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## Article

**\*149 CHALLENGES IN DESIGNING PUBLIC PROCUREMENT LINKAGES: A CASE STUDY OF  
SMES PREFERENCE IN CHINA'S GOVERNMENT PROCUREMENT**[Jianlin Chen \[FNa1\]](#)

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*Preferential treatment in government procurement, also known as procurement linkages, is a controversial yet popular tool to achieve socio-economic goals, most importantly, affirmative action for certain targeted groups. This Article utilizes the recently enacted small-medium enterprise (“SME”) procurement linkages in China to examine the pitfalls in the design of procurement linkages. Two major deficiencies of the Chinese regime impede effective implementation of procurement linkages. First, loopholes in the Chinese regulatory regime allow large enterprises to usurp the benefits meant for SMEs through the use of wholly owned subsidiaries and other corporate arrangements. Second, aggrieved suppliers face stringent procedural requirements and limited civil remedies in their attempts to enforce procurement linkages, while the government procuring authority has a perverse incentive to overlook and even acquiesce in the violations. This Article argues that these deficiencies reflect the mistaken assumption that procurement linkages should be treated as simply a conventional type of government procurement. Effective reform would have to go beyond strengthening the enforcement mechanisms for conventional government procurement and entails specific legislative action to tackle the particular requirements of the preferential policies.*

**\*150 TABLE OF CONTENTS**

I.	Introduction	151
II.	The Law and Context	154

A. Backdrop of SME Development Policies	154
1. SMEs and Chinese Economic Reform	154
2. Existing Laws and Policies on SME Support	155
B. Government Procurement in China	157
1. Infancy of the Chinese Government Procurement Regime	158
2. Role of the WTO GPA	159
3. Path to the Temporary Measures	160
C. Specifics of Preferential Policies	160
III. Defining SMEs: Pitfalls and Challenges	162
A. Current Definition of SMEs	162
B. Tension between Industry-Specific	163

	and Uniform Definitions	
	1. China's Oscillation	163
	2. Comparative Perspectives from Europe and the U.S.	165
	3. Analysis	166
	C. Risks of Abuse and Circumvention	167
	1. Comparative Perspectives from Europe and the U.S.	168
	2. Lacuna in Related Companies under Chinese Law	169
	D. Closing the Loopholes	171
IV.	Enforcement: An Incentives Perspective	173
	A. Lack of Private Enforcement Mechanisms	174
	1. A Challenge Procedure for Aggrieved Suppliers	174

2. Limitations of Remedies	176
B. Specific Problems Associated with the Temporary Measures	180
1. Preferential Treatment	180
2. Definition of SMEs	182
3. Prohibition of Sub-contracting	184
C. Challenge Procedures Under the GPA and Limited Impact on Reform	185
1. Limited Reform of Inadequate Remedies	186
2. Impediment of Standing in Enforcing SME Linkages	187
3. Summary: Limited Impact of the GPA	188
D. Perverse Incentives of Government Bodies	189
1. Perverse Incentives of the Government Procuring Authority	189

	2. Distracted Supervisory Authority	192
V.	Thoughts on Reform	194
	A. Peculiarity of SME Linkages in Government Procurement Reform	194
	B. Suggestions for Reforms	196
	1. Special Enforcement Mechanisms for SME Linkages	196
	2. Dedicated Public Enforcement Agencies	198
VI.	Conclusion: Rethinking Legal Reform in China And Procurement Linkages	199

## \*151 I. INTRODUCTION

The massive scale of government procurement, especially in light of the increased emphasis on public spending as a fiscal stimulus to combat the economic downturn, has enhanced the importance and prevalence of the use of government procurement as a means to achieve specific socio-economic goals. [\[FN1\]](#) One recent example is the Temporary Measures of Government Procurement to Promote the Development of Medium-Small Enterprises (“Temporary Measures”), [\[FN2\]](#) which was enacted in China in December 2011 to implement preferential treatment of small-medium enterprises (“SMEs”) in government procurement. Under the Temporary Measures, 30% of government procurement is to be reserved for SMEs, with SMEs also enjoying price discounts for other government procurement. [\[FN3\]](#)

Putting aside the policy significance of China committing the equivalent of more than RMB 200 billion of government procurement to support SMEs, [\[FN4\]](#) the Temporary Measures provides an illustrative case study on the perils in the design and enforcement of preferential policies in government procurement. An effective preferential policy, also known as procurement linkages, requires a carefully formulated definition of the intended beneficiaries\***152** to ensure preferential treatments are properly enjoyed by the designated entities. In particular, care must be taken to prevent non-qualifying entities from enjoying preferential treatment through the use of creative corporate structuring and other arrangements.

In addition, the common assumption that procurement linkages should be treated as a conventional type of government procurement and that the standard enforcement mechanisms for government procurement in general should be applied to procurement linkages is misguided; the considerations underpinning procurement linkages are categorically different from those of conventional government procurement. Laws governing conventional government procurement are built on the general principles of non-discrimination and “best value for the money.” [\[FN5\]](#) It should not be surprising that the resulting substantive and procedural rules are ill-equipped to ensure effective enforcement of policies requiring preferential treatment to certain suppliers - the antithesis of non-discrimination and “best value for money.”

The aforementioned problems are reflected in the two major deficiencies of the Temporary Measures. First, insufficient attention is directed at the risk of circumvention via the creative use of corporate structuring. Other jurisdictions, such as the U.S. and Europe, typically include provisions that preclude enterprises that are significantly owned or controlled by large enterprises from enjoying SME preferential treatment. [\[FN6\]](#) In China, loopholes in the Temporary Measures and relevant regulations defining SMEs allow large enterprises to usurp the benefits meant for SMEs through the use of wholly owned subsidiaries and other corporate arrangements. These loopholes are not legislative oversight but reflect the vested interests of local government and state-owned enterprises (“SOEs”) in securing dominant access to government procurement contracts.

Second, available enforcement remedies for violations of the Temporary Measures are inadequate. The inadequacies of private enforcement mechanisms under the Government Procurement Law [\[FN7\]](#) are aggravated under the Temporary Measures, whereby aggrieved suppliers face stringent procedural requirements\***153** and limited civil remedies in their attempts to enforce the Temporary Measures. Public enforcement also suffers from the perverse incentives of the government procuring authority - the government body/department conducting the procurement - a problem unique to the context of SME preferential policies. [\[FN8\]](#) Specifically, the government procuring authority is likely to overlook violations of

the Temporary Measures because such violations do not typically cause it any direct financial losses, in contrast to violations of the conventional government procurement regime. Overlooked violations often result in procurement contracts being awarded to and performed by large enterprises, an outcome that the government procuring authority is indifferent to and may even prefer.

This Article critically examines the Temporary Measures and considers possible reform proposals. In particular, the Article highlights the different challenges posed by the enforcement of government procurement linkages as compared to the enforcement of conventional government procurement, and discusses why specific amendments to substantive and procedural rules and the creation of dedicated public enforcement agencies are necessary in ensuring effective compliance with preferential policies. In addition, the Article addresses how the definitional loopholes found in the Temporary Measures are indicative of the increasingly sophisticated rent-seeking behavior of vested interests in China.

This Article is organized into six parts. Part II traces the legislative formulation of the Temporary Measures - including the effects of China's proposed accession to the WTO's Agreement on Government Procurement ("GPA") [\[FN9\]](#) - and lays out the specifics of SME preferential policies. Part III focuses on definitional issues relating to SMEs. Through a comparative analysis of U.S. and European approaches, Part III identifies China's oscillation between industry-specific and uniform definitions and analyzes current loopholes. Part IV examines the inadequacies of available private and public enforcement mechanisms and also **\*154** discusses how the GPA's domestic review procedures are ineffective in addressing the enforcement concerns of procurement linkages like the Temporary Measures. Part V highlights the conceptual distinction between conventional government procurement and preferential policies and discusses possible reform proposals. Part VI concludes with thoughts on legal reform for China's procurement linkages.

## II. THE LAW AND CONTEXT

### A. Backdrop of SME Development Policies

#### 1. SMEs and Chinese Economic Reform

Emphasis on promoting private small business has traditionally been a prominent mainstay in the economic development and commercial policies of many jurisdictions. [\[FN10\]](#) By contrast, SMEs were generally neglected or even treated with hostility in the early phases of China's market transition. [\[FN11\]](#) Despite over thirty years of market reform, many structural problems persist. Barriers to entry, whether officially sanctioned or otherwise present, are common in many industries, to the detriment of private



SMEs. [\[FN12\]](#) The regulatory burdens facing SMEs are also onerous and often discriminatory. [\[FN13\]](#) The difficulty of SME financing, [\[FN14\]](#) for \*155 example, remains a common obstacle to SME growth and development. [\[FN15\]](#) Notwithstanding the higher default risk of SMEs, [\[FN16\]](#) discrimination against private entities in favor of SOEs presents a major problem. [\[FN17\]](#) SMEs are also significantly disadvantaged and deprived of fair competition opportunities in government procurement. [\[FN18\]](#)

The recognition of the contribution of SMEs in reducing unemployment, mitigating the urban-rural divide, and stimulating technological innovation [\[FN19\]](#) has prompted a more favorable legal and policy environment for SMEs in recent times. A policy paper promulgated by the State Council General Office in 2000 represents the first concerted attempt by the government to address the development needs of SMEs. [\[FN20\]](#) Two years later, this process culminated in a specific piece of legislation, the Law on the Promotion of Medium-Small Enterprises. [\[FN21\]](#)

## 2. Existing Laws and Policies on SME Support

The Law on the Promotion of Medium-Small Enterprises provides for government support of SME development in a variety of areas. There is a special SME development fund that can be used to support SME credit guarantees, technological innovation,\*156 professional enhancement, and other strategic development plans. [\[FN22\]](#) There are also provisions directed at improving SMEs' access to financial services, credit facilities, and capital. [\[FN23\]](#) Preferential tax treatment is specifically provided for in the legislation, [\[FN24\]](#) as is the reduction of bureaucratic red tape faced by SMEs. [\[FN25\]](#) The subject of technological innovation by SMEs received substantial attention and its own chapter. [\[FN26\]](#) Finally, Article 34 expressly provides for priority in government procurement. A flurry of regulations and policy measures were promulgated pursuant to this new law, with great emphasis on enhancing SME access to financial services, credit facilities, and capital. [\[FN27\]](#) Preferential tax treatment was also specified in subsequent tax regulations. [\[FN28\]](#) Finally, specific policies were formulated to support SMEs that are involved in technological innovations. [\[FN29\]](#)

Academic evaluations of these measures have been mixed. While recognizing that steps have been taken toward supporting SME development, a common critique among commentators and \*157 academics is the lack of a comprehensive and coordinated approach. [\[FN30\]](#) Implementation of the policies is found wanting at times. [\[FN31\]](#) In addition, the lack of effective fair competition laws exacerbates the competitive disadvantages of SMEs. [\[FN32\]](#) There are also calls for more concrete and substantial tax preferential policies for SMEs. [\[FN33\]](#) The need for further reform is recognized in the special SMEs report prepared by the State Council in December 2009. Areas identified in the report include tax and other preferential policies, assistance in SME financing, and institutional support for SMEs, among others.

