to be partially or completely shut down by the end of September 2010 due to excess capacity concerns.<sup>132</sup> The firms appearing on the MIIT list are spread in eighteen industries, including iron, steel, blast furnace coke, ferrous alloy, calcium carbide, aluminum electrode, copper smelting, lead smelting, zinc smelting, cement, glass, paper, ethanol, monosodium glutamate ("MSG"), citric acid, leather, dye, and chemical fiber.<sup>133</sup> The excess capacity being tackled by the NDRC and MIIT, however, is only the tip of the iceberg. The industries mentioned above are on the government's priority list primarily because they are considered key to the national economy or because they pose serious environmental concerns. In addition to those industries, excess capacity has become a major problem in many other industries as well, including semiconductor,<sup>134</sup> automobile,<sup>135</sup> vitamin C,<sup>136</sup> and

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*Duplicate Construction in Certain Industries in Order to Guide Healthy Industrial Development*], NATIONAL DEVELOPMENT AND REFORM COMMISSION (Sept. 26, 2009), [http://www.sdpc.gov.cn/zcfb/zcfbqt/2010qt/t20100513\\_346554.htm](http://www.sdpc.gov.cn/zcfb/zcfbqt/2010qt/t20100513_346554.htm).

<sup>130</sup> *Id.* The percentages are calculated using the figures provided by the NDRC document.

<sup>131</sup> *Id.* The percentages are also calculated using the figures provided by the NDRC document.

<sup>132</sup> See *Zhonghua Renmin Gongheguo Gongye he Xinxihua Bu Gonggao* [Bulletin of the Ministry of Industry and Information Technology of the People's Republic of China], MIIT Doc. No. [2010] 111, Aug. 5, 2010, <http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/13333127.html> (providing a list of firms to be shutdown due to excess capacity).

<sup>133</sup> *Id.*

<sup>134</sup> In the first three months of 2009, seventy percent of China's semiconductor production capacity was idle. See Andrew Batson, *Stimulus Dilemma for China: Spending on Public Works Risks Making Production Glut Worse*, WALL ST. J., Mar. 21, 2009, at A6 (reporting that seventy percent of China's semiconductor production was idle due to concerns of excess capacity).

<sup>135</sup> It has been reported that China's auto industry "is expected to face excess capacity by 2012." China's top fourteen auto makers alone "will have a combined . . . capacity of 23 million vehicles by 2012, though demand is only expected to

industrial commodities,<sup>137</sup> to name just a few. Since 2008, the threat of excess capacity has been looming even larger as China rolled out its four trillion *yuan* economic stimulus program as a response to the 2008–2009 global financial crisis.<sup>138</sup>

### 3.1.2. Structural Distortions Behind China's Excess Capacity

There are several reasons for China's chronic excess capacity. The primary culprit, as it is often argued, is China's abnormally high savings and investment rates.<sup>139</sup> Domestic consumption in China has historically been low, and has trended even lower since the start of the new century.<sup>140</sup> By 2007, the share of investment in GDP reached forty-three percent, up from about thirty-five percent at the beginning of the decade.<sup>141</sup> The share of investment in GDP further increased to a staggering sixty-seven percent in 2009, thanks to the large spike in investment because of China's economic stimulus program.<sup>142</sup> With this high of an investment

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reach 20 million by that time." Dan Gallagher, *Chinese Auto Industry May Face Excess Capacity*, MARKETWATCH (Feb. 3, 2010, 7:12 PM), <http://www.marketwatch.com/story/chinese-auto-industry-may-face-excess-capacity-2010-02-03>.

<sup>136</sup> See *Fagaiwei: Wu Da Cuoshi Ezhi Weishengsu C Channeng Guosheng* [NDRC: Five Measures to Tackle Excess Capacity in Vitamin C], CHINA NEWS NET (Dec. 30, 2009), <http://finance.ifeng.com/news/industry/20091230/1648112.shtml> (noting excess capacity in the vitamin C industry).

<sup>137</sup> See Yanzheng Li, *Yuancailliao Gongye: Bufen Chanpin Channeng Guosheng Jiaju* [Industrial Commodities: Excess Capacity in Certain Products Worsens], FINANCE.EASTDAY.COM (Jan. 30, 2010), <http://finance.eastday.com/m/20100130/u1a4988960.html> (commenting on the excess capacity problems in raw materials industries).

<sup>138</sup> See Batson, *supra* note 134 (discussing the excess capacity problems that resulted from the massive investment in the Chinese economy).

<sup>139</sup> See, e.g., Editorial, *The Cost of China's Excess Capacity*, FIN. TIMES (London), Nov. 30, 2009, at 12 (arguing that China's response to the current financial crisis through continued over-investment and savings has exacerbated excess capacity).

<sup>140</sup> At the beginning of the 2000s, overall consumption spending in China accounted for more than sixty percent of GDP. That percentage declined to about fifty percent by 2007. Meanwhile, household consumption in China declined to a record low of thirty-seven percent of GDP by 2007. Jonathan Anderson, *Solving China's Rebalancing Puzzle*, FIN. & DEV., Sept. 2007, available at <http://www.imf.org/external/pubs/ft/fandd/2007/09/anderson.htm>.

<sup>141</sup> See *id.* (illustrating the increase in the investment share from 2000 to 2007).

<sup>142</sup> See Li Lin, *Guding Zichan Touzi Jiaokuai Shangzhang: Ddifang Xiangmu Zengsu Gao Zhongyang Yibei* [Fixed-Asset Investment Increases at Fast Pace: Local Projects Enjoy Rate of Increase Double That of Central Projects], ECON. OBSERVER (Mar. 11, 2010), <http://www.eeo.com.cn/Politics/shuju/2010/03/11/164886.shtml> (providing information from the Bureau of Statistics on investment in China).

rate, the expansion of production capacity appears to be a natural consequence.<sup>143</sup>

However, China's high investment rate is only part of the explanation why excess capacity is so widespread and persistent in China. When it comes to excess capacity, what matters is not just the total amount of investment, but how investment is made. In China, the investment-making process is predominantly a government-driven one. Since the founding of the People's Republic of China, investment control has been an important part of the government's economic planning and control processes. Until very recently, all fixed-asset investment, even investment by private enterprises, was subject to government-imposed quotas and required approvals by the government.<sup>144</sup> Investment control in China, however, has largely been decentralized. Back in the planned economy era, consistent with the trend towards a decentralized industrial structure,<sup>145</sup> the central government already delegated to local governments the authority for approving and supervising investment projects in a number of sectors.<sup>146</sup> In the reform era, China's investment control regime has

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<sup>143</sup> As has been pointed out, China's efforts to maintain a high economic growth rate through increasing investment will likely lead to even more excess capacity. See *The Cost of China's Excess Capacity*, *supra* note 139.

<sup>144</sup> For an explanation of China's investment regime in the reform era through the 1990s, see YASHENG HUANG, INFLATION AND INVESTMENT CONTROLS IN CHINA: THE POLITICAL ECONOMY OF CENTRAL-LOCAL RELATIONS DURING THE REFORM ERA 63-88 (1996). In 2004, the State Council issued a policy document on reforming China's investment regime. Under the proposed new regime, investment not directly funded by the government, e.g., investment by SOEs using their retained profits or investment by private enterprises will not require approval (*shenpi*) from the government. Depending on the scales and public interest implications of such projects, only "confirmation" (*hezhun*) or "registration" (*beian*) would be required. State Council, *Guowuyuan Guanyu Touzi Tizhi Gaige de Jueding* [Decision by State Council on Reforms of Investment Regime], State Council Doc. No. [2004] 20, Jul. 16, 2004, [http://www.gov.cn/zwggk/2005-08/12/content\\_21939.htm](http://www.gov.cn/zwggk/2005-08/12/content_21939.htm) [hereinafter *State Council Decision on Reforms of Investment Regime*].

<sup>145</sup> See *supra* Part 2.2. (explaining the longstanding tradition of decentralization since the founding of the People's Republic of China).

<sup>146</sup> Starting in the 1960s, the central government began to devolve a significant amount of investment control to local governments. In 1964, the central government stipulated that capital investment in nineteen nonindustrial sectors, including forestry, education, health, local husbandry, and urban public utilities, should be the primary responsibilities of local governments. In the subsequent years, "local governments acquired more investment authority over commercial distribution centers, local irrigation facilities, and some 'small' industries (e.g., [small cement and fertilizer factories])." HUANG, *supra* note 144, at

been further decentralized, with the central government now only approving larger investment projects in important sectors.<sup>147</sup> In the first two months of 2010, for example, the amount of investment approved by local governments accounted for about ninety-one percent of all investment in urban areas in China.<sup>148</sup> In addition to having the authority to approve investment, the central and local governments are the largest investors themselves. Governments at various levels in China make investment either in their own capacity or through SOEs directly under their supervision, with the line between the two often blurred. In 2006, the most recent year for which statistics on investment by ownership type are available, investment made by state entities (including SOEs and entities that are majority-controlled by the state) accounted for about forty-eight percent of all investment in urban areas.<sup>149</sup>

While the decentralization of investment control has resulted in greater investment capabilities for local governments, it is the fiscal reforms that have provided incentives for local governments to

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66. In 1974, in recognition of the increasingly important role of local governments in investment making, the central government “drew up the so-called four-three-three plan for dividing up investment [responsibilities]” between the central and local governments. *Id.* Under this plan, “the central government managed about 40 percent of the investment portfolio; the central and local governments together managed about 30 percent; and local governments managed the remaining 30 percent.” *Id.*

<sup>147</sup> China periodically publishes a list of investment projects that require “confirmation” by the government. The list also specifies the level of government that is authorized to give such confirmations. Generally, the central government is responsible for confirming only the largest projects, while the local governments are responsible for confirming the others. For example, power generation plants with a capacity of 250,000 kilowatts or more have to be confirmed by the NDRC, while power generation plants with smaller capacities need only be confirmed by local governments. See *State Council Decision on Reforms of Investment Regime*, *supra* note 144, app. (providing a list of information pertaining to investment projects requiring government confirmation).

<sup>148</sup> In the first two months of 2010, the total amount of investment in urban areas was 1,301.4 billion yuans, of which 1,179.5 billion yuans was approved by local governments and 121.9 billion yuans was approved by the central government. See Lin, *supra* note 142 (describing the increase in local government investment as much greater than central government investment based upon statistics released by the National Bureau of Statistics).

<sup>149</sup> In 2006, the total amount of investment in urban areas was 9,347.2 billion yuans, while investment by state entities in urban areas was 4,521.2 billion yuans. See NAT'L BUREAU OF STATISTICS OF CHINA, ZHONGHUA RENMIN GONGHEGUO 2006 NIAN GUOMIN JINGJI HE SHEHUI FAZHAN TONGJI GONGBAO [REPUBLIC OF CHINA 2006 NATIONAL ECONOMIC AND SOCIAL DEVELOPMENT STATISTICS] (Feb. 28, 2007), [http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/t20070228\\_402387821.htm](http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/t20070228_402387821.htm) (providing economical statistics on China's investments for the year 2006).

make the best use of their investment capabilities.<sup>150</sup> Under China's current fiscal regime, the chief means for local governments to increase their revenues is to create new local enterprises and promote the growth of existing ones.<sup>151</sup> This fiscal pressure leads to strong investment urges on the part of local governments.<sup>152</sup> Investment made by government bureaucrats, however, often lacks sound commercial justifications. In the case of China, much of the investment made under the auspices of local governments is made for the primary purpose of competing against other localities for both tax revenues and higher economic growth rates.<sup>153</sup> Recall that prior to the start of economic reforms, China's industrial structure was already decentralized, with industries being duplicated at the provincial level.<sup>154</sup> Local governments' strong motivations to out-invest one another in the reform era have led to widespread copycat investment, further adding to the duplication of industries at local levels.<sup>155</sup> As large sums of investment continue pouring into sectors already crowded with producers looking for buyers, excess capacity would appear inevitable.

Admittedly, duplicate investment in and of itself is not that unusual. Even in a market economy with little government meddling in the investment process, capacity formation cannot always accurately reflect market demand due to the uncertainties inherent in the marketplace. But in a typical market economy, excess capacity tends to be eliminated by market forces relatively quickly, through bankruptcy of firms that lose out in the

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<sup>150</sup> See *supra* Part 2.2.

<sup>151</sup> The major sources of tax revenues under China's current fiscal regime are value added tax (75% assigned to the central government and 25% assigned to local governments), business tax (100% assigned to local governments except in certain industries), and enterprise income tax (60% assigned to the central government and 40% assigned to local governments). OECD, CHALLENGES FOR CHINA'S PUBLIC SPENDING: TOWARD GREATER EFFECTIVENESS AND EQUITY 29 (2006). For local governments to increase their revenues from any of the three taxes, they need to increase the revenues or profits of local enterprises.

<sup>152</sup> See *supra* notes 52-55 and accompanying text.

<sup>153</sup> See HUANG, *supra* note 144, at 70-73 (discussing how competition between localities influences local economic investment decisions).

<sup>154</sup> See *supra* Part 2.2.

<sup>155</sup> For example, when envisioning their long-term industrial goals, twenty-two provinces listed automobile manufacturing as a "pillar" industry, twenty-four listed electronics as a pillar industry, sixteen listed machine-building and chemicals as a pillar industry, and fourteen listed metallurgy as a pillar industry. See PEI, *supra* note 61, at 129.

competition for customers.<sup>156</sup> Arguably, this capacity formation/elimination cycle is precisely the trial and error process through which the market achieves the optimal allocation of resources. But what makes China's situation unusual is that not only is capacity formation distorted by the role of the government, but capacity elimination is distorted by the role of the government, too. In China, much of the duplicate investment is made by SOEs, particularly SOEs supervised by local governments. As discussed earlier, despite China's efforts to commercialize and corporatize SOEs, many of them still shoulder responsibilities apart from profit considerations, such as the provision of employment and social services.<sup>157</sup> For this reason, when SOEs become insolvent, the government is very reluctant to let them go into bankruptcy.<sup>158</sup> And, under China's current tax regime, keeping loss-making SOEs in operation may even make financial sense for local governments, as long as the taxes paid by those SOEs—chiefly Value-Added-Taxes (“VAT”) and Business Taxes—exceed their operating losses.<sup>159</sup> Even if taxes paid by SOEs are not enough to cover their operating losses, in many cases the losses are borne not by local governments, but by the local branches of state-owned banks in the

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<sup>156</sup> A recent example of this capacity formation/elimination cycle in a market economy can be found in the fiber optic network industry in the United States. At the beginning of the 2000s, “dozens of companies rushed to build fiber-optic networks, envisioning a new era of high-speed telecommunications.” Anupreeta Das, *Networks Hope to Cash in on Fiber*, WALL ST. J., June 18, 2010, at B1. But, the anticipated demand did not materialize soon enough before many of the companies declared bankruptcy. *Id.*

<sup>157</sup> See *supra* note 103 and accompanying text.