[\[FN34\]](#)

## B. Government Procurement in China

The various policies implemented pursuant to the Law on the Promotion of Medium-Small Enterprises rendered the priority of SMEs in government procurement a conspicuous and surprising absence. The role of government procurement in achieving policy goals such as SME development is well recognized by international legal and policy circles. [\[FN35\]](#) In the U.S., the Small Business Act of 1953 specifically provided for SMEs contracting in federal procurements going back to the immediate post-war period. [\[FN36\]](#) SME preferences in Japan's government procurement have also been legislated since 1966. [\[FN37\]](#) Facilitation of SME participation in government contracts has received specific attention in the procurement policies of the European Commission since the 1990s. [\[FN38\]](#) Given the significant value of Chinese government\***158** procurement, [\[FN39\]](#) such an omission deprives SME development of a potentially potent policy measure.

### 1. Infancy of the Chinese Government Procurement Regime

One possible reason for the delay in SME procurement policy reform is the relatively short history of government procurement law in China. Prior to the economic reforms of the 1980s, the need to ensure competition and transparency in government procurement was deemed unnecessary, as the economy was dominated by the state and SOEs. [\[FN40\]](#) A meaningful notion of government procurement emerged after 1995, with cities in economically developed regions (e.g., Shanghai, Shenzhen, and Zhuhai) establishing local rules relating to government procurement. [\[FN41\]](#) The Government Procurement Law was enacted in 2002 to provide a more established framework to regulate government procurement nationally. [\[FN42\]](#) However, economic statistics on the ratio of government procurement in relation to total GDP and overall government expenditure suggest that the operation and regulation of the Chinese government procurement market remains in its early development stage, even 10 years after the enactment of the Government Procurement Law. [\[FN43\]](#)

The infancy of China's government procurement regime, however, does not fully explain the delay in SME procurement policy reform. The Government Procurement Law expressly provides that government procurement should assist in the realization\***159** of national, social, and economic policy goals, including the promotion of SME development. [\[FN44\]](#) In fact, the Chinese government has utilized government procurement to promote products that are “indigenously innovated,” “energy-saving,” and “environmentally friendly” since 2006. [\[FN45\]](#) In contrast, the procurement linkages to support SMEs were only implemented in 2012.

## 2. Role of the WTO GPA

Another possible contributing factor to the delay in SME procurement policy reform is China's pending accession to the GPA. The GPA is a plurilateral agreement covering government procurement and applies only to WTO members who choose to be party to it. Membership in the GPA comes with the obligation to comply with various transparency and non-discrimination provisions in exchange for access to the government procurement markets of other members. [\[FN46\]](#) China first submitted a formal application for membership to the GPA in 2007 and is currently negotiating accession in the context of its second application, submitted in 2010. [\[FN47\]](#) The promise of transparency arising from compliance with the GPA potentially provides fresh impetus for reform of China's government procurement regime. [\[FN48\]](#)

One potential complication arising from the accession to the GPA is that SME preferential policies in government procurement violate several GPA provisions. [\[FN49\]](#) These include Article 7(b) (“any conditions for participation in tendering procedures shall be limited to those which are essential to ensure the firm's capability to fulfill the contract in question.”), Article 10 (selective tendering procedures), and Article 16 (restrictions on offsets). [\[FN50\]](#) SME linkages are also commonly structured with a \***160** nationality requirement, which violates Article 3 (national treatment and non-discrimination) and Article 15 (limited tendering procedures mandate non-discrimination between domestic and foreign suppliers). [\[FN51\]](#)

Interestingly, the GPA does not necessarily prevent SME procurement linkages because the potential contracting parties to the GPA may negotiate for exemption of such policies from coverage in market access provisions, as is the case with Canada, Korea, Japan, and the U.S. [\[FN52\]](#) China has insisted in its application for accession to the GPA that it be free to maintain its industrial and social policies (including support for SMEs) through government procurement. [\[FN53\]](#) Therefore, while the GPA presents an obstacle in the implementation of SME preferential policies, the obstacle is not insurmountable.

## 3. Path to the Temporary Measures

The delay in the development of SME procurement linkages is not adequately explained by the inflexibility of the Chinese government procurement regime or China's pending accession to the GPA. The delay may ultimately be due to this issue's relative lack of political salience compared to other contemporaneous legislative initiatives.

With the special SMEs report by the State Council in December 2009, a timeline was introduced for enacting relevant regulations by the end of 2010. [\[FN54\]](#) While further delay ensued, some progress was made by the Shanghai municipal government, which began implementing a locally enacted SME preferential treatment regime on January 1, 2010. [\[FN55\]](#) It was only during the last week of 2011 that the Temporary Measures was finally introduced. [\[FN56\]](#)

### C. Specifics of Preferential Policies

Government procurement is the process in which a government entity (the government procuring authority) sources for **\*161** goods and services from enterprises (the suppliers). Public tender is the usual default method used to select the supplier, although competitive negotiations, single source purchases, and other methods may be employed in situations where public tender is not feasible (e.g. too few potential suppliers).

The Temporary Measures provides two concrete measures to support SMEs in government procurement. First, 30% of the government procurement budget is reserved for SMEs. Of this 30%, at least 60% is reserved for small and micro enterprises. [\[FN57\]](#) This quota may be varied and reduced in accordance with the requirements of government operations and public service needs, i.e. a government procuring authority may set aside a lower proportion of government procurement budget for SMEs on account of operational needs. [\[FN58\]](#) The second measure is price discount. For procurement projects that are not reserved for SMEs, small and micro enterprises enjoy a 6-10% discount from their submitted bid. [\[FN59\]](#) The precise discount is decided by the relevant procuring authority/agent. [\[FN60\]](#)

Consortiums that include small and micro enterprises are also encouraged to bid for procurement projects not reserved for SMEs. Article 6 provides for a 2-3% discount to the bids of consortiums that have at least 30% of the contract sum subcontracted to small and micro SMEs. If the consortium consists entirely of small and micro enterprises, then the consortium can either participate in the procurement projects specifically reserved for SMEs under Article 4 or enjoy a 6-10% discount under Article 5. To prevent abuse and circumvention, it is stipulated that large-medium enterprises and other entities in the consortium should not have any “investment relationship” with the small and micro enterprises. [\[FN61\]](#)

In terms of sub-contracting, Article 7 of the Temporary Measures prohibits sub-contracting or transfer of contract by the winning party to an entity larger than itself. By contrast, sub-contracting to SMEs is encouraged, with those sub-contracts constituting **\*162** SME procurement. [\[FN62\]](#) This is significant because Article 12 of the Temporary Measures mandates that government departments prepare annual reports on the amount of SME participation in government procurement. These annual reports are sub-

mitted to the relevant Ministry of Finance departments and are subject to public disclosure. Government departments that predominantly award their procurement contracts to large enterprises can still present respectable statistics of SME participation if the awarded contracts are sub-contracted to SMEs. Other supplementary measures include “appropriate support” for SMEs in deposits, payment due dates, and payment methods; [\[FN63\]](#) credit guarantees in government procurement to provide guarantee services for SMEs; [\[FN64\]](#) and training and consultation services to assist SMEs in navigating the government procurement process. [\[FN65\]](#)

### III. DEFINING SMES: PITFALLS AND CHALLENGES

Laws and policies that purport to grant preferences to SMEs will inevitably have to grapple with the definition of SMEs. A carefully formulated definition of SMEs that is neither over-inclusive nor under-inclusive is crucial to ensure that policy preferences are properly enjoyed by the intended entities. This part examines two definition-based issues surrounding Chinese SME procurement linkages, namely, the tension between a specific vs. general definition of SMEs and the problem of circumvention.

#### A. Current Definition of SMEs

The definitions found in the Temporary Measures are derived from existing regulations and are supplemented by additional qualifying requirements. [\[FN66\]](#) The most recent Notice on the Categorization of Medium-Small Enterprises classifies SMEs into “medium,” “small,” and “micro” based on factors such as number of employees, business revenue, and total assets and also other industry-specific characteristics. [\[FN67\]](#) The enterprises are divided into 15 industrial categories with an additional catch-all **\*163** provision for non-specified industries. [\[FN68\]](#) There are significant size variations across industrial categories. For example, a micro enterprise in the retail sector can have a maximum of 10 employees and 1 million RMB annual business revenue. [\[FN69\]](#) By contrast, a micro enterprise in the property management industry can have up to 100 employees and an annual turnover of 5 million RMB. [\[FN70\]](#)

In addition to the aforementioned requirements for capital, revenue, and employment, the Temporary Measures requires that the goods and services provided by the enterprises be either self-produced or produced by other SMEs. [\[FN71\]](#) There is also a prohibition on sub-contracting by SMEs to larger enterprises. [\[FN72\]](#)

Due to the current lack of an authoritative classification body in China and the inability of government procuring authorities to determine SME status, [\[FN73\]](#) the Temporary Measures relies on a self-declaratory mechanism for SME classification. SMEs participating in government procurement are

required to confirm their SME status via a standard declaration form that repeats the definition criteria set out in Article 2. The declaration form provides for “legal liability in accordance with the law” for false declaration. [\[FN74\]](#)

## B. Tension between Industry-Specific and Uniform Definitions

At first glance, the current approach toward defining SMEs appears to be uncontroversial. However, a historical and comparative analysis of the situation reveals an ongoing tension between industry-specific and uniform approaches to defining SMEs.

### 1. China's Oscillation

The evolution of the Chinese definition of SMEs reveals an oscillation between industry-specific and more generalized classification standards. Prior to the enactment of the Law on the Promotion of Medium-Small Enterprises in 2002, SMEs were \***164** classified under the Standards for Classifying Large, Medium, and Small Industrial Enterprises (1988). [\[FN75\]](#) This 1988 regulation adopted a highly industry-specific classification approach that not only differentiated between 19 different sub-categories of industry, [\[FN76\]](#) but also further distinguished the product lines within each sub-category. For example, within the tobacco industry sub-category, the regulation differentiated classification standards for enterprises that produce cigarettes and enterprises that engage in tobacco redrying. [\[FN77\]](#)

The Standards for Classifying Large, Medium, and Small Industrial Enterprises (1988) was enacted in the context of China's planned economy and was primarily intended for statistical and macro-management purposes. [\[FN78\]](#) The Law on the Promotion of Medium-Small Enterprises, introduced in 2002, demanded a more refined definition of SMEs to meet the new policy objective of SME development. The Interim Provisions on the Standards for Medium and Small Enterprises (2003) was enacted to replace the Standards for Classifying Large, Medium, and Small Industrial Enterprises (1988). [\[FN79\]](#) The new 2003 regulation substantially modified the prior industry-specific approach. Under the Interim Provisions on the Standards for Medium and Small Enterprises (2003), there were only five different standards for five categories: industrial; construction; transport and postal; wholesale and retail; and hospitality and food and beverages. [\[FN80\]](#)

It is interesting to note the reversal in approach by the most recent Notice on the Categorization of Medium-Small Enterprises, which replaces the Interim Provisions on the Standards \***165** for Medium and Small Enterprises (2003). [\[FN81\]](#) Adopting a more detailed industry-specific approach similar to the 1988 regulation, enterprises are now classified into 15 industrial categories, with a catch-all provision for

non-specified industries. [\[FN82\]](#)

## 2. Comparative Perspectives from Europe and the U.S.

From a comparative perspective, the Chinese evolution of the definition of SMEs represents the ongoing tension between the two major approaches to the definition of SMEs in the international arena. On one side is the European approach, a one-size-fits-all definition for SMEs regardless of industry variation. The SME definition promulgated by the European Commission focuses solely on staff headcounts and financial ceilings without taking into account industry-specific variation. The headcount and turnover limits of medium-sized, small, and micro enterprises are, 250 and 50 million Euros; 50 and 10 million Euros; and 10 and 2 million Euros, respectively. [\[FN83\]](#)

The United States represents the other side of the spectrum. The U.S. small business definition relies on the North American Industrial Classification System as a baseline classification for the various industry-specific definitions of small business. [\[FN84\]](#) Various industries are classified into 17 different basic sectors, with numerous sub-sectors within each, and further product classifications within each sub-sector. [\[FN85\]](#) For example, the agriculture, forestry, fishing, and hunting category is divided into five sub-sectors of crop production; animal production; forestry and logging; fishing, hunting and trapping; and support activities for agriculture and forestry. The sub-sector of crop production is further divided into 30 product classifications based on crop (e.g., soybean, strawberry, mushroom, grape, apple, sugar beet). In total, there are over one thousand classification categories. [\[FN86\]](#) The various size limits under the different product classifications \*166 within each sub-sector tend to be identical. For example, all the 30 product classifications under the crop production sub-sector have a size standard of \$0.75 million annual turnover. [\[FN87\]](#) Nonetheless, there can be significant variations in size definitions between these product classifications. Within the sub-sector of animal production, the product classifications of beef cattle ranching and chicken meat production both have a size limit of \$0.75 million, while the product classifications of cattle feedlots and chicken egg production have a size limit of \$2 million and \$12.5 million respectively.

## 3. Analysis

The tension surrounding the approach to defining SMEs was recognized in the legislative debate preceding the Law on the Promotion of Medium-Small Enterprises. In 2001, when the Law on the Promotion of Medium-Small Enterprises was being discussed in the National People's Congress Standing Committee, the two contrasting approaches for defining SMEs - one-size-fits-all and industry-specific - were advanced and debated. The resolution of the debate is somewhat curious and perhaps explains the



oscillation in the Chinese approach. Deferring to the bureaucratic expertise in industrial and economic policies, the Standing Committee preferred to leave the precise definition to future regulations because the relevant regulatory authorities were simultaneously in the process of formulating the definitions. [\[FN88\]](#) In terms of the debate between industry-specific and uniform approaches, however, both were “considered and used as reference” for the final proposed provision. [\[FN89\]](#) While the final provision only reflects an industry-specific approach, [\[FN90\]](#) the lip service paid to the uniform definition suggests that there was substantial support for this approach among legislators and regulatory authorities at the time of promulgation. This may also help explain why a conservative, industry-specific categorization approach of only five categories was initially adopted.

**\*167** Chinese academic Liu Qingfei argues that the Chinese Interim Provisions on the Standards for Medium and Small Enterprises (2003) provided for an overbroad definition of SMEs that not only ignored the variation in various industries but also the geographical imbalance in economic development. [\[FN91\]](#) Similar criticisms can be levied against the European one-size-fits-all approach. [\[FN92\]](#) Such a uniform approach can lead to both over-inclusion of firms that are actually considered large for a particular industry and under-inclusion of firms in industries that tend to have a higher turnover and headcount. Nonetheless, the chief advantage of the European approach and the Chinese Interim Provisions on the Standards for Medium and Small Enterprises (2003) is the simplicity of their administration. This is especially so for enterprises whose business activities straddle different industry specifications. For example, a holiday resort is arguably involved in both the hospitality business and the food and beverage business. These two business activities are classified as a single category under the Interim Provisions on the Standards for Medium and Small Enterprises (2003) [\[FN93\]](#) but are considered two distinct categories under the Notice on the Categorization of Medium-Small Enterprises (2011). [\[FN94\]](#) Government procurement authorities and bidding enterprises have less difficulty ascertaining small business status with only one or a few standards to evaluate. Conversely, overly-detailed industry categorizations (e.g., the U.S. approach), serve to increase administrative costs in determining the appropriate industry categorization that does not have any material impact on the size specification.

Observed in this light, the most recent Notice on the Categorization of Medium-Small Enterprises arguably represents a sensible compromise between ease of administration and sensitivity to specific industry conditions.

### C. Risks of Abuse and Circumvention

The more problematic definition-based issue is the circumvention of laws by large enterprises masquerading as SMEs or otherwise usurping the preferential treatment meant for SMEs. While the Tem-



porary Measures includes some measures to address potential abuses, this section identifies and discusses the various methods in which large enterprises may nonetheless circumvent the law.

**\*168** 1. Comparative Perspectives from Europe and the U.S.

In the United States, circumvention of preferential policies for small business is dealt with through the concept of affiliation. The U.S. concept of affiliation between businesses focuses on control. Control is defined broadly and includes not only situations in which control is exercised but also situations in which the power to control exists. [\[FN95\]](#) A holistic approach that considers various factors such as ownership, management, previous relationships/ties, and contractual relationships is used to determine affiliation, [\[FN96\]](#) with special attention paid to stock ownership, [\[FN97\]](#) stock options, [\[FN98\]](#) common management, [\[FN99\]](#) identity of interest, [\[FN100\]](#) the newly organized concern rule, [\[FN101\]](#) joint venture, [\[FN102\]](#) and franchise and license agreements. [\[FN103\]](#) In addition, the reality of negative control is recognized. Namely, minority shareholding can constitute affiliation if the minority shareholder can prevent a quorum or otherwise veto the enterprise's actions. [\[FN104\]](#) There is also the requirement that the employees of any given small business perform at least 50% of the awarded contract. [\[FN105\]](#) Once affiliation is established, all receipts, employees, and other measures of the size of the affiliate will be included in its size determination. [\[FN106\]](#)

European regulation, on the other hand, divides enterprises into three categories: autonomous, partnered, and linked. [\[FN107\]](#) Autonomous enterprises are totally independent (i.e. hold less than 25% of shares in other enterprises and have less than 25% of their shares held by other enterprises) and are considered a single entity for headcount and turnover purposes. [\[FN108\]](#) Partner enterprises either hold 25% to 50% of shares of other enterprises or have 25% to 50% of their shares held by other enterprises. An enterprise must add the headcount and turnover of other partner enterprises in proportion to the shares held. [\[FN109\]](#) Linked enterprises are an “economic situation of enterprises which form a **\*169** group through direct or indirect control of the majority of voting rights of an enterprise by another or through the ability to exercise a dominant influence on an enterprise.” [\[FN110\]](#) Linked enterprises include those whose majority shareholding is owned by another enterprise or situations in which one enterprise is entitled to appoint or remove a majority of management. [\[FN111\]](#) All of the headcount and turnover of each linked enterprise is included in the total headcount and turnover. [\[FN112\]](#)

2. Lacuna in Related Companies under Chinese Law

The Notice on the Categorization of Medium-Small Enterprises was promulgated pursuant to the Law on the Promotion of Medium-Small Enterprises. [\[FN113\]](#) The devised categorization standard takes into

account the whole spectrum of SME support measures provided for under the Law on the Promotion of Medium-Small Enterprises and therefore does not take into account the requirements of any specific SME support measures. It is thus commendable that the Temporary Measures supplements the definition with an additional requirement that the goods and services provided by enterprises be either self-produced or produced by other SMEs. [\[FN114\]](#) The Temporary Measures also prohibits sub-contracting by SMEs to larger enterprises. [\[FN115\]](#) This is an important requirement in the context of government procurement because the benefit of awarding contracts to SMEs would be easily diluted if the SME was merely a conduit for goods and services provided by large enterprises. This is akin to the U.S. requirement that at least 50% of the contract must be performed by employees of the small business [\[FN116\]](#) and represents an improvement over the European model, which completely lacks similar restrictions. [\[FN117\]](#) As per the official press conference introducing the Temporary Measures, the additional requirements are meant to avoid directing profits from government contracts to large enterprises that supply goods and services to SMEs. [\[FN118\]](#)

Despite the aforementioned safeguards, there are still ways for preferential treatment of SMEs under the Temporary Measures to be hijacked by large enterprises. The most obvious way \*170 is through the deliberate establishment of subsidiaries by large enterprises that individually satisfy the requirements of SME status. With the legal recognition of one-member limited liability companies since 2005, [\[FN119\]](#) an enterprise that meets the headcount and turnover size limits will be classified as an SME under the law even if that enterprise is actually wholly owned and controlled by a large enterprise.