<sup>158</sup> In August 2006, China enacted a new bankruptcy code that went into effect in June 2007. *Zhonghua Renmin Gongheguo Qiye Pochan Fa* [The Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), available at [http://www.gov.cn/flfg/2006-08/28/content\\_371296.htm](http://www.gov.cn/flfg/2006-08/28/content_371296.htm). One of the central goals of the new bankruptcy code is to place SOEs on the same footing as private enterprises when it comes to bankruptcy. In practice, however, the new bankruptcy code “has seen little use, with the government preferring negotiated solutions that keep workers at least nominally employed.” Batson, *supra* note 134, at A6.

<sup>159</sup> China's Value-Added-Tax and Business Tax are both taxes levied on turnovers, not profits. See OECD, *supra* note 48, at 628 (“[VAT] applies to sales of all goods and imports of goods within [China] . . . . The business tax is levied on turnover of taxable services, transfer of intangible assets, or sales of immovable properties in China.”). Therefore, as long as a firm is in operation, regardless of whether it makes a profit, it pays VAT or Business Taxes.



form of non-performing loans.<sup>160</sup> Therefore, local governments have the incentives, as well as the means, to keep insolvent SOEs in operation and hence prolong, if not prevent, the elimination of excess capacity.

### 3.1.3. "Excessive Competition"

The excess capacity in many of China's industries, coupled with China's low market concentration ratios,<sup>161</sup> leads to enormous competitive pressures in those industries. In fact, competition is so intense in many of China's industries, and the industries affected are so wide-ranging, that a new term was coined in the Chinese lexicon to describe just this phenomenon: "excessive competition" (*guodu jingzheng*). An Internet search using the Chinese characters for the term would return hundreds of thousands of hits, most of which are Chinese media reports of intense competition in various industries.<sup>162</sup> The industries that are reportedly affected by excessive competition are numerous, including cement,<sup>163</sup> building materials,<sup>164</sup> DVD players,<sup>165</sup> electronics,<sup>166</sup> LCD flat panels,<sup>167</sup> dairy

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<sup>160</sup> Along with fiscal decentralization, the banking system has also been decentralized in the reform era. Today, the local branches of state-owned banks are subject to "dual subordination" (*shuangchong lingdao*), i.e., subordination to the banking hierarchy as well as to local governments. Over the years, local governments have gained great influence over credit decisions of the local branches of state-owned banks. See QIAN & WEINGAST, *supra* note 44, at 16-17.

<sup>161</sup> See *supra* Part 2.3.

<sup>162</sup> See Bruce M. Owen et al., *China's Competition Policy Reforms: The Anti-Monopoly Law and Beyond*, 75 ANTITRUST L.J. 231, 247 (2008) (providing an overview of results of a Chinese Internet search using the term "excessive competition").

<sup>163</sup> See *Chuandong Quan Hangye Kuisun; Sichuan Shuini Guosheng Yali Tuxian [Cement Sees Sector Loss in Eastern Sichuan; Excess Capacity Looms]*, CHINA CEMENT, Jul. 15, 2010, <http://www.chinacements.com/news/2010/7-14/C155418545.htm> (commenting on the problems in the cement industry in the Sechuan province of China due to excessive competition).

<sup>164</sup> See *Guodu Jingzheng Daozhi Beijing Jiancai Maichang Shengcun Buyi [Excessive Competition Leads to Low Odds of Survival in Beijing's Building Materials Market]*, HC360 (Sept. 25, 2009), <http://info.bm.hc360.com/2009/09/251625106771.shtml> (describing problems faced in the building materials industry as a result of excessive competition).

<sup>165</sup> See Tong Yi, *DVD Chichang Guodu Jingzheng Lirun Jihu Wei Ling [Excessive Competition in Market for DVD Players Leads to Almost Zero Profits in Industry]*, SHENZHEN TEQU BAO [SHENZHEN SPECIAL ECONOMIC ZONE JOURNAL], Jan. 19, 2007, available at <http://news.chinabyte.com/459/3046959.shtml> (explaining problems faced in the DVD market as a result of excessive competition).

<sup>166</sup> See *Guodu Jingzheng Dianzi ye Zengchan Nan Zeng Lirun [Excessive Competition in Electronics Industry: Production Up, But Profits Down]*, GUANGZHOU

products,<sup>168</sup> biomass power,<sup>169</sup> retails,<sup>170</sup> construction,<sup>171</sup> airlines,<sup>172</sup> and ocean shipping,<sup>173</sup> to name just a few.

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DAILY, Oct. 13, 2005, available at [http://cn.ppzw.com/Article\\_Show\\_23288.html](http://cn.ppzw.com/Article_Show_23288.html) (explaining problems in the electronics industry resulting from excessive competition).

<sup>167</sup> See *Yeijing Mianban Quan Hangye Kuisun: Guonei Xin 8 Dai Xian Qianjing Hezai* [Sector Loss for LCD Flat Panels: Where Does the Future of the Eighth-Generation Production Lines Lie?], *DIYI CAIJING RIBAO* [FIRST BUSINESS & FINANCE DAILY], Sept. 3, 2009, available at, <http://finance.oeeee.com/a/20090903/269113.html> (describing losses in the LCD television market from excessive competition).

<sup>168</sup> See *Zhongguo Naiye Jinru Panzheng Qi: Niunai Shoujia Huidao Shinian Zhiqian* [China's Dairy Industry in Consolidation Mode: Milk Prices Drop to Levels Unseen in Ten Years], *SHICHANG BAO* [MARKET DAILY], Jan. 21, 2008, available at [http://news.xinhuanet.com/fortune/2008-01/21/content\\_7460884.htm](http://news.xinhuanet.com/fortune/2008-01/21/content_7460884.htm) (attributing milk price increases due to overall rise in the market, i.e. excessive competition).

<sup>169</sup> See *Shandong Shengwuzhi Fadian Qiye Jihu Quanbu Kuisun* [Almost All Biomass Power Plants in Shandong Province Operate at Losses], *YOUGUOW*, July 13, 2010, <http://www.youguow.com/2010/0713/15633.html> (explaining the effect of challenges stemming from excess competition on the energy industry).

<sup>170</sup> See Xiaoding Wu & Xiaoyan Wang, *Jilin Sheng Daxing Lingshou Qiye Guodu Jingzheng de Yuanyin Ji Duice Yanjiu* [Causes of and Policy Responses to Excessive Competition Among Large Retailers in Jilin Province], *QKZZ.NET*, <http://qkzz.net/article/de2a0525-9151-4bf7-ab0c-43e358a07f11.htm> (last visited Oct. 26, 2010) (discussing the effects of excess competition on the retail industry in the Jilin Province and proposing potential solutions).

<sup>171</sup> See *Jianzhu Shigong Qiye Shichang Jingzheng de "Nitan": Guanyu Jianzhu Hangye Guodu Jingzheng de Sikao* [Construction Firms Trapped in Market Competition: Thoughts on Excessive Competition in the Construction Industry], *ZGJZY.ORG* (Dec. 26, 2006), <http://www.zgjzy.org/guild/sites/ccia/detail.asp?i=ZT&id=10077> (discussing the effects of excessive competition on the construction industry including hyper-competitive market share, fierce price competition, and disorder stemming from non-standard competition).

<sup>172</sup> See *Hangkongye Guodu Jingzheng: San Da Hang Huo Zai Chongzu* [Excessive Competition in the Airline Industry; Restructuring of the Big Three Airlines is a Possibility], *SHIDAI ZHOUKAN* [TIMES WEEKLY], May 6, 2010, available at <http://i.lwcj.com/news/news100506003.htm> (explaining the effects of excessive competition in the airline industry, particularly on the three major airlines).

<sup>173</sup> See *Haiyun Jing Xian "Fu Baojia"* [Startling: Negative Shipping Fees in Ocean Shipping Industry], *JIAODIAN FANGTAN* [FOCUS INTERVIEWS], Sept. 22, 2006, available at <http://news.sohu.com/20060922/n245477144.shtml> [hereinafter *Negative Ocean Shipping Charges*] (discussing the fierce competition in the ocean shipping industry and how it has caused negative shipping rates through a transcript of a China Central TV broadcast); *14 Jia Riben Hangxie Chuandong Zucheng Yunjia Zili Lianmeng* [Fourteen Shipping Companies Operating in Sino-Japan Shipping Routes Form Self-Discipline Coalition], *TIANJIN OCEAN NETWORK*, July 30, 2009, available at, <http://www.t-shipping.net/a/20090730/674.html> [hereinafter *Sino-Japan Ocean Shipping Price Coalition*] (reporting on an agreement between Chinese shipping companies to provide reasonable transport at a reasonable rate).

On its face, the term “excessive competition” is puzzling, as it suggests that there is a “right” amount of competition above which competition will become “excessive”. In a typical market economy, competition is the very mechanism through which the market “discovers” the price that best allocates scarce resources among competing uses. It appears to make little economic sense, therefore, to speak of competition as if it required intrinsic limitations.<sup>174</sup> But China is not a typical market economy, at least not yet. As discussed earlier, because of the transitional stage China is currently in, the market environment in which competition takes place in China is still distorted by state control of both capacity formation and capacity elimination. In such a distorted environment, competition may well be “excessive” if it leads to outcomes that are not socially optimal from an economic efficiency point of view.

A closer examination of the circumstances of competition in China’s industries does confirm that competition is indeed “excessive” in many industries from an economic efficiency point of view. In a typical market economy, competition usually occurs on both price and product quality dimensions. But in China, the abundance of small-scale firms<sup>175</sup> dictates that a large number of Chinese firms lack the financial capabilities to engage in product differentiation through technological innovation.<sup>176</sup> Also contributing to the lack of innovation in China’s marketplace is the

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<sup>174</sup> In essence, this view of competition is what drives the U.S. Supreme Court’s opinion in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), where the Court reaffirmed that price fixing was a per se violation of Section 1 of the Sherman Act. See *Socony-Vacuum*, 310 U.S. at 218 (“[T]his Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful per se under the Sherman Act, and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense.”).

<sup>175</sup> See *supra* Part 2.2.

<sup>176</sup> Particularly, because of their limited financing abilities and preferences for immediate results, local governments in China typically prefer investing in small, easy-to-build firms. Many of those firms, as a result, are still utilizing sub-par or even obsolete technologies. In the cement industry, for example, thirty-eight percent of China’s cement capacity consists of “shaft” kilns, which have been obsolete in most of the rest of the world for over a century, and accounted for less than three percent of production even in 1957. See Mark DeWeaver, *China’s Excess-Capacity Nightmare*, PROJECT SYNDICATE (Dec. 22, 2009), <http://www.project-syndicate.org/commentary/deweaver2/English> (explaining how small regional firms in China utilize cheap, obsolete technology to increase regional benefits, but which cause harm to the industry as a whole).

country's lax protection of intellectual property rights.<sup>177</sup> As a result, competition in many industries in China occurs on one dimension alone, i.e., price. The fact that intense price competition drives industry profits to abnormally low or even negative levels is common to almost all of the reported instances of excessive competition.<sup>178</sup> In some industries, the intensity of price competition has reached a staggering level. In the ocean shipping industry operating between Shanghai and Japan, for example, price competition once reached a point where shipping companies charged shippers negative shipping fees, with a weekly loss of about \$760,000 for an average shipping company.<sup>179</sup> Not surprisingly, the only firms that could remain standing under such intense competition and heavy losses were SOEs.<sup>180</sup> The enormous downward pressures on price are not limited to China's domestic industries, but are felt by China's trading partners on the world stage as well. In 2005, a senior Chinese trade official lamented that the root cause of the rising number of antidumping proceedings against Chinese products in overseas markets was the "vicious competition" among Chinese firms.<sup>181</sup> In addition, intense price competition has posed product safety concerns, as some financially squeezed firms seek to cut corners on raw materials and product quality.<sup>182</sup>

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<sup>177</sup> For general discussions on the protection of intellectual property rights in China, see JIANQIANG NIE, *THE ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS IN CHINA* (2006).

<sup>178</sup> See *supra* notes 163–73 and accompanying text.

<sup>179</sup> See *Negative Ocean Shipping Charges*, *supra* note 173.

<sup>180</sup> It was noted that in the Sino-Japan Ocean shipping industry, all of the firms that were quoting negative shipping fees were SOEs. *Id.*

<sup>181</sup> See Long Yongtu: "Fan Qingxiao" Genzi Zaiyu Guonei Qiye Exing Jingzheng [Long Yongtu: Malignant Competition Among Domestic Firms the Root Cause of Antidumping Cases], ANHUINEWS (Jun. 13, 2005), <http://finance.anhnews.com/system/2005/06/13/001282695.shtml> (discussing the notion that vicious competition among domestic companies is the main reason why China faces so many antidumping proceedings, and advocating strong regulation of the domestic trade environment).

<sup>182</sup> In recent years, Chinese products have been involved in numerous safety and quality scandals, both domestically and abroad. The most notorious of the recent scandals is the 2008 milk contamination incident, where at least three children died and tens of thousands more became ill after drinking milk contaminated with melamine, a cheap industrial chemical that, if added to raw milk, would make milk seem as though it is in higher protein than it actually is. See Gordon Fairclough, *Tainting of Milk is Open Secret in China*, WALL ST. J., Nov. 3, 2008, at A1 (reporting on how Chinese dairy farmer's spiked their milk with the toxin melamine in order to artificially increase the protein levels when tested by

### 3.1.4. *Cartels as Disguised Price Control*

When competitive pressures are up, so are the incentives to organize cartels. China has proven no exception to this rule. As discussed earlier, beginning in the early 1990s, China's price liberalization began advancing at a fast pace.<sup>183</sup> Unshackled from the government's price control, Chinese firms began to use price as a competitive weapon. It did not take the firms very long to learn, however, that price competition did not always work in their favor. In 1993, in what appears to be China's first price cartel in modern history, five top retail outlets for electrical appliances in Beijing conspired to increase the price of washing machines sold at their stores by 10%.<sup>184</sup> That was only one year after the price control for light industry goods, which included washing machines, was abolished.<sup>185</sup>

Ever since the first price cartel in 1993, China's cartel policy has been caught in a tug-of-war between two forces brought about by China's price reforms. On one hand, the general trend towards price liberalization requires the setting of prices by the market, and any interference with the setting of prices by the market, including efforts by cartels to fix prices, is undoubtedly against the fundamental goal of price liberalization. As a result, as price reforms deepened, China has sought to ban cartels, at least as a matter of principle. The 1997 Price Law, enacted after the bulk of China's price liberalization was completed, contained China's first legal provision banning price fixing.<sup>186</sup> Price fixing also topped the

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health inspectors). It has been noted by the Chinese media that excessive competition in the dairy industry is to blame for the incident. See Buke Jiang, *Sanlu Nai An Shi Guodu Jingzheng De Jieguo* [Sanlu Milk Incident an Outcome of Excessive Competition], CNAOTOP.COM (Jan. 8, 2009), <http://www.cnadtop.com/brand/superBrands/2009/1/8/1e0bec56-3ea2-4414-9a33-e7987b6d4efc.htm> (explaining that continued excessive competition will always lead to violations by companies trying to turn a profit and suggesting price competition restraints, government regulations on competition, and implementing strategies to avoid severe competition).