Despite the cause for concern that this circumvention loophole presents, the possibility of circumvention via related subsidiaries is only recognized in the context of consortium bids under Article 6. Article 6 stipulates that there shall be no “investment relationship” among the various enterprises in a consortium. However, there is nothing prohibiting a wholly owned subsidiary of a large enterprise from participating in government procurement as an SME under Articles 4 and 5. Such an SME can compete for government procurement specifically reserved for SMEs or enjoy the significant 6-10% price discount in general procurement. In addition, the wording of Article 6 is ambiguous such that it can be interpreted to allow for an “investment relationship” between small and micro enterprises in a consortium bid. [\[FN120\]](#) This potentially allows for a consortium that is eligible for SME preferential treatment but is comprised entirely of small and micro enterprises that are wholly owned by one enterprise. This is aggravated by the current definition of SMEs, in which only three of the industrial categories include “asset amount” as a size specification. [\[FN121\]](#) As for the other categories, extensive shareholding in other enterprises does not disqualify an enterprise from obtaining SME status. Moreover, asset amount is only an alternative requirement for those three categories, i.e., an enterprise with multi-million dollar assets (including ownership of other enterprises) would still qualify as an SME so long as its number of employees is below

a certain threshold.

**\*171** D. Closing the Loopholes

Given the common concerns and corresponding anti-circumvention provisions in U.S. and European regulations, the lacuna in China's regulations becomes all the more so unfortunate. The solution to the problem is seemingly obvious: China should adopt similar types of restrictions on ownership and control by large enterprises. The U.S. concept of affiliation focuses on control. [\[FN122\]](#) Its strength is its weakness. Control is conceptualized broadly to include even negative control by a minority shareholder. This is an effective approach to dealing with a wide range of possible circumvention methods by large enterprises but also introduces elements of uncertainty to legitimate corporate structuring. For example, granting veto power to a minority shareholder in a bona fide attempt to safeguard the investment interests of the minority shareholder may inadvertently nullify the small business status of that enterprise. The problem of uncertainty is aggravated by the fact that once affiliation is established, all the receipts, employees, and other measures of the affiliate are included in size determinations. [\[FN123\]](#) In comparison, European regulations recognize an intermediate category of “partnered” enterprise in which only the headcount and turnover in proportion to ownership or shareholding is added. [\[FN124\]](#) Nonetheless, the European focus on ownership that exceeds 25% is a weakness in its regulatory regime and leaves open considerable room for manipulation by large business and government agencies. [\[FN125\]](#) In any event, either the U.S. or European approach would be a marked improvement over the current approach in China.

The more interesting and less obvious question is why so little has been done to close these loopholes. An analysis of the relevant Chinese legislative history reveals that the lacuna in the Chinese definition of SMEs is not indicative of legislative oversight. The danger of circumvention via corporate structuring was recognized during the legislative process leading up to the Law on the Promotion of Medium-Small Enterprises in 2001. There was initially a provision that stipulated that the preferential policies in the Law on the Promotion of Medium-Small Enterprises would not be applicable to SMEs with more than 25% shareholding or investment by large enterprises. [\[FN126\]](#) However, this provision was omitted in the final version. [\[FN127\]](#) The official reason provided **\*172** in the record of the National People's Congress is that “some commissioners and some local and regulatory authorities” opined that such SMEs should still be covered by the law because the primary investment, even if by a large enterprise, is still “within the domain of SMEs.” [\[FN128\]](#) This is a circular and unconvincing argument that ignores the risk of circumvention and abuses by large enterprises masquerading as SMEs.

Another perspective afforded by the legislative history of the Law on the Promotion of Medium-Small Enterprises is that because, at the time, the classification of SMEs had not yet been finalized, the

drafters preferred to accord full discretion to the relevant regulatory body (i.e., the State Council) in stipulating the appropriate SME classifications. [\[FN129\]](#) However, this rationale was not proffered as a justification for the removal of the provision.

The removal of the aforementioned limitation provision may have also resulted from the influence of locally-vested interests of SOEs and local authorities who have significant investments in the form of SMEs. Notwithstanding the increasing contribution of private enterprises to China's economy, SOEs remain major players and dominate the list of large enterprises in China. [\[FN130\]](#) SOEs, often owned at the local governmental level, are also crucial to the political and economic interests of local government. [\[FN131\]](#) Not surprisingly, SOEs have dominated China's government procurement, usually at the expense of foreign and non-SOE domestic suppliers. [\[FN132\]](#) Indeed, one policy utilized by the government procuring authorities is the awarding of contracts to enterprises that are owned and controlled by the same government procuring authority. [\[FN133\]](#) It is telling that under the Government Procurement Law, the prohibition on conflict of interests between the government procuring authority and the supplier is only restricted at the individual level, i.e. the management personnel of the supplier and the persons making procurement \*173 decision for the government procuring authority must not be related or otherwise have conflicts of interest. [\[FN134\]](#) There is no prohibition, however, of investment relationships between suppliers and the government procuring authority. [\[FN135\]](#) Thus, a small-scale enterprise with substantial ownership by a local government body is perfectly entitled to both participate in the government procurement of that government body and enjoy SME preferential treatment. This practice not only raises serious conflict of interests issues, but also defeats the rationale for SME preferential treatment - helping enterprises that otherwise have difficulty accessing government procurement contracts. SOEs, by virtue of their state-ownership, are not disadvantaged in the government procurement process, even if they may individually meet the size requirements of SMEs.

Seen in this light, the inclusion of SMEs owned and controlled by large enterprises in the SME preferential policy scheme is consistent with the approach under the Government Procurement Law, which allows enterprises owned by the state to participate in government procurement without hindrance. Subsequent regulations that specifically address the definition of SMEs, including the most recent June 2011 definition, [\[FN136\]](#) have also maintained this approach. In light of what is at stake in this issue for those vested interests of SOEs and local government, if any definition reform is to take place, the Chinese government must become truly committed to the idea of supporting the development of privately-owned SMEs.

#### IV. ENFORCEMENT: AN INCENTIVES PERSPECTIVE

A law without enforcement rings hollow. This Part critically examines the enforcement mechanisms of the Temporary Measures. From an incentives perspective, this Part highlights how the lack of private enforcement mechanisms (i.e. litigation) is aggravated by the perverse incentives of the government procuring authority in acquiescing to manipulation of the preferential treatment scheme under the Temporary Measures.

#### **\*174** A. Lack of Private Enforcement Mechanisms

Suppliers in compliance with the government procurement regime are the parties most affected by its violation and are accordingly the parties with the strongest incentive to ensure that the law surrounding government procurement is followed. [\[FN137\]](#) Their ground-level perspectives also place them in the right position to detect violations and raise complaints. An effective enforcement mechanism for government procurement should thus allow suppliers in compliance to play a significant role in monitoring violations. [\[FN138\]](#) This can be achieved through granting legal rights and standing to affected suppliers in order to allow them to lodge complaints and by creating a provision for adequate remedies to be implemented upon successful challenge.

##### 1. A Challenge Procedure for Aggrieved Suppliers

Private enforcement is covered in Article 16 of the Temporary Measures, which provides that any contravention of law or regulation by government procuring authorities, procuring agencies, or SMEs during government procurement shall be governed by the Government Procurement Law and relevant laws and regulations. Chapter 6 of the Government Procurement Law sets out the relevant procedures for complaints by suppliers regarding the conduct of government procurement. Any complaints by suppliers are to be directed in written form to the relevant procuring authority within seven days of first obtaining knowledge that one's rights and interests were harmed. [\[FN139\]](#) The government procuring authority is to respond within seven working days. [\[FN140\]](#) If the complaint is not properly dealt with by the response or if the procuring authority does not respond within the stipulated timeframe, the complainant may appeal to the supervising authority, [\[FN141\]](#) here the Ministry of Finance. [\[FN142\]](#) The supervising authority is to review the complaint and render its decision within thirty working days of receiving the complaint. [\[FN143\]](#) If the complainant is unsatisfied with the decision of the supervising authority, **\*175** he may then proceed to apply for administrative review or administrative litigation. [\[FN144\]](#)

Two limitations of the private enforcement mechanism are clear. First, the scope of persons who can initiate challenges under the specified procedure is limited. Chinese academics interpreting Article 52 have suggested that it excludes suppliers whose rights are only potentially but not actually harmed.

[FN145] Thus, potential suppliers who do not actually participate in government procurement are not entitled to initiate complaint proceedings even if their failure to participate is attributable to others' violations during of government procurement laws (e.g., the discriminative bid requirement). [FN146] While there is sufficient ambiguity in the wording of Article 52 to support a broader interpretation of the standing requirement, [FN147] the more restrictive view has been adopted in the interpretation of the law by the supervisory authority. [FN148] This restriction is also perpetuated in the proposed draft of the implementation regulations for the Government Procurement Law. [FN149] This indicates that the narrow interpretation, which excludes standing for potential suppliers, is the prevailing interpretation in Chinese legal circles.

\*176 Second, exhausting the administrative complaint procedure is a prerequisite for initiating administrative review or administrative litigation under Article 58. [FN150] This can pose an undue and costly delay for the complainant, particularly when there is an acute lack of independence on the part of the government body handling the complaint. [FN151] The government procuring authority whose procurement is the subject of the complaint also handles the complaint. Furthermore, the subject matter of judicial review is the decision of the administrative supervising authority (i.e. whether the complaint has been properly handled by the administrative supervising authority) and not the substantive inquiry into the award or performance of the government procurement contract itself. [FN152] This limited and deferential judicial review scheme means that only the most egregious bias or errors by the administrative supervising authority will be remedied. This has led to calls to abolish the prerequisite of exhausting the administrative complaint procedure prior to initiating judicial review. [FN153]

These limitations arguably account for the low number of administrative or judicial reviews in practice. In the first seven years after the Government Procurement Law went into effect, there were only 62 administrative review cases received by the Ministry of Finance. Even after taking into account the administrative review cases received by local branches, the total is still only slightly over 200. [FN154] The absence of a comprehensive survey of judicial review precludes a precise account of the utilization of judicial review. Nonetheless, Chinese commentators and academics commonly opine that such cases are rare. [FN155]

## 2. Limitations of Remedies

Criminal and administrative liabilities are the primary sanctions envisaged under the Government Procurement Law. [FN156] Violators of the provisions of the Government Procurement Law \*177 are typically subject to administrative and criminal sanctions. In addition, and when available, corrective action is taken. [FN157] However, the Government Procurement Law mostly relies on existing adminis-



trative regulations and criminal law provisions and only occasionally supplements it with additional provisions imposing a fine. For example, Article 76 provides that any improper handling of procurement documents is subject to a fine of between 20,000 and 100,000 RMB, with individuals involved subject to administrative punishment and criminal liability “in accordance [with] the law.” [\[FN158\]](#) The sole exceptions are sanctions for false declarations of information and bribery by a supplier. Article 77 provides that such violations are subject to fines of between 0.5% to 1.0% of the contract amount. The guilty supplier is also blacklisted and prohibited from participating in government procurement for one to three years. Any illegal gains will be forfeited as well. In addition, the business license of the supplier may be revoked for serious violations. It is noteworthy that the extensive sanctions under Article 77 are the only provisions in the chapter on legal liability that address violations by the supplier. All of the other provisions address violations by the government procuring authority and relevant regulatory authority. [\[FN159\]](#)

For an aggrieved supplier challenging violations by the government procuring authority, three remedies are available. The applicability of the remedies is dependent on the stage of the procurement process at the time of challenge. If the procurement process has not concluded, the improper procurement process will be terminated. [\[FN160\]](#) If the procurement process has concluded but the contract has not been performed, the contract shall be voided and re-awarded to other qualifying suppliers. [\[FN161\]](#) If the \*178 contract has been performed, monetary compensation payable by the government procuring authority is the remedy. [\[FN162\]](#) All three remedies hinge on whether the violations by the government procuring authority fall under Article 71 and Article 72 of the Government Procurement Act. As will be discussed further below, a key issue is whether violations of the Temporary Measures are covered by these Articles. [\[FN163\]](#)

In terms of monetary remedies, Article 79 provides that a party in violation of Articles 71, 72, and 77 is liable for civil compensation for any losses caused by the violation. [\[FN164\]](#) While this seems to provide for a generous and far-reaching civil liability, it is important to recognize that the provision does not independently create a new cause of action for aggrieved suppliers or other parties. Civil liability under Article 79 is to be determined in accordance with relevant civil law and regulations. [\[FN165\]](#) Thus, in addition to proving violations of Articles 71, 72, or 77, an aggrieved party seeking civil compensation under Article 79 also carries the burden of articulating how such violations constitute civil liability under existing civil laws and regulations. [\[FN166\]](#)

This poses significant problems for an aggrieved supplier seeking civil compensation for violations by a government procuring authority during the government procurement process. Violations by the government procuring authority can cause significant and real financial loss to those suppliers participating in government procurement. An undue preference for a particular supplier, for example, deprives

other competing suppliers from fair consideration. A supplier who would have otherwise won a bid (but for the undue preference for another supplier expressed by the relevant procuring authority) also loses the potential\*179 profit from the contract. However, because there is still no contractual relationship between the government procuring authority and the aggrieved supplier at this point, the government procuring authority is only subject to limited pre-contractual obligations and liability.

Article 43 of the Government Procurement Law insinuates that Contract Law is applicable to government procurement contracts. [\[FN167\]](#) Articles 42 and 43 of the Chinese Contract Law [\[FN168\]](#) do provide for some civil liability arising from pre-contractual conduct. Article 42 covers three separate grounds, namely negotiation in bad faith, deliberate concealment of important matters or false declaration, and other bad faith conduct. Article 43 addresses improper use or disclosure of commercial trade acquired during contract negotiation. It is theoretically possible that the general prohibition on bad faith conduct under Article 42(3) be interpreted to include violations of the Government Procurement Law and Temporary Measures. Indeed, the common law courts in Australia, Canada, New Zealand, and the U.K. have extended contractual obligations to the pre-award tender process by government procuring authorities, providing aggrieved suppliers with potent and substantial civil compensation claims against government procuring authorities. [\[FN169\]](#) Nonetheless, conventional Chinese jurisprudence views such violations as administrative violations that give rise to administrative and criminal liabilities but which preclude civil claims. [\[FN170\]](#)

The applicability of the Chinese Contract Law to government procurement under the Government Procurement Law is also limited in situations where the contract has been awarded. [\[FN171\]](#) This reflects the German approach, which bifurcates the government procurement process into the initial contract selection period (considered administrative in nature and remedied primarily \*180 via administrative process) and contract performance (considered contractual in nature and remedied by civil litigation based on breach of contract). [\[FN172\]](#) In the absence of judicial interpretation by the People's Supreme Court, it is unlikely that Article 42 of the Chinese Contract Law will serve as the basis for civil compensation claims for procedural violations during the government procurement process. [\[FN173\]](#)

## B. Specific Problems Associated with the Temporary Measures

The inadequacies of the enforcement mechanisms available to aggrieved suppliers under the Government Procurement Law have been highlighted by Chinese academics and commentators. Common criticisms include the restrictiveness of the standing requirement, [\[FN174\]](#) the lack of interim remedies during the complaint proceedings, [\[FN175\]](#) limited access to information necessary to facilitate effective complaint, [\[FN176\]](#) bias of the government procuring authority handling the initial complaint, [\[FN177\]](#)



insufficient provision for settlement, [\[FN178\]](#) and incompatibility with the requirements of the WTO GPA. [\[FN179\]](#) In addition to these critiques, the specific nature of the preferential treatment of SMEs under the Temporary Measures introduces further obstacles to effective enforcement by aggrieved suppliers.

### 1. Preferential Treatment

The Temporary Measures provides concrete and significant preferential treatment for SMEs during government procurement.\***181** [\[FN180\]](#) The failure of the government procuring authority to accord such preferential treatment to a qualifying SME can materially affect the final award of the contract, to the detriment of the qualifying SME. However, an SME deprived of this legally-provided benefit does not have access to the type of legal recourses typically available for other violations of law in the government procurement process. The best bet for an SME wrongly denied preferential treatment is to either terminate the improper procurement process or, if the procurement process is complete, seek compensation. As discussed above, these remedies are only available if the violations fall under Article 71 and Article 72 of the Government Procurement Law. [\[FN181\]](#)

There is significant overlap between Article 71 and Article 72, both dealing with improper conduct of government procuring authorities during the procurement process. The distinction is in the severity of the violation: Article 72 covers violations that are capable of constituting criminal offenses, while Article 71 involves administrative irregularities that are subject to administrative sanctions. [\[FN182\]](#) It is hard to fit the failure to grant a discount to qualifying SMEs into the grounds established in those two provisions. Provisions of Article 71 seem to apply most to situations involving failure to grant a discount to qualifying SMEs. Article 71(2) covers “arbitrarily increas[ing] procurement standard[s],” while Article 71(4) covers “discrimination via imposing unreasonable conditions.” Article 71(2) is intended to apply to specifications for goods and services set out in the procurement documents and primarily targets overspending by the government procuring authority. [\[FN183\]](#) The failure to give a discount to a particular supplier is unlikely to fall under this Section. Article 71(4) targets an intentionally discriminatory act by the government procuring authority, and it is doubtful whether the provision is immediately capable of being extended to a situation involving the more passive decision to not grant a discount.

The failure to set aside the minimum quota of government procurement specifically reserved for SMEs is even harder to enforce. First, the quota may be reduced on account of operational constraints and the basic needs of public service, [\[FN184\]](#) providing the government authority with a possible legal defense for not reserving government procurement for SMEs. Second, the standing\***182** requirement of actual participation in the challenged government procurement [\[FN185\]](#) means that the complainant is

faced with the impossible task of establishing that the particular procurement participated in is one that should be reserved for SMEs. Finally, the limitations of Article 71(2) and 71(4) in covering the non-granting of SME discounts, as discussed above, pose similar challenges here.

## 2. Definition of SMEs

Another enforcement concern relates to the classification of SMEs. An erroneous classification of SMEs may harm a supplier in two ways. First, an otherwise qualifying SME is deprived of its entitled preferential treatment if it is wrongly classified as a larger enterprise. Second, an enterprise (be it a large enterprise [\[FN186\]](#) or SME) is at a comparative disadvantage in the bidding of a contract if its competitors enjoy preferential treatment arising from an erroneously designated SME status. The likelihood of the former scenario is not particularly high because the Temporary Measures relies primarily on a self-declaratory mechanism. [\[FN187\]](#) This is due to the current lack of an authoritative classification body in China and the inability of government procuring authorities, which are government organs without particular expertise in dealing with SMEs, to determine SME status. [\[FN188\]](#) The self-declaratory mechanism, however, is likely to aggravate the later scenario in which competitors falsely declare SME status to enjoy preferential treatment.