<sup>183</sup> See *supra* notes 36–37 and accompanying text.

<sup>184</sup> INTERNAL MARKET, *supra* note 29, at 134.

<sup>185</sup> See *supra* note 36 and accompanying text.

<sup>186</sup> See Price Law, *supra* note 39, art. 14(1) (instituting a ban on collusive behavior that manipulates market prices and causes detriment to others operating in the market or consumers).

list of prohibited pricing conduct in a regulation issued by the NDRC in 2003<sup>187</sup> and, most recently, the AML.<sup>188</sup>

On the other hand, government regulators in China continue to see a positive role of cartels in addressing structural distortions caused by the incompleteness of price reforms. As discussed earlier, although firms, particularly SOEs, have been granted the power to decide on pricing on their own, they are still not entirely responsible for the consequences of their pricing decisions because of soft budget constraints and government-imposed exit barriers. And many of the firms competing in China's industries would not have been there in the first place but for the distortive role of the governments, particularly local governments, in the investment process. Government regulators soon found out that under such structural distortions, unbridled competition would only lead to unbridled price wars, which in turn would lead to the draining of the state's coffer and the pile-up of non-performing loans in state-owned banks. As a result, China's government regulators have, as discussed below, looked to cartels as a means of reinstating some sort of price control that was abolished in the price reforms.

Initially, the government's efforts to reinstate price control took the form of direct government regulation of price. In June 1998, the National Bureau of Building Materials (one of the national bureaus downgraded from ministries and subordinated under the State Economic and Trade Commission ("SETC") in 1998),<sup>189</sup> in conjunction with the then State Development and Planning Commission (the predecessor to the NDRC), issued a regulation prohibiting sales of plate glass at below-cost prices, a practice widespread in the plate glass industry due to intense, or as it later became known, "excessive" competition.<sup>190</sup> The regulation

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<sup>187</sup> NDRC, *Zhizhi Jiage Longduan Xingwei Zhanxing Guiding* [Provisional Provisions on Prohibition of Monopoly Pricing], art. 4(1), Jun. 18, 2003, NDRC Order No. 3, <http://www.jincao.com/fa/09/law09.47.htm> [hereinafter *NDRC Provisional Provisions on Monopoly Pricing*].

<sup>188</sup> See AML, *supra* note 10, art. 13(1) (prohibiting monopoly agreements among competing operators that fix or change the price of a commodity).

<sup>189</sup> See *supra* note 108 and accompanying text.

<sup>190</sup> See State Development and Planning Commission & National Bureau of Building Materials, *Guanyu Zhizhi Dijia Qingxiao Pingban Boli De Bu zhengdang Jingzheng Xingwei De Zhanxing Guiding* [Provisional Provisions on Prohibition of Sales of Plate Glass at Below-Cost Prices], Jun. 15, 1998, [http://www.law-lib.com/law/law\\_view.asp?id=13983](http://www.law-lib.com/law/law_view.asp?id=13983) [hereinafter *Provisional Provisions on Plate Glass*] (prohibiting the sale of plate glass at below-cost prices in order to maintain fair, open, and lawful market competition).

authorized the National Bureau of Building Materials to periodically calculate and publish a "social average cost of production" for each type of plate glass,<sup>191</sup> and ordered manufacturers to price above those costs.<sup>192</sup>

In essence, the regulation on plate glass pricing was a throwback to the price control era, as it imposed price floors in an industry that had already seen complete price liberalization. This development was hardly consistent with the general trend away from price setting by the government. Therefore, two months later, when the SETC picked up the idea of price floors and expanded it to additional products, it implemented the price floors not through direct government regulation, but through "voluntary" industry action. In August 1998, the SETC issued an opinion calling for the implementation of the so-called "industrial self-discipline prices" in certain industries.<sup>193</sup> The SETC opinion required industrial associations<sup>194</sup> to determine, in consultation with the national bureaus, "industrial self-discipline prices" based on social average costs of production.<sup>195</sup> The implementation of industrial self-discipline prices was to rely on "equal coordination, mutual monitoring, and self discipline" among or by firms.<sup>196</sup> Apparently, what was expected of firms under the SETC opinion was little different from price fixing, albeit with government approval. Note that it was only one year earlier that the Price Law explicitly outlawed price fixing.<sup>197</sup> Subsequent to the issuance of the SETC opinion, industrial self-discipline prices, or more

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<sup>191</sup> *Id.* art. 4.

<sup>192</sup> *Id.* art. 5 (mandating that manufacturer prices should not dip below the average social cost).

<sup>193</sup> See State Economic and Trade Commission, *Guanyu Bufen Gongye Chanpin Shixing Hangye Zilü Jia De Yijian* [*Opinion on the Implementation of Industrial Self-Discipline Price for Certain Industrial Products*], Aug. 17, 1998 (on file with author) [hereinafter *SETC 1998 Opinion on Industrial Self-Discipline Prices*] (explaining that the manufacturer's price should be based on the ex-factory price or lowest average cost).

<sup>194</sup> See *supra* note 115 and accompanying text.

<sup>195</sup> See *SETC 1998 Opinion on Industrial Self-Discipline Prices*, *supra* note 193, art. 2(1)-(2) (explaining that the self-discipline price should be based on the lowest average cost or post-factory price).

<sup>196</sup> *Id.* art. 1(1).

<sup>197</sup> See *supra* note 186 and accompanying text.

accurately, government-sanctioned price cartels, were implemented for as many as twenty-one products.<sup>198</sup>

The tension between the need for market pricing, called for by price reforms, and the need for limits on market pricing, called for by structural distortions caused by the incompleteness of price reforms, has led to a wide gap between how cartels are treated under formal laws and how cartels are treated in practice. On one hand, there are laws and regulations that strictly prohibit cartels. On the other hand, there are public, widespread attempts at cartels, so public and so widespread that the media routinely reports them with a sense of resignation or even normalcy. In the color TV industry, for instance, five publicly reported attempts were made to organize nationwide price or production cartels by China's largest color TV manufacturers in a short period of two years between April 1998 and June 2000.<sup>199</sup> In the VCD player industry, three publicly reported attempts were made to organize nationwide price cartels between May 1997 and May 2000.<sup>200</sup> In late 2005, twenty-three of China's largest aluminum electrode producers announced the formation of a production cartel to jointly reduce their volumes of production by ten percent.<sup>201</sup> The producers made the announcement in a very high-profile manner, seemingly unconcerned by the NDRC's 2003 regulation on monopoly pricing that explicitly banned production cartels like the one they were organizing.<sup>202</sup> In the airline industry, there have been repeated attempts at price cartels to curb ever-increasing price competition. It was reported that in March 2005, almost all of

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<sup>198</sup> See Yanbei Meng, *Fanlongduan Fa Dui Shichang Zhuti Zizhu Dingjia Quan De Xianzhi* [Restrictions on Pricing Power of Market Entities Under Antitrust Law], FAXUE ZAZHI [LEGAL SCI. MAG.], Nov. 6, 2005 (discussing China's Anti-Monopoly Law and the autonomy of market players in determining pricing).

<sup>199</sup> See SCOTT KENNEDY, THE BUSINESS OF LOBBYING IN CHINA 113 (2005) (discussing the price fixing attempts by cartels to stabilize prices in the color TV industry and how those efforts repeatedly failed).

<sup>200</sup> See *id.* tbl.4.2 (documenting attempts by the VCD industry to set price floors from May 1997 to May 2000).

<sup>201</sup> See *Zhongguo 23 Jia Dianjieliü Gugan Qiye Jiang Lianhe Jianchan 10%* [Twenty-Three of China's Largest Aluminum Electrode Manufacturers to Jointly Reduce Production by Ten Percent], Dec. 2, 2005, <http://www.cnmn.com.cn/ShowNews.aspx?id=55765> (explaining that a rapid growth in China's electrolytic aluminum industry led to a rapid increase in costs, leaving businesses with an overall loss).

<sup>202</sup> See NDRC *Provisional Provisions on Monopoly Pricing*, *supra* note 187, art. 4(2) ("Operators are prohibited from . . . manipulating price through [jointly] imposing restrictions on output.").



China's airline companies were involved in a "price coalition" aimed at propping up ticket prices for flights between Beijing and seven major Chinese cities.<sup>203</sup> In April 2009, eight months after the AML went into effect, "price coalition" reappeared in the airline industry, this time in the form of a new industry price quoting system that lowered the basis for calculating price discounts.<sup>204</sup> Similarly, the ocean shipping industry operating the Sino-Japan shipping routes has seen repeated attempts to organize price cartels as a means of stopping zero or negative shipping charges. One such attempt was made in the summer of 2005,<sup>205</sup> followed by another attempt in August 2009.<sup>206</sup>

The government's attitudes towards cartels, not surprisingly, have been ambivalent at best. Only in very few cases has the NDRC rigorously enforced the anti-cartel provisions of the Price Law, the AML, and its own 2003 regulation on monopoly pricing.<sup>207</sup> All of those cases involved daily necessities and likely implicated non-antitrust concerns such as social stability. In the remaining cases, the NDRC and other government regulators have been silent about cartels, or even have played an active role in organizing cartels themselves.<sup>208</sup> As discussed earlier, this

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<sup>203</sup> See *Guonei Hangkong Gongsu Dacheng Jiage Tongmeng; Jipiao Jiage Pubian Shangsheng* [China's Airline Companies Form Price Coalition; Air Ticket Prices Increase], BEIJING XIANDAI SHANGBAO [Beijing Modern Business Journal], Apr. 4, 2005, <http://finance.sina.com.cn/chanjing/b/20050404/07401484238.shtml> (suggesting domestic airlines formed a price-fixing cartel because, while airline representatives remained silent, the ticket prices were surprisingly consistent).

<sup>204</sup> See *Wu Da Hangkong Gongsu Yi Gongmou Zhangjia; Fangan Huo Minhangju Renke* [Five Airline Companies Suspected for Colluding to Raise Prices; Scheme Approved by General Administration of Civil Aviation], GUANGZHOU RIBAO [GUANGZHOU DAILY], Apr. 22, 2009, <http://finance.jrj.com.cn/2009/04/2209124197055.shtml>.

<sup>205</sup> See *Negative Ocean Shipping Charges*, *supra* note 173.

<sup>206</sup> See *Sino-Japan Ocean Shipping Price Coalition*, *supra* note 173.

<sup>207</sup> In recent years, the NDRC took enforcement action against only three price cartels, all in the food or agricultural sector. See, e.g., Hannah C.L. Ha et al., *China Steps Up Antitrust Capacity Building – Cartels a Focus*, MONDAQ, Jul. 20, 2010, <http://www.mondaq.com/article.asp?articleid=105788> (noting, in July 2010, the NDRC made public its enforcement action in October 2009 against members of a price cartel involving mung bean); Kala Anandarajah & Dominique Lombardi, *China's First Public Anti-Cartel Action Under the Anti-Monopoly Law*, MONDAQ, Jun. 11, 2010, <http://www.mondaq.com/article.asp?articleid=102700> (noting that the NDRC, in March 2010, made public its enforcement action against twenty-one members of a rice noodle cartel in the Guangxi Autonomous Region).

<sup>208</sup> It is reported that the government in recent years has been actively encouraging "price cooperation" among airline companies as a means of coping with increasing competition and losses. See *Zhongguo Si Da Hangkong Lianshou*

tolerance or promotion of cartels is in essence a disguised effort to reinstate some sort of price control in an economy where incomplete price reforms have led to widespread structural distortions. An argument could be made that under such structural distortions, the government's tolerance or promotion of cartels, if successful, would not be as welfare-reducing as it would be in a typical market economy, or may even be welfare-improving, because the "market" prices prevailing under such structural distortions do not necessarily represent maximum economic efficiency. In addition, the government's tolerance or promotion of cartels, if successful, may not harm consumers as much as it would in a typical market economy, as consumers would have incurred harms of comparable magnitudes, albeit indirectly, in the form of SOE losses but for successful cartels. But leaving these normative issues aside, the bottom line seems to be that China, despite all of its stringent anti-cartel laws on the books, is unlikely to develop a rigorous anti-cartel policy before structural distortions in its economy are removed, which likely will take at least a while, if it happens at all.

It is worth noting, however, that as important as China's cartel policy may be for formal antitrust analysis, it probably will not make too big a practical difference either way. In most of China's industries where competition is so intense that cartels have been attempted, such attempts, even with active government encouragement, have almost invariably failed because of cartel members' enormous incentives to cheat in a highly competitive environment. For instance, all of the five color TV cartels and the three VCD player cartels in the late 1990s failed in a few weeks, not because the government cracked down on them, but because there were always cartel members who were willing to undercut their co-conspirators.<sup>209</sup> Similarly, the 2005 price cartel in the Sino-Japan

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*Zhiding Piaoqia Yi Tisheng Lirun [China's Big Four Airlines Jointly Set Prices to Increase Profits]*, XIAMEN HUOYUN WANG [LOGISTICS WEBSITE OF THE CITY OF XIAMEN] (Mar. 15, 2010), <http://www.xmwuliu.net/WuLiuXinWen/20100315/89748.html> (suggesting that pricing cooperation among airlines has been encouraged by the government in order to expand airlines' profit margins). In the ocean shipping industry, the Ministry of Transportation reportedly took an active role in organizing the 2009 price cartel in the Sino-Japan ocean shipping industry. See *Sino-Japan Ocean Shipping Price Coalition*, *supra* note 173 (explaining the Ministry of Transportation's actions with regard to the 2009 price cartel and tariff filing procedures in the Sino-Japan ocean shipping industry).

<sup>209</sup> See KENNEDY, *supra* note 199, at 113-16 (describing the TV and VCD player cartels' incentives to cheat and set price floors, thereby cannibalizing their

ocean-shipping industry lasted for only three days.<sup>210</sup> And the March 2009 price-fixing scheme in the airline industry, reportedly supported by the government, collapsed in only one week.<sup>211</sup> The ineffectiveness of using cartels as disguised price controls, as seen in China, is one additional demonstration of the irreversibility of price liberalization in transitional economies.<sup>212</sup> If anything, this should provide China with more incentives to complete price reforms and remove structural distortions from its economy, rather than rely on cartels that will not be helpful anyway.

### 3.2. Abuse of Dominance: Exclusionary or Exploitative?

A central task of antitrust law is to regulate the conduct of firms that have market power.<sup>213</sup> A monopolist will be able to reduce output and sell at a price higher than the price under perfect competition, causing inefficiency and wealth transfers from the consumer to the monopolist.<sup>214</sup> Antitrust law, however, has generally distinguished abusive conduct of dominant firms from legitimate conduct of such firms. Under antitrust law, a dominant market position is not *per se* illegal; it is the *abuse* of that position that will invite antitrust scrutiny.<sup>215</sup> Antitrust law has generally

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market). It should be added that the reason why so many attempts at cartels were made in such a short period is precisely because those attempts did not work.