The declaration form certifying SME status contains a clause that provides for “legal liability in accordance with the law” for false declaration. False declaration of information by a supplier during procurement is one ground for a variety of different sanctions, including the payment of fines, forfeiture of illegal gains, and being blacklisted, all under Article 77 of the Government Procurement Law. [\[FN189\]](#) These are substantial sanctions that arguably can provide effective deterrence against false declaration of SME status. The issue at hand is whether this provision will be vigorously enforced when a supplier is not effectively deterred.

An aggrieved supplier can initiate complaint proceedings under the Government Procurement Law because the false declaration of a fellow competitor affects the outcome of the procurement\***183** process. However, issues relating to the categorization of SMEs during the supervision and complaint components of government procurement are handled by the relevant local branches of the SME regulatory body. [\[FN190\]](#) This creates a lacuna in administrative responsibility. On the one hand, the government procuring authority that handles the initial complaint is not responsible for resolving the issue. On the other hand, the SME regulatory body tasked with ascertaining SME status is not subject to the seven-day response deadline imposed on the government procuring authority. [\[FN191\]](#) A similar dilemma occurs during the administrative appeal process. The Ministry of Finance and its local branches are tasked with handling the appeal [\[FN192\]](#) and are subject to a thirty-day deadline. [\[FN193\]](#) This corresponds with the

right to suspend the procurement process for a maximum of thirty days during the handling of an appeal. [\[FN194\]](#) This time limit and the administrative sanctions for delay [\[FN195\]](#) are not applicable to the SME regulatory body. [\[FN196\]](#)

This lacuna in administrative responsibility means that both the government procuring authority and the supervising regulatory authority will not be at fault for the delay in handling the complaint involving disputed SME status. Delay is foreseeable given the institutional limitations of the SME regulatory authority. The SME regulatory authority is a specialized department under the Ministry of Industry and Information Technology. [\[FN197\]](#) \*184 The mandate of this department is broadly defined and focuses on macroeconomic development. [\[FN198\]](#) It is not geared toward resolving certification issues within the tight timeline set forth in the Government Procurement Law. [\[FN199\]](#) While the complainant can proceed with judicial review if there is no decision after the stipulated timeline, such a right is hollow because the subject matter of judicial review is determined by the decision (or inaction) of the supervising authority and not the government procurement contract itself. [\[FN200\]](#) With no fault on the part of the supervising authority for delay, the likely outcome of judicial review will be to wait for the resolution by the SME regulatory authority. In addition, any dispute as to the decision of the SME regulatory authority must be appealed separately via administrative review, given the limited scope of judicial review under the Government Procurement Law. [\[FN201\]](#) Such undue delay and additional procedural requirements are certainly not conducive to enforcement actions.

### 3. Prohibition of Sub-contracting

The prohibition on sub-contracting is an important measure to prevent abuses of the preferential treatment meant for SMEs. Given that an enterprise can qualify as an SME even if wholly owned by a large entity, there is a real risk that such a subsidiary may sub-contract the government contract back to its parent enterprise. In any event, sub-contracting to a large enterprise diminishes\*185 the effectiveness of the preferential treatment for SMEs. Article 7 of the Temporary Measures purports to tackle this problem by prohibiting an SME from sub-contracting government procurement contracts to entities larger than itself. This is the right approach. However, the enforcement mechanism for this provision is lacking.

The key obstacle arises from the fact that illegal sub-contracting, by definition, occurs after the contract has been awarded. The remedies for post-contractual award matters are usually limited to those that occur between the contracted party and the government procuring agency. The complaint procedure set out in Chapter 6 of the Government Procurement Law concerns violations in relation to the procurement process and does not cover violations that occur after the award of the contract. Similarly, there is no remedy available under Article 73 because the provisions set out in Articles 71 and 72 only cover viola-

tions of the procurement process. Unless it could be shown that the SMEs in question intended at the outset to subcontract with larger enterprises, [\[FN202\]](#) not even Article 77 would authorize the imposition of legal liability for sub-contracting. [\[FN203\]](#) While this distinction reflects the well-established principle of the privity of contract, an aggrieved supplier may rightly feel that an SME who subsequently sub-contracts to large enterprises should not be entitled to the SME price discount or to participate in government procurement reserved for SMEs. The aggrieved supplier is, however, left without recourse under the law.

### C. Challenge Procedures Under the GPA and Limited Impact on Reform

In addition to the possible implications for SME preferential policies, [\[FN204\]](#) the GPA's domestic review procedures can potentially provide an illustrative benchmark for strengthening the enforcement mechanisms of the Chinese Government Procurement Law. Article 18 of the GPA provides for domestic review procedures that are significantly broader in scope than those currently in place in China. Much has been written by Chinese commentators and academics on the reform opportunities provided by the planned accession to the GPA. Liu Lui has argued that reform is necessary to strengthen the complaint mechanism and expand coverage to include government construction procurement contracts\*<sup>186</sup> and the issuance of financial instruments. [\[FN205\]](#) A comprehensive analysis by Yang Huihui and Yang Peng has identified several areas for reform, including the clarification of the nature of government procurement contracts, the reconciliation of discrepancies between the threshold for central and local procurement, etc. [\[FN206\]](#) Cao Heping and Zang Jugai and other commentators have also engaged in similar reconciliation proposals. [\[FN207\]](#)

However, even the full adoption of the domestic review procedures set forth in the GPA is unlikely to substantially alter the enforcement deficiencies highlighted in this Article. In particular, the inadequacies of remedies and the stringent standing requirement will remain, even under the GPA.

#### 1. Limited Reform of Inadequate Remedies

The revised version of the GPA has already been criticized for failing to remedy the independence requirement of the review body, inadequacies of interim measures, and the narrow grounds for challenge. [\[FN208\]](#) In particular, the limited compensatory remedies mandated by the GPA impede effective private enforcement. The GPA limits compensation to either the costs for preparation of the tender or the costs relating to the challenge. [\[FN209\]](#) Either would be an improvement over the current Chinese regime in providing clarity of the monetary compensation available for successful challenge of pre-contractual violations by the government procuring authority. However, neither is likely to provide an adequate incen-

tive for suppliers to vigorously challenge violations by the government procuring authority.

Suppliers are likely to pursue legal action only if the gains flowing from a successful action, multiplied by the probability of success, are greater than the costs of the challenge. The time and money required to bring a challenge from start to finish can be substantial. [\[FN210\]](#) The ability to recoup lost profits as monetary compensation is thus arguably necessary to mitigate the high costs of challenge. Such monetary compensation is paramount in situations in which the procurement contract has been awarded and performed. Remedies of rescission and possibilities of re-award **\*187** are no longer available in such situations. [\[FN211\]](#) Simply put, recovering only the costs of tender or costs of the challenge is not sufficient for aggrieved suppliers.

Moreover, there are other indirect costs to suppliers that further constrain private enforcement. Successful complainants in Canada, for example, can recover lost profits in addition to the costs of proposal and tender preparation. [\[FN212\]](#) Recent developments in English common law have also resulted in similar generous awards of monetary damages. [\[FN213\]](#) However, the availability of such remedies has not necessarily resulted in a flood of cases in Canada [\[FN214\]](#) or in the UK. [\[FN215\]](#) A survey in the UK of contractors, legal firms, and authorities found that aside from the probability of success, costs and the speed of proceedings remain key factors in a firm's decision to sue. The opportunity for significant damage awards is not a motivating factor to aggrieved bidders in the UK. [\[FN216\]](#) Another more significant constraint is the concern that such suits might jeopardize the chance of future contracts. [\[FN217\]](#) Given the domineering influence of the Chinese government on the economy as well as on daily life, such concerns are only likely to be exacerbated in China.

## 2. Impediment of Standing in Enforcing SME Linkages

As discussed above, the stringent standing requirement under Chinese law, which requires participation in the procurement being challenged, is a significant restriction on the enforcement of the Government Procurement Law. [\[FN218\]](#) In addition, this stringent standing requirement is aggravated by the particular challenges posed by SME preferential policies, such as the enforcement of preferential treatment and the prohibition of sub-contracting.

The GPA will provide little reform in this regard. Article 18(1) of the GPA provides that challenge procedures need only be applicable to a “supplier” who “has, or has had, an interest.” The lack of a definition under the GPA as to the meaning of “supplier” and “interest” creates uncertainty as to whether potential **\*188** suppliers who did not actually participate in the government procurement have standing to sue. Xinglin Zhang has opined that even a narrow interpretation of the provision would likely still include

potential suppliers and that the debate on interpretation is really about the issue of potential sub-contractors and other suppliers in the supply chain. [\[FN219\]](#) However, given that the Chinese supervisory and legislative authorities have chosen to exclude potential competitors under the similarly ambiguously worded provisions in the Chinese Government Procurement Law, such exclusion is likely to be perpetuated in the absence of a specific and non-ambiguous provision under the GPA.

### 3. Summary: Limited Impact of the GPA

Even if China manages to resolve the significant obstacles standing before its accession to the GPA, [\[FN220\]](#) the implementation of the GPA is unlikely to be the basis of any dramatic reform of enforcement mechanisms under the Government Procurement Law. Remedies remain inadequate to provide sufficient incentive for private enforcement and restrictions on standing continue to limit the number of viable challenges.

Moreover, the GPA does not remedy the particular challenges of enforcing SME preferential policies. The GPA reforms provide no relief to a qualified SME supplier that is wrongly denied preferential treatment (e.g., price discount). Like the lack of legal coverage under Articles 71 and 72 of the Chinese Government Procurement Law, failure to grant preferential treatment does not violate the substantive rules of the GPA. These include the principle of non-discrimination under Article 4(1), the limitations of conditions for participation under Article 7, and the need to award the contract to the most advantageous tender under Article 15(5). Similarly, given that the GPA is limited to the procurement process and not post-award contractual performance, an aggrieved supplier will continue to lack both legal standing and a legal basis to challenge a breach of the sub-contracting prohibition.