<sup>210</sup> See *Negative Ocean Shipping Charges*, *supra* note 173.

<sup>211</sup> "2 Zhe Jipiao" Zaixian; "Jipiao Jiage Tongmeng" Yizhou Wajie ["Twenty-Percent Discount Air Tickets" Reappears; Airline Price Coalition Collapses in One Week], FINANCE EASTDAY (Apr. 28, 2009), <http://finance.eastday.com/m/20090428/u1a4339142.html>.

<sup>212</sup> The irreversibility of price liberalization in transitional economies was first demonstrated in Russia in January 1993, when efforts to re-impose price control on key foodstuffs and basic raw materials by the Chernomyrdin Administration were aborted after merely two weeks. See David Hearst, *Russian PM is Forced to Revoke Price Controls: Cabinet Divided as Key Economic Strategist Calls Idea "Unworkable,"* THE GUARDIAN, Jan. 15, 1993, at 9 (explaining that re-instating price controls was impractical since there was no system in place to assess profitability at different enterprises).

<sup>213</sup> See William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 939 (1981) (defining market power as the seller's ability to raise and sustain a price increase without losing so many sales that it must rescind the increase).

<sup>214</sup> See LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 33 (2000) (explaining that allocative inefficiency results as buyers who would have purchased the product at a competitive price will no longer do so at the higher monopoly price).

<sup>215</sup> The U.S. Supreme Court, for example, once held that a firm with market power would be allowed to retain that power if it was the outcome of "a superior

recognized two types of abuses of dominant market position: exclusionary and exploitative. Exclusionary conduct, such as price predation, refusal to deal with a competitor, and raising rivals' costs, seeks to exclude competition and competitors from the market and create or maintain the dominant firm's market power.<sup>216</sup> Exploitative conduct, by contrast, exploits "other market participants without directly affecting the structure of the market. . . ." <sup>217</sup> A typical exploitative conduct is the charging of high prices to consumers, known as "excessive pricing" under the antitrust laws of the EU<sup>218</sup> and some other countries.<sup>219</sup> The line between exclusionary and exploitative abuses, however, is not always clear. Some practices, such as exclusive dealing, tying, and price discrimination, could be used to exclude competitors, but could also be used to exploit customers directly.<sup>220</sup>

Over the years, the antitrust laws of the United States and the European Union (two major sources of modern antitrust jurisprudence) have developed different approaches towards exclusionary and exploitative abuses. In the United States, antitrust law in abuse-of-dominance cases has focused on

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product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966).

<sup>216</sup> See Russell Pittman & Maria Tineo, *Abuse of Dominance Enforcement Under Latin American Competition Laws*, in HANDBOOK OF RESEARCH IN TRANS-ATLANTIC ANTITRUST 325 (Philip Marsden ed., 2006) (defining exclusionary conduct as actions "aimed directly at the preserving or exacerbating of anticompetitive aspects of the structure of the market: conduct that creates or maintains the monopolist's power, in which the firm tries to suppress competition. . . .").

<sup>217</sup> *Id.*

<sup>218</sup> See Treaty on the Functioning of the European Union, May 9, 2008, 2008 O.J. (C 115) art. 102(a) [hereinafter TFEU] ("directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions").

<sup>219</sup> See Pittman & Tineo, *supra* note 216, at 326 (listing Argentina, Brazil, Peru, and Venezuela as countries whose antitrust laws prohibit excessive and exploitative pricing); see also Ariel Ezrachi & David Gilo, *Excessive Pricing, Entry, Assessment and Investment: Lessons from the Mittal Litigation*, 76 ANTITRUST L.J. 873, 874 n.5 (2010) (explaining that excessive pricing is prohibited by the antitrust laws of South Africa, Israel, and Russia).

<sup>220</sup> In fact, Judge Posner has argued that "some of the practices deemed as exclusionary, mainly price discrimination in its various guises (including most tie-in agreements), are monopolistic but not exclusionary. . . . They enable the monopolist to extract higher profits without preventing equally or more efficient new entrants from challenging his monopoly." RICHARD A. POSNER, ANTITRUST LAW 41-42 (2d ed. 2001). Cf. Eleanor M. Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 ANTITRUST L.J. 371 (2002) (questioning whether exploitative abuse is the only one type of abuse under antitrust law).

exclusionary conduct, and has refrained from attacking purely exploitative conduct such as excessive pricing.<sup>221</sup> Although in recent years scholarly opinions in the United States have favored requiring an exploitative effect for exclusionary conduct to be actionable under antitrust law,<sup>222</sup> exclusionary effect is still a necessary element for a successful abuse-of-dominance claim in the United States. By contrast, EU antitrust law appears to have a broader focus. The EU treaty provision that prohibits abuses of dominant market position, i.e., TFEU Article 102, explicitly covers exploitative conduct.<sup>223</sup> But by and large, enforcement in the EU against purely exploitative conduct has been fairly limited,<sup>224</sup> and according to the European Commission's official communication, the Commission's enforcement priorities in the abuse-of-dominance area are exclusionary conduct.<sup>225</sup>

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<sup>221</sup> See Brian A. Facey & Dany H. Assaf, *Monopolization and Abuse of Dominance in Canada, the United States, and the European Union: A Survey*, 70 ANTITRUST L. J. 513, 544 (2002) ("In Canada and in the United States, monopolization or abuse of dominance laws appear to focus on anticompetitive acts relating to exclusionary conduct that maintain or create market power and harm the competitive process, as opposed to simply harming a competitor or merely charging high prices or exploiting consumers.").

<sup>222</sup> For some of these opinions, see Pittman & Tineo, *supra* note 216, at 332-33 n.30 (citing Robert Pitofsky, *The Essential Facilities Doctrine Under U.S. Antitrust Law*, 70 ANTITRUST L. J. 443 (2002); Brian A. Facey & Dany H. Assaf, *Monopolization and Abuse of Dominance in Canada, the United States, and the European Union: A Survey*, 70 ANTITRUST L. J. 513, 544-45 (2002); Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 ANTITRUST L. J. 693 (2000); David A. Balto & Ernest A. Nagata, *Proof of Competitive Effects in Monopolization Cases: a Response to Professor Muris*, 68 ANTITRUST L. J. 309 (2001); Timothy J. Muris, *Anticompetitive Effects in Monopolization Cases: Reply*, 68 ANTITRUST L. J. 325 (2001); Eleanor M. Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 ANTITRUST L. J. 371, 376 (2002).

<sup>223</sup> See Pinar Akman, *Exploitative Abuse in Article 82EC: Back to Basics?* 9-10 (Ctr. for Competition Pol'y, Working Paper No. 09-1, 2009) (explaining that there is comprehensive evidence supporting the notion that Article 82EC covers exploitative conduct). Indeed, it has been argued that Article 82EC was originally meant to cover only exploitative conduct. *Id.*

<sup>224</sup> The EU competition authority, for example, has attacked excessive pricing very rarely. See Massimo Motta & Alexandre de Streel, *Excessive Pricing and Price Squeeze Under EU Law*, in EUROPEAN COMPETITION LAW ANNUAL 2003: WHAT IS AN ABUSE OF A DOMINANT POSITION? 91 (C.D. Ehlermann & I. Atanasiu eds., 2006) (providing a discussion of the EC Treaty's Article 82 and EU case law to illustrate the EC Treaty's condemnation of exploitative and excessive pricing).

<sup>225</sup> See European Community Commission, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*, 2009 O.J. (C 45) (Feb. 24, 2009), available at <http://ec.europa.eu/competition/antitrust/art82/index.html> (discussing the EU's priorities in applying Article 82 to exclusionary conduct).

Therefore, despite the conceptual differences between U.S. and EU antitrust laws in the abuse-of-dominance area, in practice both have focused on exclusionary conduct. As discussed below, this exclusion-focused paradigm appears to have been adopted by the AML as well.

In keeping with the civil law tradition of spelling out statutory prohibitions,<sup>226</sup> the AML in Article 17 provides a non-exhaustive list of six types of conduct that are considered abuses of dominant market position.<sup>227</sup> Those six types of conduct resemble what are generally referred to as excessive pricing, predatory pricing, refusal to deal, exclusive dealing, tying, and price discrimination under U.S. and EU antitrust laws. Article 17, however, is ambiguous about the scope of its prohibition. It is clear that Article 17 prohibits one type of purely exploitative conduct—excessive pricing. But it is not clear whether the other types of prohibited conduct encompass only exclusionary conduct, or both exclusionary and exploitative conduct. For example, “refusal to deal” as prohibited under Article 17(3) could be exclusionary if the dominant firm refuses to deal with a competitor, but could also be exploitative if the dominant firm refuses to deal with a consumer, harming the consumer directly. The usage of the generic term “transaction counterparties” in Article 17 does not indicate

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<sup>226</sup> See Pittman & Tineo, *supra* note 216, at 326 & n.32 (citing Malcolm B. Coate, René Bustamante & A.E. Rodriguez, *Antitrust in Latin America: Regulating Government and Business*, 24 U. MIAMI INTER-AM. L. Rev. 37, 53–54 (1992)).

<sup>227</sup> Article 17 of the AML reads in full:

An undertaking that possesses a dominant market position is prohibited from engaging in the following conduct that abuses its dominant market position:

Selling goods at unfairly high prices or buying goods at unfairly low prices;

Selling goods at below-cost prices without justifications;

Refusal to deal with transaction counterparties without justifications;

Restricting transaction counterparties to only deal with the undertaking or undertakings designated by the undertaking without justifications;

Tying the sale of goods or imposing other unreasonable conditions on a transaction without justifications;

Discriminatory treatment of similarly situated transaction counterparties with respect to price or other transaction terms without justifications;

Other conduct that constitutes abuse of dominant market position as determined by the Antimonopoly Enforcement Agency.

AML, *supra* note 10, art. 17.

whether Article 17 intends to cover the former or latter “refusal to deal,” or both.

But what is missing in Article 17 appears to have been filled by another article. Article 6, one of the AML’s “general provisions” (*zongze*), provides that “undertakings that have a dominant market position are prohibited from abusing that position *to exclude or impede competition.*”<sup>228</sup> By virtue of being in the general provisions, Article 6 applies to the entire statute, including Article 17. Thus Article 6 appears to limit the conduct prohibited under Article 17 to exclusionary conduct only, perhaps with the exception of excessive pricing, which is specifically listed under Article 17 but is purely exploitative.<sup>229</sup>

However, the focus of antitrust law on exclusionary conduct presupposes the existence of competitors or at least potential competitors to be excluded. As discussed below, this presupposition may not hold in China’s “monopoly industries,” where the number of firms tends to be small and market entry tends to be tightly controlled by the state.<sup>230</sup> Also, as discussed below, the exclusion-focused paradigm as adopted by the AML leads to a mismatch between monopoly abuses that are prohibited under the AML and monopoly abuses that are most prevalent in China.

### 3.2.1. *Abuse-of-Dominance Lawsuits Targeting Exploitative Conduct*

Since the AML went into effect, the enforcement agencies charged with enforcing the AML’s abuse-of-dominance provisions, i.e., the State Administration for Industry and Commerce (“SAIC”) and the NDRC, have not taken any enforcement action in this respect. The slow pace of enforcement agencies in enforcing the AML, however, has not prevented aggrieved firms and citizen activists from seeking redress in the courts.<sup>231</sup> In the AML’s first two years, Chinese media reported that the courts accepted five

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<sup>228</sup> *Id.* art. 6 (emphasis added).

<sup>229</sup> This inconsistency appears to be an oversight, not a deliberate choice, on the part of the drafters of the AML.

<sup>230</sup> See *supra* Part 2.4. (discussing market-entry restrictions in China).

<sup>231</sup> See AML, *supra* note 10, art. 50 (showing that the AML allows a private right of action: “Undertakings that are engaged in monopolistic conduct and cause damages to other parties assume civil liabilities in accordance with law.”).

lawsuits alleging abuse-of-dominance violations for adjudication.<sup>232</sup>

Of the five lawsuits, three involved the so-called “monopoly industries,” i.e., industries where SOEs are dominant and entry by non-SOEs is generally prohibited by the government.<sup>233</sup> The fact that private abuse-of-dominance lawsuits targeted the monopoly industries is not surprising. As discussed earlier, low levels of concentration generally characterize the market structure in most of China’s “competitive industries.”<sup>234</sup> With few exceptions, those industries tend not to produce dominant firms.<sup>235</sup> It is the largest SOEs in the monopoly industries that come closest to possessing what is referred to as “dominant market position” under the AML.

That the AML’s abuse-of-dominance provisions would raise questions about SOE monopolies was clearly something anticipated by the drafters of the AML, as the AML contains one provision specifically about the treatment of SOE monopolies. That provision, however, is remarkably ambiguous, and is perhaps intended to be so. In Article 7, the AML provides, in relevant part, that “in SOE-dominated industries concerning the health of national economy and national security, and in industries where state trading is authorized by law, the lawful operations of the undertakings are protected by the state.”<sup>236</sup> This provision prompted observations that SOE monopolies are more or less exempted from the AML.<sup>237</sup> But although smacking rather strongly of an exemption, technically Article 7 could be read either way, depending on the exact meaning of the word “lawful” in the sentence “the lawful operations of the undertakings are protected by the state.” If “lawful” means lawful under laws *other than* the AML, then the AML effectively grants a blanket exemption for

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<sup>232</sup> There may be even more abuse-of-dominance lawsuits filed and accepted by the courts but not reported by the media. Since there is no reliable case reporting system in China, the exact number of such lawsuits is unknown.

<sup>233</sup> See *supra* Part 2.5 (discussing China’s SOE reform strategy between the 1970’s and the 1990’s).

<sup>234</sup> *Supra* Part 2.3.

<sup>235</sup> See *Baidu Forecast Beats Estimates as Rival Good Fades*, BLOOMBERG, Jul. 22 2010, <http://www.businessweek.com/news/2010-07-22/baidu-forecast-beats-estimates-as-rival-google-fades.html> (observing that one exception is China’s Internet search market, where China’s No. 1 search engine company, Baidu, had a market share of 70.8 percent by revenue).

<sup>236</sup> AML, *supra* note 10, art. 7.

<sup>237</sup> See, e.g., Fox, *supra* note 18, at 178 (“[D]ominant SOEs . . . in strategic sectors are all but exempted from the prohibitions of the AML.”).



SOE monopolies. But if “lawful” means lawful under laws including the AML, then there will not be an exemption for SOE monopolies, and Article 7 will only serve as a reminder that SOE monopolies must comply with the AML, too. But from the text of Article 7 alone, there is no way to tell which interpretation is correct.

Despite the ambiguity of Article 7, Chinese plaintiffs challenged SOE monopolies in courts anyway. But in contrast to the focus of the AML’s abuse-of-dominance provisions on exclusionary conduct, the conduct challenged under those lawsuits has all been exploitative in nature. One of such lawsuits, for example, was filed against a local branch of China Construction Bank, one of China’s “big four” state-owned commercial banks, in the southwestern city of Chongqing.<sup>238</sup> The plaintiff was a business that had a bank account with the defendant. The defendant charged an “account management fee” for all accounts with deposits less than a certain amount, and the plaintiff’s account was assessed such a fee. The plaintiff refused to pay the fee, believing that it was unreasonable. When the plaintiff tried to withdraw funds from its account, the defendant refused to honor the withdrawal, citing non-payment of the account management fee as the reason. The plaintiff sued the defendant in court, alleging that the defendant violated Article 17(3) of the AML for “refusal to deal” with the plaintiff and Article 17(6) of the AML for “discriminatory treatment of equally situated transaction counterparties.”<sup>239</sup> The banking community in Chongqing was reportedly “shocked” by the court’s acceptance of the suit, and “actively communicated and coordinated” with the plaintiff and finally reached a settlement with the plaintiff.<sup>240</sup>

But it is not clear whether the defendant’s conduct was even covered under the AML. According to Article 6 of the AML, conduct, perhaps with the exception of excessive pricing, constitutes an abuse of dominance only if it “excludes or impedes

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<sup>238</sup> See Junhua Hu, *Yinhangye Fanlongduan Diyi An: Zhongguo Jianshe Yinhang Qiangzhi Shoufei Cheng Beigao* [First Antimonopoly Lawsuit in Banking Industry: China Construction Bank Sued for Mandatory Fees], *Meiri Jingji Xinwen* [DAILY ECON. NEWS], Sept. 12, 2008, <http://active.zgjr.com/News/2008912/zgjr/260083051100.html>.

<sup>239</sup> *Id.*

<sup>240</sup> See *Zuigaoyuan Yantao Fanlongduan Minshi Susong* [Supreme People’s Court Looking Into Antimonopoly Civil Litigation], Oct. 29, 2008, <http://user.qzone.qq.com/17150205/blog/1225256456>.

competition.” The alleged “refusal to deal” by the defendant, however, was exploitative, not exclusionary. It exploited the plaintiff, but did not exclude any of the defendant’s competitors. In other words, the alleged conduct of the defendant was “refusal to deal,” but probably not the kind of “refusal to deal” contemplated under Articles 6 and 17(3) of the AML. The analysis of the plaintiff’s “discriminatory treatment” claim is similar. The alleged “discriminatory treatment” by the defendant had no exclusionary effects, as it did not exclude competition between the defendant and its competitors. Nor did it exclude competition among the defendant’s customers, as there was no evidence that the plaintiff was in a competitive relationship with owners of accounts that were waived the fee.<sup>241</sup> The alleged “discriminatory treatment,” again, was exploitative only.

The plaintiffs in the other two lawsuits involving SOE monopolies also targeted exploitative, not exclusionary, conduct. The defendants in those two lawsuits, China Netcom and China Mobile, were China’s two major telecommunications carriers.<sup>242</sup> In the lawsuit against China Netcom, the plaintiff, an individual subscriber of the defendant, alleged that the defendant offered discount packages only to subscribers with a Beijing certificate of residence (*hukou*),<sup>243</sup> thereby violating the AML’s prohibition of “discriminatory treatment of equally situated transaction counterparties” under Article 17(6).<sup>244</sup> In the lawsuit against China

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<sup>241</sup> Even if the plaintiff were in a competitive relationship with owners of accounts that were waived the fee, this “secondary line” injury to competition is still exploitative in nature. See POSNER, *supra* note 220, at 41 (arguing that some practices that seem exclusionary, such as price discrimination, are not indeed exclusionary).

<sup>242</sup> See *infra* note 251 (discussing China’s restructuring of its telecommunications industry, which led to the creation of China Netcom and China Mobile).

<sup>243</sup> China’s *hukou* system was originally introduced in the 1950s as a population management tool. Under the system, each person was assigned either agricultural or non-agricultural status. Non-agricultural *hukou* holders had broad access to urban employment and subsidized housing and public services such as education, health care, and transportation. In recent years, although the constraints of *hukou* have gradually loosened, the requirements of *hukou* are still quite burdensome. See OECD, OECD RURAL POLICY REVIEWS: CHINA 79–80 (2009) (discussing the *hukou* system, its reforms, and the subsequent effect on China and her citizens).

<sup>244</sup> See Xiaofang Ma, Lüshi Su *Beijing Wangtong Weifan Fanlongduan Fa Zuo Zhengshi Li’an* [Court Officially Accepts Antimonopoly Lawsuit Against Beijing China Netcom by Attorney], *DIYI CAIJING RIBAO* [FIRST BUSINESS DAILY] (Sept. 17, 2008), <http://tech.sina.com.cn/t/2008-09-17/02502459506.shtml> (discussing a lawsuit

Mobile, the plaintiff, again an individual subscriber of the defendant, alleged that the defendant violated Article 17(6) of the AML by charging a monthly fixed fee to mobile subscribers using its global roaming services, but not to other subscribers.<sup>245</sup> As in the lawsuit against China Construction Bank, the alleged conduct in these two lawsuits was only exploitative, not exclusionary. It did force the plaintiffs to pay a higher fee than they otherwise would pay, but did not cause the kind of competitive injury contemplated under Article 6 of the AML.<sup>246</sup>

### 3.2.2. *The Inadequacy of the AML's Exclusion-Focused Paradigm*

That all of the abuses challenged by private plaintiffs in lawsuits involving China's monopoly industries were exploitative ones is not purely accidental. For there to be exclusionary abuses, there must be competitors or at least potential competitors that, but for antitrust intervention, would be excluded. But this condition is to varying degrees not satisfied in China's monopoly industries, where the state tightly controls the number of incumbent firms as well as market entry by new firms. In an extreme scenario, where the state allows only one firm in an industry and strictly prohibits entry by others, that industry will not see any exclusionary conduct within the meaning of antitrust law, because, with the exclusion of competitors and potential competitors already done by the state, the monopoly firm will not need to resort to exclusionary conduct itself. The absence of exclusionary conduct, however, does not mean that such industry is competitive. Indeed, such industry is a monopoly industry in the ultimate sense, with

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brought against Beijing China Netcom for alleged unlawful treatment of prepaid telephone users in violation of antitrust laws).

<sup>245</sup> See *Fayuan Shouli Zhongguo Yidong Beisu Longduan An* [Court Accepts Antimonopoly Lawsuit Against China Mobile], CAIJING WANG [BUSINESS & FINANCE NET], Mar. 31, 2009, <http://www.caijing.com.cn/2009-03-31/110130848.html> (discussing lawsuit brought against China Mobile for abuse of a dominant market position and violation of anti-monopoly law).

<sup>246</sup> Despite the fact that the plaintiff's claim probably was not supported by the AML, China Mobile settled the lawsuit with the plaintiff, agreeing to transfer the plaintiff to a mobile service that did not charge a monthly fixed fee. *Zhongyidong Bei Su Longduan An Hejie*; "Jiangli" Yuangao 1000 Yuan [Antimonopoly Lawsuit Against China Mobile Settled; Plaintiff "Awarded" 1000 Yuan], Oct. 27, 2009, [http://www.lrn.cn/science/frontSciTech/200910/t20091027\\_425960.htm](http://www.lrn.cn/science/frontSciTech/200910/t20091027_425960.htm) [hereinafter *China Mobile Antimonopoly Settlement*]. There have been no press reports of the disposition of the lawsuit against China Netcom, but it likely was settled as well.

the sole firm's monopoly status guaranteed by the state. In such single-monopoly industries, for antitrust law to even become relevant, competition must be first "created" – i.e., by breaking up the state-sanctioned monopoly and/or allowing the possibility of entry by new firms.<sup>247</sup>

To be sure, most of China's monopoly industries today have evolved away from this "single monopoly" model.<sup>248</sup> Thanks to the government's past efforts to break up single monopolies through reshuffling SOE assets, the market structure in most of China's monopoly industries is an oligopoly, with three or more large SOEs controlling the market.<sup>249</sup> The breakup of single monopolies in the monopoly industries stood in contrast with the general trend towards greater consolidation of SOEs,<sup>250</sup> and signaled the government's intention to "create" competition in those industries. As a matter of fact, the defendants in two of the three abuse-of-dominance lawsuits so far, China Netcom and China Mobile, were themselves outcomes of the breakup of the single monopoly, China Telecom, in the telecommunications industry.<sup>251</sup> The government-initiated efforts to create competition

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<sup>247</sup> One commentator has previously noted, without elaboration, the need for transitional economies to create competition as opposed to merely maintaining it. See Song, *supra* note 117, at 387–88 ("Unlike market economies, however, transitional economies face the task of creating, not simply maintaining, competitive markets.").

<sup>248</sup> See *supra* notes 113–14 and accompanying text (observing that the only monopoly industry that fits this "single monopoly" model is the railroad industry, where all of the operating assets are owned and managed by the Ministry of Railroads).

<sup>249</sup> For one particular monopoly industry – the airline industry – the name "monopoly industry" has indeed become a misnomer because of the intense competition in the industry. Prior to its restructuring in 2001, China's airline industry was crowded with regional SOE airlines funded by local governments. In 2001, China consolidated ten top airline companies into three major airline groups headed by Air China (including Air China, China Southwest, and Zhejiang Airline), China Eastern (including China Eastern, China Northwest, and Great Wall Airlines), and China Southern (China Southern, China Northern, China Xinjiang, and China Yunnan). See Alev M. Efendioglu, *The Airline Industry in China: Evolution and Competitive Dynamics*, in CHINESE ECONOMIC TRANSITION AND INTERNATIONAL MARKETING STRATEGY 213 (Ilan Alon ed., 2003).

<sup>250</sup> For China's efforts to consolidate SOEs in the reform era, see *supra* Part 2.4.

<sup>251</sup> Prior to 1994, China's telecommunications market was monopolized by China Telecom, an arm of the Ministry of Post and Telecommunications. In 1994, the government formed two new carriers, China Unicom, and China Jitong, to compete with China Telecom. In 2000, the government broke up China Telecom into four separate companies. Under the 2000 restructuring, the landline services

in the monopoly industries, however, have not always achieved the intended outcomes. In the past, the breakup of single monopolies into separate entities in the monopoly industries was predominantly along functional or geographical lines, which often resulted in new "single monopolies" in particular functions or geographical regions. The restructuring of the telecommunications industry prior to 2008, for example, was mostly along functional and geographical lines.<sup>252</sup> Although the 2008 telecommunications restructuring was originally intended to consolidate six carriers into three that would be better able to compete against one another across functions on a nationwide basis, a March 2009 notice from MIIT re-divided the nationwide landline market into two mutually exclusive territories, and assigned the two territories to two of the three carriers.<sup>253</sup> In the electricity industry, another monopoly industry, the breakup of the dominant SOE was along functional

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of China Telecom were retained by China Telecom. The mobile services of China Telecom were separated into a new company, China Mobile. Another new company, China Netcom, was formed to build and operate a broadband data transmission network and to provide internet services. Yet another new company, China Satellite, was formed to provide satellite communications services. In addition, China Unicom was allowed to take over China Telecom's mobile paging operations, and a new landline carrier, China Railcom, was formed by transferring to it the telephony network built by the Ministry of Railroads along China's rail networks. In 2002, China's telecommunications industry underwent another reshuffle. China Telecom, already slimmed down in 2000, was further divided into two parts: China Telecom Northern and China Telecom Southern. China Telecom Northern was merged into China Netcom, while China Telecom Southern became the new China Telecom. See Grace Li, *Can the PRC's New Anti-Monopoly Law Stop Monopolistic Activities: Let the PRC's Telecommunications Industry Tell You the Answer*, 33 TELECOMM. POL'Y 360, 361-62 (2009) (describing the breaking up of China Telecom's four divisions of services). In 2008, China's telecommunications industry saw one more round of restructuring. Under the 2008 restructuring, China Telecom took over China Unicom's CDMA mobile network and China Satellite's basic telecommunications business, China Unicom took over China Netcom, and China Mobile took over China Railcom. *Id.* at 365-66.

<sup>252</sup> See *id.* at 261.

<sup>253</sup> Under the MIIT notice, China Unicom was assigned ten provinces and provincial-level cities in northern China and the province of Sichuan and the city of Chongqing in southern China, while China Telecom was assigned twenty provinces and provincial-level cities in southern China and the city of Beijing in northern China. See Gongxinbu Huading Yunyingshang Jingying Fanwei; Dianxin Liantong "Geju" Nanbei [MIIT Divides Business Territories for Carriers; China Telecom and China Unicom Assigned Southern and Northern China Respectively], GUANGZHOU RIBAO [GUANGZHOU DAILY], Mar. 18, 2009, [http://news.xinhuanet.com/fortune/2009-03/18/content\\_11029184.htm](http://news.xinhuanet.com/fortune/2009-03/18/content_11029184.htm).

and geographical lines as well.<sup>254</sup> As a result, the amount of competition introduced in the monopoly industries is still fairly limited.<sup>255</sup>

Further exacerbating the exploitative abuses in the monopoly industries are the market entry restrictions in those industries. Under conventional antitrust theory, the threat of entry serves as a curb on a dominant firm's exploitative conduct.<sup>256</sup> In state-controlled industries, however, this curb is generally missing. Without much competitive pressure, dominant firms in many of the monopoly industries could afford to exploit consumers, very often with impunity from market discipline. An antitrust law that focuses on exclusionary conduct, therefore, will be left powerless to address these exploitative abuses that harm consumers in a more direct way than exclusionary abuses.

### 3.2.3. *The AML as a Compensation for Regulatory Failure and Regulatory Capture*

The fact that there is a need for enforcement against exploitative abuses, however, does not necessarily mean that such

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<sup>254</sup> In 2002, the government broke up the State Power Corporation into two parts: power generation and grids. Together with the assets of the pre-existing Huaneng Group, the power generation assets of the State Power Corporation were assigned to five regional power generation companies: China Huaneng Power Group, China Datang Corporation, China Huadian Corporation, China Guodian Corporation, and China Power Investment Corporation. The transmission and distribution assets of the State Power Corporation were divided between two new companies, again along geographical lines: the State Grid Corporation was to own and operate the majority of regional grids in the country, while the Southern China Power Grid Company took over assets in the far south of the country in Yunnan, Guizhou, Guangxi, Guangdong, and Hainan. See OECD, *supra* note 107, at 235-36.

<sup>255</sup> Sometimes, the government's efforts to create competition in the monopoly industries were thwarted by collusion among SOEs to not compete against one another. Take the telecommunications industry for example again. In 2007, China Netcom (with its main assets in northern China) and China Telecom (with its main assets in southern China) signed an agreement not to compete for landline business in each other's territory. See *Dianxin Wangtong Qianshu "Junzi Xieyi," Shuangfang Chengnuo Hubu Qinfan [China Telecom and China Netcom Sign "Gentleman's Agreement," Promise Mutual Non-Agression]*, Feb. 27, 2007, <http://it.people.com.cn/GB/8219/78671/78672/5421402.html> (describing the agreement between Telecom and China Netcom).