This is not surprising, given that procurement linkages (whether to support SMEs or otherwise) are frowned upon by **\*189** the GPA, which has strived to eliminate discrimination and enhance transparency in government procurement. Accordingly, SME procurement linkages must be negotiated as exceptions to coverage by acceding members. [\[FN221\]](#) As will be elaborated upon in the next Section and in V.A, a point that is often overlooked in the design of procurement linkages is that the issues relating to the enforcement of such government procurement are categorically different from conventional government procurement. Thus, an enhancement of the enforcement mechanisms for government procurement in general will often fail to translate into improved enforcement of these preferential policies.

#### D. Perverse Incentives of Government Bodies

Chinese academic critiques of the enforcement of the Government Procurement Law usually focus on



the limited availability and procedural obstacles of its challenge mechanisms. [\[FN222\]](#) These are undoubtedly important considerations for effective enforcement of any law and regulation. An equally important but often overlooked issue, however, is whether the relevant party has the right incentive to utilize enforcement mechanisms. The current limitations on private enforcement mechanisms under the regulatory regime place increased emphasis on effective public enforcement. This is not always a bad thing in the context of government procurement because excessive private enforcement may impose undue delay and costs on proper procurement decisions (i.e. losing bidders may initiate complaints simply to stall the procurement process and frustrate their competitors). [\[FN223\]](#) However, if public enforcement is to take center stage in the enforcement of SME preferential policies, it is paramount that government procuring authorities and supervising authorities have the right incentives to carry out this function. Unfortunately, this is not the case.

### 1. Perverse Incentives of the Government Procuring Authority

The main institutional incentive of the government procuring authority is to minimize expenditures and to maximize the quality of goods. [\[FN224\]](#) In practice, corruption and conflict of interests plague government procurement in China. [\[FN225\]](#) Moreover, \*190 there is little incentive for the government procuring authority to pursue violations and circumventions of the Temporary Measures. Violations of the Government Procurement Law by a supplier generally cause real financial loss to the government procuring authority. For example, misrepresentation by the supplier, [\[FN226\]](#) perhaps as to its credentials and experience, can negatively affect the quality of goods and services supplied to the government procuring authority. Similarly, collusion among competing suppliers [\[FN227\]](#) can artificially drive up the contract price to the detriment of the government procuring authority. However, the situation is reversed in the particular context of SME preferential treatment under the Temporary Measures.

The Temporary Measures was enacted to mitigate the difficulties faced by SMEs in government procurement. A particular problem is the preference of the government procuring authority for large enterprises and the prejudice against the perceived unreliability and technical deficiencies of SMEs. [\[FN228\]](#) Such bias against SMEs is not entirely unfounded. SMEs do face constraints in size, capabilities, economies of scale, and factors that may either affect the quality of their output or increase the risk of breach. [\[FN229\]](#) Of course, large enterprises are not entirely immune from sub-standard work. Indeed, some of the widely reported public infrastructure accidents in the Chinese press can be attributed in part to the sub-standard work of large enterprises. [\[FN230\]](#) However, such reports may actually strengthen the incentive of the government procuring authority to prefer large enterprises. The blame for the incidents is likely to be shared by the large enterprises and not simply attributed to the government procuring authority that awarded the contract. In the absence of corruption, the government procuring authority is at best

gullible for trusting the established name of a large enterprise. One can envisage a very different attribution of blame if the government procuring authority had awarded the contract to an SME whose performance was found to be inadequate. In the latter scenario, \*191 the government procuring authority would likely be perceived as risking public safety by selecting small enterprises that lack the experience, expertise, and reputation of established enterprises.

Taken together, the government procuring authority has a strong incentive to prefer goods and services from an established, large enterprise. This places the government procuring authority in a position of conflicting interests with respect to violations of the Temporary Measures. As discussed above, the common violations and circumvention of the Temporary Measures typically involve large enterprises attempting to usurp the preferential treatment meant for SMEs. [FN231] This can be achieved through existing legal loopholes such as the establishment of wholly owned subsidiaries that individually satisfy SME requisites. This can also be achieved through other illegal means such as false declarations of SME status and improper investment relationships between suppliers constituting a consortium bid. SMEs that win a contract may also sub-contract it to a large enterprise. The government procuring authority is not, in relation to its interests, in a position to police such legal circumventions. The government procuring authority will also not be vigorous in policing false declarations of SME status and other violations of the Temporary Measures because such violations result in the preferred outcome for the government procuring authority - receiving goods and services from an established large enterprise.

The effect of a perverse incentive is particularly salient in the prohibition of sub-contracting to large enterprises. As discussed above, fellow competitors lack standing to challenge improper sub-contracting because these are post-award matters between the government procurement authority and the contracted supplier. [FN232] Competitors also lack information at this point because they are no longer included in the procurement process. This renders the government procurement authority the primary enforcer of improper sub-contracting. This is usually not a severe problem. Most situations of improper sub-contracting involve sub-contractors providing goods and services of inferior quality. Notwithstanding the significant presence of corruption, in which the government procurement authority turns a blind eye toward post-contractual substitution of inferior goods and services, [FN233] the government procurement authority is still theoretically\*192 well-placed to monitor and enforce any such violations. However, when the improper sub-contracting involves sub-contracting to large enterprises or the contracted SMEs supply goods and services from large enterprises, [FN234] the government procurement authority suffers no financial loss and might even benefit financially. This can result in indifference or even implicit approval by the government authority of such violations.

Acquiescing in violations brings other benefits to the government procuring authority as well. Article



12 of the Temporary Measures mandates that government departments prepare annual reports on the amount of SME participation in government procurement. These annual reports are submitted to relevant Ministry of Finance departments and are subject to public disclosure. By ignoring violations such as false declarations of SME status and improper investment relationships in consortium bids, the statistics for SME participation in government procurement are in fact artificially inflated and allow the government procuring authority to meet the political expectation of complying with preferential treatments policies for SMEs.

## 2. Distracted Supervisory Authority

At the frontline of public enforcement, the government procuring authority is in the best position to detect improper and illegal conduct by suppliers. As discussed in the preceding Section, the perverse incentives of the government procuring authority pose serious obstacles to the effective enforcement of the Temporary Measures. That being said, the supervising regulatory authority can help to offset some of these obstacles. The supervising regulatory authority is an integral component of the public enforcement of government procurement, [\[FN235\]](#) particularly because the government procuring authority is frequently the primary perpetuator of illegal conduct. Unfortunately, however, compliance with the Temporary Measures is unlikely to be an important priority of the supervisory regulatory authority.

The Ministry of Finance is the responsible supervisory regulatory authority tasked with ensuring proper conduct in government procurement. [\[FN236\]](#) Its areas of supervision are broad and varied. As set out in a 2009 policy directive by the State Council, the Ministry of Finance and its relevant local branches are responsible for ensuring that the proper mode and conduct of procurement\*<sup>193</sup> is utilized, [\[FN237\]](#) setting out concrete standards and procedural requirements for the documentation and procedures relevant to government procurement, [\[FN238\]](#) enhancing the monitoring of contract valuation and contract awarding to improve budget control and procurement effectiveness, [\[FN239\]](#) supervising the implementation of socio-economic policies in government procurement, [\[FN240\]](#) vigorously enforcing violations, [\[FN241\]](#) promoting information technology in government procurement, [\[FN242\]](#) and assisting in the improvement of the qualifications and professionalism of procuring personnel. [\[FN243\]](#) Enforcement of SME procurement linkages is, at best, just one of many responsibilities imposed on the Ministry of Finance, and one that may be neglected from time to time.

Moreover, SME procurement linkages are dwarfed by the dominant concern of financial and budgetary issues in government procurement. For example, in a 2012 policy directive by a municipal government on the topic of strengthening supervision of government procurement, the Finance Department was tasked with ensuring proper budgeting, accounting, procedure monitoring, and other finance-related

matters. While the Finance Department was also tasked with supervising the use of government procurement to advance macro-economic policy goals, this function was more of an afterthought compared to the Department's other roles. [\[FN244\]](#) Indeed, in the 2009 policy directives by the State Council, the predominant problem identified was the loss of public funds through corruption and other government contracts that are inefficient and overpriced. [\[FN245\]](#) This focus is unsurprising because it reflects the prevailing views of academics and the public on the fiscal aspects of government procurement. [\[FN246\]](#) The relative ease of quantifying this aspect of government procurement also facilitates empirical studies that further serve as a benchmark for **\*194** evaluating the effectiveness of the Chinese government procurement regime. [\[FN247\]](#) However, this also increases the likelihood that the supervising regulatory authority will overlook enforcement of less salient and measurable socio-economic policies, such as the Temporary Measures. [\[FN248\]](#)

## V. THOUGHTS ON REFORM

### A. Peculiarity of SME Linkages in Government Procurement Reform

The discussion above in Part IV highlights an often overlooked aspect of the design of SME procurement linkages - the system of enforcement for these preferential policies is categorically different from that of conventional government procurement. The common practice is to treat procurement linkages like any other type of government procurement and apply the standard enforcement mechanisms for government procurement in general. In China, the Temporary Measures simply imports the standard enforcement mechanisms built into the Government Procurement Law. A similar approach is also adopted for other procurement linkages. For example, the now repealed [\[FN249\]](#) government procurement policies to support indigenous innovation similarly referred to the complaint mechanisms under the Government Procurement Law. [\[FN250\]](#)