<sup>256</sup> See *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 294 (2d Cir. 1979) ("[A]lthough a monopolist may be expected to charge a somewhat higher price than would prevail in a competitive market, there is probably no better way for it to guarantee that its dominance will be challenged than by greedily extracting the highest price it can.").

enforcement should be carried out under the authority of antitrust. An enforcement policy directed at purely exploitative conduct would almost inevitably require the scrutiny of the terms, particularly the price terms, of the transactions of dominant firms, turning antitrust authorities or courts into a price regulator.<sup>257</sup> Aside from the practical problem of how to identify appropriate price levels,<sup>258</sup> antitrust authorities are generally reluctant to assume a role that is considered "the antithesis of the free market."<sup>259</sup> For these reasons, the consensus appears to be that price regulation is better restricted to situations of natural or legal monopoly, and should be carried out by industry regulators in the form of *ex ante* regulation.<sup>260</sup>

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<sup>257</sup> See Akman, *supra* note 223, at 33 (explaining the problems with remedies in an enforcement policy directed solely at exploitation).

<sup>258</sup> A good illustration of this practical problem is the EC Commission's experience in determining what constituted "excessive pricing" in *United Brands*. In that case, the Commission condemned UBC for charging excessive prices for Chiquita bananas in Germany, Denmark, and Benelux. To ascertain what the Chiquita prices might have been in a more competitive market, the Commission looked to prices of unbranded bananas, prices of competitors' bananas, and prices of Chiquita bananas in Ireland. It determined that the prices being investigated were "excessive in relation to the economic value of the product supplied." The Commission's decision that unfair prices were charged was later annulled by the European Court of Justice. See ALISON JONES & BRENDA SUFRIN, *EC COMPETITION LAW: TEXT, CASES, AND MATERIALS* 586 (3d ed. 2008).

<sup>259</sup> *Id.* This sentiment is shared by courts and enforcement agencies in most countries. In the United States, for example, Judge Kaufman of the Second Circuit declared in *Eastman Kodak* that "judicial oversight of pricing policies would place the courts in a role akin to that of a public regulatory commission" and "[w]e would be wise to decline that function unless Congress clearly bestows it upon us." *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 294 (1979). Even countries that had extensive experience with price control are reluctant to have competition authorities assume the role of a price regulator. In Mexico, for example, the Federal Law of Economic Competition, which replaced another law that granted extensive authority for price control, does not prohibit exploitative abuses at all. One reason for this non-prohibition of exploitative abuses in Mexico is the belief that competition authorities should not be turned into a price regulator. See Adriaan ten Kate & Gunnar Niels, *Mexico's Competition Law: North American Origins, European Practice*, in *HANDBOOK OF RESEARCH IN TRANS-ATLANTIC ANTI-TRUST* 721 (Philip Marsden ed. 2006) ("This decision to abstain from prohibiting exploitative abuses of dominant positions seems to have been taken deliberately, in recognition of the fact that market may not only reflect a lack of competition today but could have been obtained as a result of fierce competition in the past.").

<sup>260</sup> See JONES & SUFRIN, *supra* note 258, at 586 (noting that price regulation, in certain circumstances, may be a disincentive for competition, but where natural or legal monopolies exist, price regulation may be effective).

However, what muddles the picture in China is that its monopoly industries are indeed subject to the ex ante regulation of industry regulators. As discussed earlier, almost all of China's monopoly industries are those in which the government has retained its regulatory apparatus.<sup>261</sup> Indeed, all of the defendants in the three abuse-of-dominance lawsuits discussed above had an industry regulator: China Construction Bank by the China Banking Regulatory Commission ("CBRC") and China Netcom and China Mobile by the MIIT. Therefore, the real question posed by the three abuse-of-dominance lawsuits is not *whether* exploitative abuses in those industries should be regulated, but *by whom* they should be regulated. Considered in this light, what the plaintiffs in the three abuse-of-dominance lawsuits were trying to accomplish was essentially to have the courts take over the responsibilities for setting prices from the industry regulators.

That the courts were called upon to regulate prices in the monopoly industries underscores the problems with China's regulatory process in those industries. As discussed earlier, although the intent of China's regulatory reforms in the monopoly industries was to forge "independent" industry regulators, there are still no institutional guarantees of the impartiality of the regulators.<sup>262</sup> The regulators of the monopoly industries are still vulnerable to various forms of regulatory failure and regulatory capture. The industry regulators often fail to regulate a conduct that is patently exploitative or, in the event that they do regulate, they often regulate in a way that tends to perpetuate, rather than correct, exploitative conduct. Examples of regulatory failure and regulatory capture can be found by looking no further than the three abuse-of-dominance lawsuits discussed above. The China Construction Bank case appears to provide an example of regulatory failure. The conduct challenged in that case—the charging of an "account management fee" for small accounts—is one of the banking industry's common practices that is widely viewed by the public as unreasonable.<sup>263</sup> Yet under a regulation

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<sup>261</sup> See *supra* Part 2.6.

<sup>262</sup> See *id.*

<sup>263</sup> The Chinese press reported in August 2010 that a Beijing resident was surprised to see that his one hundred *yuan* shrank to sixty *yuan* after nine years of being deposited in a bank. See *Shimin 100 Yuan Cun 9 Nian Jin Sheng 60 Yuan; Yinhang Shoufei Chao Lixi [Only 60 yuan Left of Resident's 100-yuan Deposit; Bank Fee Higher Than Interest]*, RENMIN RIBAO [PEOPLE'S DAILY], Aug. 12, 2010, <http://news.163.com/10/0812/07/6DSANUP700011229.html>; see also *Gongzhong*



issued by CBRC in 2003, most bank fees are subject to “market pricing,” i.e., they are not regulated by CBRC.<sup>264</sup> Deregulation of bank fees might have been a right step had the banking industry been a competitive one, as market competition would reign in at least some of the unreasonable fees. But given that China’s banking industry is still far from being competitive, the lack of effective regulation will undoubtedly contribute to exploitative abuses in the industry.<sup>265</sup> The China Mobile case, by contrast, appears to provide an example of regulatory capture. The conduct challenged in that case—the charging of a monthly fixed fee for phone services—was indeed a policy set by the industry regulator.<sup>266</sup> The regulator’s action here may have made consumers worse off than if the regulator did not act. Not only does this regulatory action legitimize what is widely viewed as exploitative conduct, but it preempts potential market competition that would otherwise chip away at the exploitative conduct. This anticompetitive use of regulation has been very common in other countries<sup>267</sup> and certainly poses a real danger to China’s regulated industries as well.

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*Zui Fangan De Yinhang Shoufei Xiangmu: Xiaoe Guanlifei Ju Shou* [Small-Account Management Fee Tops List of Bank Charges Most Disliked by Public], CHONGQING CHENBAO [CHONGQING MORNING DAILY], Aug. 20, 2010, <http://bank.hexun.com/2010-08-20/124659978.html?from=rss> (describing public sentiment towards account management fees).

<sup>264</sup> See CBRC & NDRC, *Shangye Yinhang Fuwu Jiage Guanli Zhanxing Banfa* [Provisional Measures on Service Fees of Commercial Banks], June 26, 2003, <http://www.jincao.com/fa/09/law09.41.htm> (stating measures for commercial bank service fees).

<sup>265</sup> Since CBRC deregulated most bank fees in 2003, the number of fee items charged by Chinese banks increased from about 300 in 2003 to more than 3000 in 2010. See *Yinhang Shoufei Xiangmu 3000 duo: Ruhe Dui Bu Heli Shoufei Shuo Bu?* [More Than 3000 Bank Fee Items: How to Say “No” to Unreasonable Bank Fees?], Aug. 6, 2010, [http://news.xinhuanet.com/fortune/2010-08/06/c\\_12416381.htm](http://news.xinhuanet.com/fortune/2010-08/06/c_12416381.htm) (describing the proliferation of banking fees and the resulting consumer dissatisfaction). It was reported that as of August 2010, NDRC and CBSC were drafting a new regulation on bank fees, which would outlaw seven unreasonable fee items. But with only a few exceptions, the account management fee for small accounts would still be allowed under the proposed new regulation. See *Liang Buwei Qicao Yinhang Fuwu Jiage Banfa: 7 Xiang Shoufei Jiang Quxiao* [Two Agencies Draft Regulatory Measures on Bank Fees: Seven Fee Items to be Prohibited], Aug. 10, 2010, <http://finance.people.com.cn/GB/12390049.html>.

<sup>266</sup> In response to the plaintiff’s claim, China Mobile pointed to a number of government notices and measures dating back to 1994 that mandated the monthly fixed charge. See *China Mobile Antimonopoly Settlement*, *supra* note 246.

<sup>267</sup> See Roger G. Noll, *Regulatory Reform and International Trade Policy*, in *DEREGULATION AND INTERDEPENDENCE IN THE ASIA-PACIFIC REGION* 13, 39–40

So, given that there is not enough competition in China's monopoly industries to rein in exploitative abuses and that the industry regulators often fail to regulate those abuses, the question that should be asked is: should exploitative abuses be addressed under antitrust law instead? A similar question was asked of natural monopoly industries of central and eastern European countries during the initial periods of those countries' transition to a market economy in the early 1990s, when antitrust authorities were created before regulatory agencies overseeing the natural monopoly industries were created. It was suggested back then that in areas where regulation was relatively straightforward or areas where regulation was deemed necessary only on a short-term basis as competitive forces develop in a particular sector, it might be advantageous to rely on antitrust authorities, rather than specialized industry regulators, to combat exploitative abuses.<sup>268</sup> But in China, with industry regulators in the monopoly industries already entrenched when antitrust authorities came on the scene, addressing exploitative abuses under antitrust law would necessarily require antitrust authorities to exercise power over industry regulators. Such institutional arrangement might be feasible in an economy with a political structure based on rules of law,<sup>269</sup> but is not an attractive option for a country like China that already suffers from governance deficiencies and inter-agency conflicts.<sup>270</sup> That might, at least partially, explain why the AML

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(Takatoshi Ito & Anne O. Krueger eds., 2000) (describing competition policies in general and its use by various governments). This anticompetitive use of regulation is one form of what is often termed "public restraints" in the antitrust literature. See D. Daniel Sokol, *Limiting Anticompetitive Government Interventions that Benefit Special Interests*, 17 GEO. MASON L. REV. 119, 119-20 (2009).

<sup>268</sup> See Janusz A. Ordover, Russell W. Pittman & Paul Clyde, *Competition Policy for Natural Monopolies in a Developing Market Economy*, in *DE-MONOPOLIZATION AND COMPETITION POLICY IN POST-COMMUNIST ECONOMIES* 179 (Ben Slay ed., 1996).

<sup>269</sup> See DEPARTMENT OF JUSTICE ANTITRUST DIVISION, ANTITRUST DIVISION MANUAL, V-5 (2009) <http://www.justice.gov/atr/public/divisionmanual/chapter5.pdf> (noting that in the United States, for example, federal antitrust authorities can intervene in proceedings of federal regulatory agencies to suggest adoption of the least anticompetitive and best-designed forms of regulation where continued regulation is deemed necessary); see also Roger G. Noll & Bruce M. Owen, *The Anticompetitive Uses of Regulation: United States v. AT&T (1982)*, in *THE ANTITRUST REVOLUTION* 290 (John E. Kwoka Jr. & Lawrence J. White eds., 1989) (noting that antitrust authorities can also bring enforcement action against companies that use the regulatory process for anticompetitive purposes).

<sup>270</sup> For discussions of China's inter-agency conflicts, see generally Randall Peerenboom, *A Government of Laws: Democracy, Rule of Law, and Administrative Law*

largely stayed away from exploitative abuses and focused on exclusionary abuses instead.

It appears that in order to address exploitative abuses in the monopoly industries, the only viable option left for China is for the government to continue its efforts to “create” more competition in those industries through breaking up SOE monopolies and relaxing market entry restrictions—efforts that would take place outside of the framework of the AML, if at all. Of course, if those efforts are successful and meaningful competition is introduced in those industries, those industries will see increasingly more exclusionary abuses. But until then, the AML will have only limited relevance to abuse-of-dominance issues in those industries, and by extension, to abuse-of-dominance generally.

### 3.3. Merger Review: How Relevant Is It To Domestic Firms?

As with antitrust laws in most jurisdictions, the AML provides a merger review regime—a regime in which parties to a proposed merger or “concentration” are required to notify the government of the proposed transaction and wait for government review of the likely effects of the transaction on competition before the transaction can be officially consummated.<sup>271</sup> Prior to the AML, there was a merger review process for foreign companies seeking to acquire domestic Chinese companies,<sup>272</sup> but there was not a corresponding merger review process for domestic mergers. This was changed by the AML, at least in theory. By virtue of applying to “monopoly conduct in economic activities within the People’s Republic of China,”<sup>273</sup> the AML extends its merger review regime to domestic mergers as well.

Two years later, however, the AML appears not to have significantly changed China’s merger review landscape. As of August 2010, the Ministry of Commerce (“MOFCOM”), the agency charged with merger review, had rejected one proposed merger

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*Reform in China*, in DEBATING POLITICAL REFORM IN CHINA: RULE OF LAW VS. DEMOCRATIZATION 58, 69 (Suisheng Zhao ed., 2006).

<sup>271</sup> Articles 20 through 31 of the AML detail the merger review regime under the AML. See *supra* note 10.

<sup>272</sup> See Ministry of Commerce, *Guanyu Waiguo Touzizhe Binggou Jingnei Giye De Guiding* [Provisions on Acquisitions of Domestic Enterprises by Foreign Investors], Aug. 6, 2006, [http://www.fdi.gov.cn/pub/FDI/zcfg/law\\_ch\\_info.jsp?docid=56103](http://www.fdi.gov.cn/pub/FDI/zcfg/law_ch_info.jsp?docid=56103).

<sup>273</sup> AML, *supra* note 10, art. 2.

and approved six others with conditions since the AML went into effect.<sup>274</sup> All seven transactions involved foreign companies, and six of them were transactions initiated overseas between multinational corporations that had operations in China.<sup>275</sup> In terms of mergers notified to MOFCOM, foreign companies accounted for the majority of them as well. According to statistics provided by MOFCOM, as of June 2009, of the fifty-eight mergers accepted by MOFCOM for review under the AML, forty involved multinational corporations.<sup>276</sup> The more recent statistics on merger review cases, released by MOFCOM in August 2010 in a press conference, did not provide the exact number of notified mergers involving foreign companies, but a senior MOFCOM official stated at the press conference that “the majority of mergers accepted for review involved foreign companies.”<sup>277</sup>

The disproportionately high percentage of foreign companies involved in cases notified to MOFCOM and in cases for which MOFCOM published its merger review decisions has led to suspicions or charges that MOFCOM discriminated against foreign companies in its merger review process.<sup>278</sup> But whether MOFCOM discriminates against foreign firms in its merger review process, although a legitimate question, is less important than the extent to which the AML is capable of reaching firms other than foreign firms in the first place. For reasons to be discussed below, the answer to the latter question is: not too much, at least presently.

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<sup>274</sup> The one merger that was rejected by MOFCOM was Coca-Cola's acquisition of Huiyuan Juice Co. The six mergers that were approved by MOFCOM with conditions were the InBev/Anheuser-Busch, Mitsubishi Rayon/Lucite, GM/Delphi, Pfizer/Wyeth, Panasonic/Sanyo, and Novartis/Alcon mergers. For MOFCOM's merger decisions in these cases (in Chinese), see MOFCOM, <http://fldj.mofcom.gov.cn/ztxx/ztxx.html>.

<sup>275</sup> The InBev/Anheuser-Busch, Mitsubishi Rayon/Lucite, GM/Delphi, Pfizer/Wyeth, Panasonic/Sanyo, and Novartis/Alcon mergers all belong to this category. Of the seven transactions, only the Coca-Cola/Huiyuan transaction involved a domestic Chinese company.

<sup>276</sup> See *Fanlongduan Fa Shishi Yinian: Kuaguo Gongsu Canyu Anjia Zhan 69% [Antimonopoly Law One Year On: Multinational Corporations Involved in Sixty-Nine Percent of Cases]*, Nov. 17, 2009, <http://www.fclaw.com.cn/Details.asp?id=13994>.

<sup>277</sup> See Liu Ling, *Shangwubu: Fanlongduan Shencha Wei Qishi Qaizi [MOFCOM: No Discrimination Against Foreign Companies in Antimonopoly Merger Review]*, MORNING POST, Aug. 12, 2010, <http://www.morningpost.com.cn/xwzx/jjxw/2010-08-12/66994.shtml>.

<sup>278</sup> It appears that MOFCOM's August 2010 press conference was called primarily as a response to the discrimination charges.

### 3.3.1. *Market Structure and Merger Review*

The first reason the AML's merger review process has not involved many domestic firms is none other than the market structures of China's industries. As discussed earlier, most of China's industries, with the exception of the monopoly industries, are characterized by small-scale firms and low market concentration ratios.<sup>279</sup> Mergers among small firms in non-concentrated markets hardly pose threats to competition, and a merger review process that aims to prevent only mergers that have anticompetitive effects typically does not, and should not, reach those mergers. Indeed, in the mid 1990s, when a merger control regime was not in place in China, the consensus among policy experts and scholars appeared to be that the concentration of economic power was "not a major issue, at present"<sup>280</sup> and that the lack of merger controls was "not alarming from the point of view of antitrust law."<sup>281</sup> With the further decentralization of most of China's industries after the 1990s, fueled mostly by duplicate investment by local governments,<sup>282</sup> it appears that those assessments would still hold by the time the AML was enacted.

### 3.3.2. *SOEs and Merger Review: Conceptual Issues*

The second reason the AML's merger review process has only had limited relevance to domestic firms has to do with the treatment of SOE mergers. Despite low market concentration ratios in most of China's industries, there are large firms in China whose sizes reach or exceed the AML's notification thresholds. Those firms are mostly SOEs, many of which are in the monopoly industries.<sup>283</sup>

Indeed, after the AML went into effect in 2008, there was a "tidal wave" of SOE mergers, as described by the Chinese media.<sup>284</sup>

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<sup>279</sup> See *supra* Part 2.3.

<sup>280</sup> INTERNAL MARKET, *supra* note 29, at 134. But see OECD, *supra* note 48, at 403-04 (offering an opposing view that China's low market concentration ratios were not an accurate indicator of the competitiveness of China's industries).

<sup>281</sup> Song, *supra* note 117, at 399.

<sup>282</sup> See *supra* Part 2.2.

<sup>283</sup> See *supra* Part 2.5.

<sup>284</sup> See, e.g., Guoyou Qiye Xin Yi Lun Binggou Chongzu Dachao Lailin [The Advent of the Tidal Wave of a New Round of SOE Mergers and Acquisitions and Restructuring], SHANGHAI SEC. NEWS, Feb. 25, 2009, <http://news.cnfol.com/090225/101,1277,5501333,00.shtml>.

Mergers among China's largest SOEs, i.e., SOEs supervised by the central government or "central SOEs," have been particularly active. Since the AML went into effect, the number of central SOEs directly supervised by SASAC has been reduced from 149 in August 2008 to 123 in August 2010, mostly through SASAC-initiated mergers.<sup>285</sup> Mergers among SOEs supervised by local governments, or "local SOEs," and mergers between central and local SOEs, have also been increasing since the beginning of 2009.<sup>286</sup>

So, are mergers among large SOEs being notified to MOFCOM for merger review? The answer to that question has been evasive so far. Since MOFCOM does not disclose the identities of the parties to a merger notified to it unless it rejects or attaches conditions to the merger, there is no practical way to know, among the SOEs that went through a merger after the AML went into effect, who filed a merger notification and who did not.<sup>287</sup> MOFCOM's official position regarding this question is that "all mergers whose size reach a certain threshold should be notified, as long as the mergers are among market entities."<sup>288</sup> But that is not always the way SOE mergers have proceeded. In the case of the mergers among central SOEs, for example, it appears that none underwent MOFCOM review, as the press releases put out by SASAC announcing the consummation of those mergers all listed "the State Council" as the only government authority that

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<sup>285</sup> For a listing of mergers among central SOEs, see [State-owned Assets Supervision and Administration Commission of the State Council], SASAC, <http://www.sasac.gov.cn/n1180/n1226/n2665/index.html>.

<sup>286</sup> See Jin Jiang Qi, *12 Shengshi Guli Zhenghe Shangshi Gongsi; Difang Guoqi Re Pan Duijie Yangqi* [Twelve Provinces and Cities Encourage Mergers Among Publicly Listed Companies; Local SOEs Eagerly Awaits Mergers with Central SOEs], Jan. 17, 2009, <http://stock.jrj.com.cn/2009/01/1707173368126.shtml>.

<sup>287</sup> It was reported by the Chinese press that in May 2009, a lawyer-activist once requested, pursuant to China's Government Open Information Law, that MOFCOM disclose all materials relating to its review of the China Netcom/China Unicom merger. The response he received from MOFCOM was that the AML does not require it to disclose information about individual cases. See Xiangdong Zhang, *Fanlongduan: Yige Ren De Zhanzheng* [Antimonopoly: A War of One Person], *JINGJI GUANCHAO* [ECON. OBSERVER J.], Nov. 22, 2009, [http://www.eeo.com.cn/Politics/beijing\\_news/2009/11/21/156314.shtml](http://www.eeo.com.cn/Politics/beijing_news/2009/11/21/156314.shtml).

<sup>288</sup> See Gengyan Bing & Xie Wenxing, *Shangwubu: Fanlongduan Bingfei Fan Waiqi* [MOFCOM: Antimonopoly Not Anti-Foreign Firms], *GUANDONG NEWSPAPER*, Aug. 12, 2010, <http://www.21cbh.com/HTML/2010-8-13/zNMDAwMDE5MTkzNA.html> (quoting Ming Shang, Director-General of the Antimonopoly Bureau of MOFCOM).

approved the mergers.<sup>289</sup> However, in at least one merger between a central SOE and a local SOE, i.e., the merger between China Eastern Airlines and Shanghai Airlines in 2009, it was reported that clearance from MOFCOM was obtained prior to the merger.<sup>290</sup>

No matter whether SOE mergers are as a matter of fact being notified to MOFCOM, there appears to be a consensus that such notifications are required by the AML.<sup>291</sup> But that conclusion is at least debatable, from both a textual and a conceptual point of view. From a textual point of view, leaving aside the question of whether Article 7 exempts SOEs in the monopoly industries from the AML altogether,<sup>292</sup> it could be argued that Article 22(2) of the AML almost, if not indeed, explicitly exempts all SOEs from the AML's merger notification requirement. Article 22(2) provides that a merger need not be notified if "more than fifty percent of the voting shares of each of the undertakings to the merger are owned by a common undertaking that is not a party to the merger."<sup>293</sup> "Undertakings," in turn, are defined under the AML as "natural persons, legal persons, or other organizations that engage in the production and distribution of products or the provision of services."<sup>294</sup> Apparently, Article 22(2) is intended to exempt mergers among subsidiaries of a common shareholder from the notification requirement. But technically speaking, are not all SOEs "subsidiaries" of a common shareholder, i.e., the state? Given that the state still retains an active role in the production and distribution of products or the provision of services (mostly through SOEs, but not always), it might not be entirely nonsensical to argue that the state itself should be considered an "undertaking" within the meaning of the AML.

Setting aside this textual ambiguity, subjecting SOE mergers to merger review would be problematic from a conceptual point of

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<sup>289</sup> The press releases (in Chinese) can be found at *Press Releases, SASAC*, <http://www.sasac.gov.cn/n1180/n1226/n2665/index.html> (last visited Jan. 7, 2011).

<sup>290</sup> Han Zhe, *Donghang Shanghang Hebing Huo Zhengjianhui Tongguo; Chongzu Zhengfu Shenpi Quanbu Guoguan* [CSRC Approves Eastern-Shanghai Merger; All Government Approvals Received], BEIJING SHANGBAO [BEIJING BUS. NEWS], Dec. 1, 2009, <http://news.hexun.com/2009-12-01/121864153.html>.

<sup>291</sup> See Zhang, *supra* note 287.

<sup>292</sup> For discussions of the ambiguity of Article 7, see *supra* notes 236-37 and accompanying text.

<sup>293</sup> AML, *supra* note 10, art. 22(2).

<sup>294</sup> *Id.* art. 12.

view as well. If a merger among private firms that are subsidiaries of a common parent should be exempted from the merger notification requirement, why should a merger among SOEs that are also owned by one common parent, i.e., the state, not be exempted, too? One plausible answer to this question appears to be that there is an implicit assumption in exempting mergers among subsidiaries of private firms from merger review, and that assumption is that such subsidiaries are not in a competitive relationship with one another. Such assumption does not hold, the answer would go, for China's SOEs that are, or are at least intended to be, competitors of one another.

This answer, while intuitive, actually underscores the paradoxical nature of China's SOEs. In a continuum between a pure state entity on one end and a pure market entity on the other, China's SOEs appear in the middle—perhaps closer to the market entity end, but not quite there yet. They have moved far enough in the process of becoming market entities to be in a competitive relationship with one another, but have not moved far enough in that process to be completely independent of state control. So when the state merges two SOEs, to what extent is that merger an “economic activity”<sup>295</sup> that should be subject to the AML? Does the answer to that question depend on whether the SOE merger takes the form of a market transaction?

The last question merits asking because, although many SOE mergers in China so far have involved the making of payments for equity stakes or assets,<sup>296</sup> there are SOE mergers that do not involve anything even remotely resembling a market transaction. In February 2009, in an effort to expedite the consolidation of central SOEs and to reduce the number of management layers that would otherwise result from the consolidation, SASAC issued a guidance document on the “gratuitous transfer,” or transfer without payment (*wuchang huazhuan*), of SOE equity stakes among

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<sup>295</sup> See *id.* art. 2 (providing that only “economic activities” are subject to the AML).

<sup>296</sup> For example, when China Telecom acquired the CDMA network of China Unicom in June 2008, the former paid the latter a total sum of one hundred and ten billion *yuans*. See *Zhongguo Dianxin Aongjia 1100 Yi Shougou Liantong C Wang* [China Telecom Acquires C-Network of China Unicom with a Total Sum of 110 Billion Yuans], SINA, June 2, 2008, <http://tech.sina.com.cn/t/2008-06-02/16362231328.shtml>. Obviously, the payment was made necessary in part because both China Telecom and China Unicom have subsidiaries whose stocks are listed on the Hong Kong Stock Exchange. For discussions of the 2008 restructuring of the telecommunications industry, see *supra* note 251 and accompanying text.



central SOEs.<sup>297</sup> Should SOE mergers accomplished through such gratuitous transfers be exempted from the AML's notification requirement now that such mergers do not resemble conventional mergers anymore? If the answer to this question is in the affirmative, then where is the line to be drawn between SOE mergers that should be considered "mergers" and SOE mergers that should not? Not all of these questions yield simple answers.

### 3.3.3. *SOEs and Merger Review: Policy Tensions*

In addition to the conceptual issue discussed above, subjecting SOEs to merger review would also create tensions between competing policy goals. China has long had a policy favoring SOE mergers, a policy that dates back to the early 1980s.<sup>298</sup> As time went on, China appeared to keep adding new justifications for this policy. Initially, beginning in the early 1980s, SOE mergers were intended primarily as a response to low market concentration and market segmentation across provinces.<sup>299</sup> Beginning in the early 1990s, along with the need to address market segmentation, the government's strategic repositioning of SOEs in the national economy—a strategy referred to as "grasp the large, let go of the small"—became a major factor driving SOE mergers.<sup>300</sup> Most recently, in addition to the need for addressing market segmentation and the need for carrying out the government's overall SOE strategy, a third factor, i.e., the need for forming China's "national champions," appeared to have made its way to the expanding list of policy considerations favoring SOE mergers. This newest goal of SOE mergers was vividly on display in a strategic SOE consolidation plan issued by SASAC in December 2006, in which SASAC vowed to maintain "absolute control" by SOEs in seven industries and to form thirty to fifty "internationally

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<sup>297</sup> See SASAC, *Qiyè Guoyou Chanquan Wuchang Huazhuan Gongzuo Zhiyin* [Guidance on the Gratuitous Transfer of State-Owned Equity Rights in Enterprises], Feb. 26, 2009, [http://www.gov.cn/zwggk/2009-02/24/content\\_1240882.htm](http://www.gov.cn/zwggk/2009-02/24/content_1240882.htm) (listing of gratuitous transfer of state-owned property rights guidelines by SASAC).

<sup>298</sup> See Song, *supra* note 117, at 397 ("The Chinese government realized in the early 1980s that low industrial concentration and market segmentation across provinces were causing economic inefficiency. Since then, it has actively encouraged industrial combinations of various types, with state-owned enterprises (SOEs) as leading firms.").

<sup>299</sup> *Id.*

<sup>300</sup> See *supra* Part 2.5.

competitive” SOEs in those industries.<sup>301</sup> All of the three policy goals driving SOE mergers appear to be at least equally important, if not more important, than the merger control goal of the AML. As a result, even if SOE mergers were indeed notified to MOFCOM, it would be exceedingly difficult for MOFCOM to exercise independent merger review to override these competing policy goals.

In sum, what appeared to be one of the AML’s most significant breakthroughs—the creation of a merger review regime for domestic mergers—has not had a significant impact on domestic mergers, if any impact at all. Before China’s industries become more concentrated, and before China reconciles its SOE policies with its merger control policy, the merger review process under the AML will likely remain a process largely focused on foreign companies.

#### 4. WHY WAS THE AML ENACTED?

A recurring pattern emerges from the analyses above: despite having been widely regarded as a historic step for China, the AML has not yet become an integral part of China’s competition policy. The transitional stage that China is currently in, China’s market structures, and pervasive state control of China’s economy have limited the reach and applicability of the AML in all three major areas of antitrust: cartels, abuse of dominant market position, and merger review.

A question brought to the forefront by the above analyses is then this: if the AML appears to be ill-suited to address the most pressing competition issues in China today, why was it enacted in the first place? This question is a variant of the “original intent” question that was once asked of antitrust laws in other countries, such as the United States<sup>302</sup> and Japan.<sup>303</sup> Although plenty has

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<sup>301</sup> See Owen et al., *supra* note 162, at 244.

On December 18, 2006, the State Assets Supervision and Management Commission announced that seven ‘strategic’ industries . . . will be controlled by SOEs. The government aims to increase State capital in those seven industries and seeks to maintain ‘absolute control’ of them by SOEs. The State Assets Supervision and Management Commission also announced that it is China’s goal to foster thirty to fifty large ‘internationally competitive’ SOEs in those industries by 2010.

*Id.*

<sup>302</sup> Many scholars in the United States, including Hans Thorelli, William Letwin, Robert Bork, John Flynn, and Robert Lande, have debated the original

been written about the drafting process of the AML<sup>304</sup> and the driving forces behind the enactment of the AML,<sup>305</sup> the question of the "original intent" of the AML has not yet been specifically asked and answered.

Short of having access to documentation of behind-the-scenes deliberations that eventually led to the consensus within the government on the need for a formal antitrust law, the identification of the original intent of the AML may never be completely accurate. Nevertheless, publicly available information about the AML's drafting process can, and does, provide important clues.

As has been observed elsewhere, some of the driving forces behind the AML were the government's desires to promote the development of the market and to contain abusive state power.<sup>306</sup> These "domestic incentives," however, had not been strong,<sup>307</sup> and certainly not strong enough to make the idea of enacting a formal antitrust law a quick sell. It has been widely noted that the AML

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intent of U.S. antitrust law in general and the Sherman Act in particular. See Harry First, *Antitrust in Japan: The Original Intent*, 9 PAC. RIM L. & POL'Y J. 1, 1-2 & nn.1-3 (2000) (arguing that while most Japanese sources assume Japan's Antimonopoly Act to be an American invention and imposition on Japan, negotiators from Japan's government not only understood the legislation but also drafted the statute that was finally enacted).

<sup>303</sup> Drawing on the original Occupation document, Professor First challenged the conventional notion that Japanese antitrust law was improperly imposed on Japan by the United States by demonstrating that the government of Japan drafted the statute that was finally enacted and that its provisions reflected the success Japan's negotiators had in achieving many of their goals. See generally *id.*

<sup>304</sup> For discussions on the drafting process of the AML, see Wu, *supra* note 10, at 76-78 (describing the AML's drafting process); Yong Huang, *Pursuing the Second Best: The History, Momentum, and Remaining Issues of China's Anti-Monopoly Law*, 75 ANTITRUST L.J. 117, 118-20 (2008) (detailing the long legislative history of the AML and the AML project's sudden revival after a decade).

<sup>305</sup> For discussions of the driving forces behind the enactment of the AML, see Huang, *supra* note 304, at 120-24 (listing and discussing each of the driving forces behind the AML: the desire to establish a market economy, the desire to contain abusive state power, the desire to protect national interest, and the desire to narrow income disparity). See generally David J. Gerber, *Economics, Law & Institutions: The Shaping of Chinese Competition Law*, 26 J.L. & POL'Y 271 (2008) (examining some of the factors that have influenced the shaping of the AML and that are likely to influence the operation of competition law and its institutions).

<sup>306</sup> See Huang, *supra* note 304 at 121-22.

<sup>307</sup> See Gerber, *supra* note 305, at 282 ("Domestic incentives to enact a competition law have not been strong, and there has been opposition to the idea within the government, but on balance they seem to have provided support for competition law.").

was first placed on the government's legislative agenda in 1994.<sup>308</sup> The efforts to draft an antimonopoly law, however, started much earlier, when a drafting team was first assembled under the Legislative Affairs Office of the State Council in 1987.<sup>309</sup> The plan back then was to enact a "unitary" law that would combine an antimonopoly law and an anti-unfair competition law, and in 1988, the drafting team produced the first draft of a provisional rule following this unitary model.<sup>310</sup> The draft provisional rule, however, was vetoed by the government after investigations by the State Economic and Trade Commission ("SETC") and the State Administration for Industry and Commerce ("SAIC") into China's market conditions led to the conclusion that "monopoly issues were neither typical nor widespread."<sup>311</sup> The drafting team then decided to bifurcate the drafting process for the antimonopoly law and the anti-unfair competition law, and, as a result, the Anti-Unfair Competition Law was enacted in 1993.<sup>312</sup> In 1994, the antimonopoly law was placed on the government's legislative agenda and a new drafting team consisting of officials from SETC and SAIC was assembled again.<sup>313</sup> The new drafting team did produce a draft of the antimonopoly law, but that draft was never introduced in the National People's Congress.<sup>314</sup> The drafting process for the AML then "languished for a decade," and it was not until 2004 that the drafting efforts were "suddenly revived and expedited."<sup>315</sup>

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<sup>308</sup> See, e.g., Huang, *supra* note 304, at 118 ("The drafting of the Chinese AML bill commenced in 1994, but it was not enacted until 2007."); Wu, *supra* note 10, at 76 ("It is well known that the AML was on the legislative agenda for the Eighth, Ninth, and Tenth National People's Congresses. Thirteen years have passed since 1994, when the former State Economic & Trade Commission (SETC) was first responsible for the drafting of the AML.").

<sup>309</sup> See *Fanlongduan Fa 21 Nian Fengyu Licheng* [The Antimonopoly Law's Bumpy Journey of Twenty-One Years], ZHONGGUO JINGJI SHIBAO [CHINA ECON. TIMES], July 29, 2008, <http://www.competitionlaw.cn/show.aspx?id=3984&cid=13> [hereinafter *AML's Twenty-One Year Journey*] (stating the former State Council Legislative Council set up a drafting group for the anti-monopoly law in August 1987).

<sup>310</sup> *Id.*

<sup>311</sup> *Id.*

<sup>312</sup> *Id.*

<sup>313</sup> *Id.*

<sup>314</sup> Huang, *supra* note 304, at 118 n.3 ("Since 1994 the two drafters [the SETC and the SAIC] had produced a single, joint draft, but for various reasons it had never been introduced in the NPC.").

<sup>315</sup> *Id.* at 120; see also *AML's Twenty-One Year Journey*, *supra* note 309.

What happened? Based on Chinese media reports, it was apparently a 2003 incident involving alleged anticompetitive practices of a foreign company in China that led to the sudden acceleration of the drafting process for the AML. In 2003, Tetra Pak, a Swedish company specializing in aseptic packaging equipment and supplies for dairy and beverage products, was accused of tying the sale of packaging equipment to the sale of packaging supplies in China.<sup>316</sup> After receiving complaints from domestic firms competing with Tetra Pak for packaging supplies, SAIC and MOFCOM conducted a series of investigations into anticompetitive conduct by foreign companies in China.<sup>317</sup> In April 2004, SAIC reported the findings of its investigations in an internal publication. In its report, SAIC gave detailed data on market shares of foreign companies in China in seven product groups or industries, and warned of a trend of foreign companies monopolizing the Chinese markets.<sup>318</sup>

It is important to bear in mind that the Tetra Pak incident and the ensuing investigations by SAIC and MOFCOM took place against the backdrop of a more globalized economy in the post-WTO era. Upon its accession to the WTO in 2001, China made a broad range of commitments, including commitments on tariff reductions and binding for a large number of products<sup>319</sup> and commitments on trade in services in a large number of sectors.<sup>320</sup> The direct outcomes of these WTO commitments are enhanced access to the Chinese market by foreign companies, from both

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<sup>316</sup> See Ruidian Lile Shishi Kunbang Xiaoshou Zao Zhiyi [Swedish Tetra Pak's Tying Practices Questioned], GUOJI JINRONG BAO [INT'L FIN. J.], Nov. 5, 2003, <http://finance1.jrj.com.cn/news/2003-11-05/000000680733.html> (discussing Tetra Pak's bundling practices and their aseptic package marketing dominance); see also AML's *Twenty-One Year Journey*, *supra* note 309.

<sup>317</sup> See AML's *Twenty-One Year Journey*, *supra* note 309.

<sup>318</sup> The seven product groups or industries included in the SAIC report were software, photosensitive materials, personal computers, cell phones, cameras, tires, soft drink packaging, retails, and beverages. See Guojia Gongshang Zongju Baogao: Kuanguo Jutou Zai Hua Jian Xian Longduan Taishi [SAIC Report: Multinational Giants Show Signs of Monopolizing China's Markets], XINWEN CHENBAO [NEWS MORNING DAILY], Nov. 15, 2004, [http://news.xinhuanet.com/fortune/2004-11/15/content\\_2221465.htm](http://news.xinhuanet.com/fortune/2004-11/15/content_2221465.htm).

<sup>319</sup> For discussions of China's WTO commitments on tariffs, see CHING CHEONG & CHING HUNG YEE, HANDBOOK ON CHINA'S WTO ACCESSION AND ITS IMPACTS 36-45 (2003).

<sup>320</sup> For a list of China's WTO commitments on trade in services, see *id.* at 104-07 (describing the commitments as well as the underlying principles for both horizontal and sectoral commitments).

within and without China. With the elimination of many policy tools that used to be available to protect China's domestic industries from multinational corporations, Chinese firms are to an increasing degree facing direct competition from multinational corporations, which are generally considered in China to be stronger competitors because of their advantages in financial resources, technologies, and management skills. It is therefore not surprising that the alleged anticompetitive practices of Tetra Pak and possibly other multinational corporations received a strong reaction in China. In retrospect, the aforementioned SAIC report perhaps overreacted to the Tetra Pak incident. In most of the seven product groups or industries examined by the report, it grouped the market shares of all competing foreign companies together in arriving at the "dominant" market shares of those companies. The report also did not offer any concrete evidence of foreign companies actually engaging in anticompetitive practices to increase or maintain their market shares. Four years later, these flaws of the SAIC report were pointed out by a MOFCOM report published in March 2008.<sup>321</sup>

But at the time, the Tetra Pak incident and the SAIC report appeared to have led to a broad consensus that China needed a formal antitrust law as a precaution against anticompetitive practices of multinational corporations. After the issuance of the 2004 SAIC report, the drafting process for the AML accelerated,<sup>322</sup> culminating in the adoption of the AML in August 2007.

The adoption of the AML, however, did not change the fact that there was still not a consensus on the need to have a formal antitrust law to deal with domestic competition issues. In the post-WTO era, China could not really enact an antitrust law that would apply to foreign firms only. But subjecting domestic firms, particularly SOEs, to the new antitrust law would pose numerous conceptual and policy challenges. In the last three years of the

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<sup>321</sup> See Zhile Wang, *Waizi Binggou Yu Guojia Jingji Anquan [Mergers and Acquisitions by Foreign Companies and National Economic Security]*, in *ZHONGGUO WAISHANG TOUZI BAOGAO 2007 [REPORT ON FOREIGN INVESTMENT IN CHINA 2007]*, Mar. 21, 2008, [http://www.fdi.gov.cn/pub/FDI/wzyj/yjbg/zgwstzbg/2007chinainvestmentreport/t20080122\\_89094.htm](http://www.fdi.gov.cn/pub/FDI/wzyj/yjbg/zgwstzbg/2007chinainvestmentreport/t20080122_89094.htm).

<sup>322</sup> See *Fanlongduan Fa Yunnian 10 Nian Jiasu Chutai; Waiqi Fanbo Longduan [Drafting of Antimonopoly Law Accelerates After Ten Years in the Making; Foreign Companies Rebut Monopoly Charges]*, *BEIJING QINGNIAN BAO [BEIJING YOUTH DAILY]*, May 28, 2004, <http://hyconference.edu.cn/chinese/law/574907.htm> (reporting that the drafting of the AML accelerated upon the release of the SAIC report).

AML's drafting process, therefore, efforts appeared to have been made to draft a law that would at least nominally conform to antitrust principles but would at the same time accommodate the status quo, rather than a law that would require the status quo to conform to antitrust principles. One example of this "minimalist" approach of the AML is the ambiguity in the text of the AML about whether SOE monopolies are exempted from the AML.<sup>323</sup> This minimalist approach is largely made necessary by China's unique local conditions as discussed in this Article. Before these local conditions become more compatible with a coherent competition policy, and before there is a consensus on the role of competition in the domestic sectors, the AML will likely remain a minimalist law, and China's competition policy will likely continue being shaped more by ad hoc government action initiated outside of the AML than by the AML.

## 5. CONCLUSION

This Article demonstrates that the transplant in China of a formal antitrust law in the mold of Western antitrust laws takes place under local conditions that are not entirely compatible with Western antitrust models. These local conditions, chiefly the transitional stage China is currently in, China's market structures, and pervasive state control in China's economy, have limited the reach and applicability of the AML in all three major areas of antitrust: cartels, abuse of dominant market position, and merger review. With respect to cartels, widespread structural distortions caused by the roles of the government in the investment process and the exit barriers erected by the government have prevented China from pursuing a rigorous anti-cartel policy. With respect to abuse of dominance, the focus of the AML on exclusionary abuses has led to a mismatch between monopoly abuses that are most prevalent in China's economy and monopoly abuses that are prohibited under the AML. With respect to merger review, China's minimally concentrated market structures and long-running policies favoring SOE mergers have prevented the AML from being meaningfully applied to domestic mergers. In sum, despite having a Western-style antitrust law, China has not developed and likely will not develop Western-style antitrust jurisprudence in the near future due to these local conditions.

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<sup>323</sup> See *supra* notes 236-37 and accompanying text.

But is the AML a wasted effort? The answer to that question is a clear “no.” The AML has at least forced China’s policymakers to ponder, perhaps for the first time, over questions about competition in a systematic manner. It is true that the initial answers given by the AML to those questions were timid, but many of China’s far-reaching reforms started with steps that are even more timid.<sup>324</sup> Given how the Chinese-style incrementalism has worked in the past, it is still far too early to assess the eventual fate of antitrust regulation in China. To a large extent, the future of the AML and Western antitrust models in China depends on how China’s local conditions will evolve in coming years. In other words, with the adoption of the AML, the transplant of antitrust in China has not ended, but has just begun.

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<sup>324</sup> In fact, China’s entire economic reforms were set in motion by a timid step taken by a group of farmers who made a secret pact among themselves in 1978 to contract out collectively owned lands. See FENG CHEN, *ECONOMIC TRANSITION AND POLITICAL LEGITIMACY IN POST-MAO CHINA: IDEOLOGY AND REFORM* 68 (1995).



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