The problem with this common approach is that the particular challenges of enforcing procurement linkages are not addressed in the design of enforcement mechanisms for general government procurement. The challenges are threefold. First, procurement linkages often require additional determinations to **\*195** gauge the scope of qualified suppliers entitled to preferential treatment. This determination often requires the expertise of a specialized agency (i.e. not the general procurement entity). Unfortunately, the procedural requirements that apply to general government procurement are not applied to special agencies, leading to a lacuna in administrative and legal responsibility that impedes effective enforcement. This problem is manifested in challenges in enforcing the definition of SMEs under the Temporary Measures, which delegates the SME definition to the specialized SME regulatory authority but does not impose any particular procedural requirements or timelines on the SME regulatory authority. [\[FN251\]](#)

Second, violations of SME preferential policies are often not automatically covered by the substantive legal obligations applicable to general government procurement. As discussed above, the existing grounds for challenges under Articles 71 and 72 of the Chinese Government Procurement Law do not cover the failure by the procuring entity to provide preferential treatment to qualified SMEs. Such violations are similarly omitted from the substantive rules under the GPA. This is not surprising because the very act of granting preferential treatment to certain suppliers is antithetical to the general principles of non-discrimination and “best value for money” that form the basic foundation of laws governing government procurement. Whether this departure is desirable is the subject of intense debate. As to SME preferential policy, John Linarelli has made a limited case in support of SME procurement linkages on the ground that this may actually improve competition while promoting justice and other non-economic values. [\[FN252\]](#) Richard J. Pierce, Jr., on the other hand, is skeptical of the justifications for government preferences for small firms, noting that small firms do not in fact account for a disproportionate share of net job growth (total jobs created minus jobs lost; small firms tend to fail at a higher rate) and contribute disproportionately in terms of social harms such as occupational injuries, pollution, etc. [\[FN253\]](#) In any event, if the policy decision is to move ahead with an SME support program involving preferential treatment in government procurement, then it must be recognized that what is involved is not simply an exercise in conventional government procurement but an exercise that entails a substantial reevaluation of the current enforcement mechanisms.

**\*196** Third, the need for overhaul in enforcement is aggravated by the specific nature of procurement linkages, which give rise to perverse incentives among the government procuring authorities and supervisory authority to overlook violations. As noted above, violations of the Temporary Measures typically do not cause financial loss to the government procuring authority. In fact, the government procuring authority may secretly prefer violations. This should be unsurprising as the whole purpose of instituting procurement linkages is that the government procuring authority, under normal circumstances, prefers other suppliers, resulting in the need to mandate preferential treatment to tilt the scale in favor of the targeted suppliers. However, this insight is not carried through to the enforcement mechanisms built around the government procuring authority and the supervisory authority. If government authorities are indeed indifferent towards violations of procurement linkages, they cannot be relied on to vigorously enforce the procurement linkages.

In sum, a critical examination of China's SME procurement linkages raises a general point on how policy makers should approach preferential policies in government procurement. The key conclusion is that procurement linkages are not part of conventional government procurement and should not be conceived of as such. In particular, effective enforcement mechanisms for these procurement linkages require

reforms beyond strengthening existing enforcement mechanisms for government procurement. It is important to ensure a targeted inquiry into enforcement issues relating to specific preferential policies, particularly the incentives of enforcers who are expected to ensure compliance. In this regard, the next Section will proffer two suggestions as to possible approaches for enhancing enforcement of the Temporary Measures.

## B. Suggestions for Reforms

In light of the enforcement problems identified above, this Section offers two possible approaches for reform. First, private enforcement can be strengthened with special enforcement mechanisms that apply only to procurement linkages. Second, a dedicated public enforcement body, whether a dedicated government organ or a government-sanctioned non-profit organization, can be established to create the right incentives in public enforcement.

### 1. Special Enforcement Mechanisms for SME Linkages

To ensure adequate private enforcement of the Temporary Measures, special enforcement mechanisms should be designed \*197 for aggrieved competitors. This would involve changes to both substantive and procedural rules.

Reform of substantive rules is necessary to remedy the lacuna under the current stipulated grounds for challenges, which omit the failure to grant preferential treatment. This can be achieved in two ways. First, Articles 72 and 73 of the Government Procurement Law, which set forth the grounds for challenges, could be amended to include the failure to grant preferential treatment under any regulations that provide for procurement linkages. Second, the Temporary Measures could be amended to incorporate a special challenge mechanism for failure to grant preferential treatment to qualified SMEs.

The advantage of the former method is that the effect is not simply limited to SME preferential policies under the Temporary Measures. Given that procurement linkages are typically administrative regulations enacted pursuant to or with reference to the Government Procurement Law, amending the Government Procurement Law will resolve the enforcement difficulties of other Chinese procurement linkages, both present and future. However, this wide-ranging effect will inevitably increase political resistance to the amendment, especially given that the merits of procurement linkages remain unsettled in both domestic and international circles.

In this regard, the piecemeal approach under the latter method may be more politically feasible, with

implications restricted to SME procurement linkages. Nonetheless, it is important to note that this method would require the Temporary Measures to not only stipulate that the failure to grant preferential treatment is ground for challenge, but also to establish a new independent challenge mechanism. If the Temporary Measures continues to import the challenges mechanisms under the Government Procurement Law, the grounds for challenges will remain limited by Articles 72 and 73 of the Government Procurement Law. As an administrative regulation, the Temporary Measures cannot override the Government Procurement Law enacted by the National People's Congress. [\[FN254\]](#)

In any event, another amendment to the procedures is also necessary to synchronize the current disconnect between the procedural requirement for decision making within a stipulated timeframe and the actual decision maker. The SME regulatory body tasked with adjudicating the issue of SME qualifications should be subject to the same procedural requirements as the relevant\***198** government authority that is processing the complaint. This can be achieved by either a general amendment to the Government Procurement Law or by specific changes to the Temporary Measures.

## 2. Dedicated Public Enforcement Agencies

The strengthening of private enforcement mechanisms should be coupled with measures to mitigate the perverse incentives of the government procuring authority and the supervisory authority. This requires the creation of a public enforcement agency dedicated to enforcing procurement linkages. This new public enforcement agency could serve as the single resource for complaints by aggrieved suppliers and serve to initiate investigations and enforcement proceedings upon receipt of complaints. In addition, an important task of this public enforcement agency would be to regularly follow up on the performance of contracts that involve preferential treatments specified by the Temporary Measures. Such post-award violations remain ill-suited for private enforcement, even with amendments to procedural and substantive laws, given the practical problem of lack of information by other suppliers and the normative concern about undue disruption to the privity of contract.

There are two possible ways to set up this new public enforcement agency. First, the public enforcement agency could be a government body. This could be a specific government procurement enforcement branch set up within the current SME regulatory authority or a newly created department tasked to monitor and enforce preferential policies in government procurement. In either case, it will be imperative to clearly define the mandate of this government agency to focus primarily on ensuring that the preferential policies reach their intended targets. In particular, the mandate should exclude any general supervision of the government procurement process to avoid unnecessary distraction, especially because financial losses in government procurement are usually more politically salient than the failure to grant

preferential policies.

Alternatively, a government-sanctioned non-profit organization could be formed. China has already adopted a state-sponsored non-profit organization in the realm of consumer protection. [\[FN255\]](#) This consumer protection organization is tasked with investigating and mediating consumer complaints. [\[FN256\]](#) It also **\*199** supports consumers in initiating legal action against consumer rights infringement. [\[FN257\]](#) A similar non-profit organization could be created to aggressively monitor compliance with the Temporary Measures and to assist aggrieved suppliers in pursuing remedies for violations of the Temporary Measures.

Creating either of the two public enforcement agencies would inevitably result in an increase in regulatory costs and bureaucracy that might seem disproportionate to the enforcement of the Temporary Measures and/or other procurement linkages. Nonetheless, 30% of government procurement is to be reserved for SME support purposes under the Temporary Measures, in addition to price discounts for other procurement. [\[FN258\]](#) This easily involves a commitment of government procurement well in excess of 200 billion RMB. [\[FN259\]](#) Having made the decision to initiate SME procurement linkages, the sheer scale and economic significance of the Temporary Measures warrant the additional regulatory costs to ensure effective enforcement and compliance.

## VI. CONCLUSION: RETHINKING LEGAL REFORM IN CHINA AND PROCUREMENT LINKAGES

Two important takeaways emerge from this Article's critical examination of the Temporary Measures and the corresponding reform proposals. First, preferential policies in government procurement are different from conventional government procurement. The inadequacies in private enforcement, even under the GPA challenge procedures, reflect the different principles underlying procurement linkages and conventional government procurement. The perverse incentives of the procuring authority and supervisory authority to overlook circumventions and other violations of the Temporary Measures pose particular challenges in the design and reliance of public enforcement mechanisms. This disconnect between procurement linkages and the legal rules designed for conventional government procurement means that effective enforcement of these procurement linkages requires specific legislative attention to create private and public enforcement mechanisms that are tailored to the specific needs of these preferential policies.

The second takeaway relates to law reform in China. The lacunas in the definition of SMEs and related enforcement mechanisms will likely thwart effective implementation of the Temporary**\*200**

Measures. There is little being done to stop large enterprises from usurping the preferential treatment of SMEs via the use of wholly owned subsidiaries or other related corporate entities. However, notwithstanding the obvious reform solution in light of the various established practices of other jurisdictions, close examination of the legislative background and socio-political circumstances reveals that the lacunas in the SME definition and enforcement mechanisms are not oversights. The loopholes in the definition are unlikely to be closed if local governments continue their dominance of local economies.

These insights highlight the need for a different understanding of the legislative process and legal reform in China. Unlike in the early days of reform, [\[FN260\]](#) legal expertise and regulatory sophistication is no longer in short supply in China. [\[FN261\]](#) Comparative perspectives from other jurisdictions are also commonly incorporated into the legislative drafting process. [\[FN262\]](#) Thus, any conspicuous deficiencies in the legal or regulatory regime are more likely to be the result of conscious decisionmaking. These could be relatively innocuous, such as the tension between industry-specific and uniform approaches to defining SMEs driving China's oscillation. They could also be more intentional, such as the surreptitious disregard of circumvention by related enterprises in SME preferential policies. Unraveling these often non-apparent influences shaping the legislative process will be essential in the study of law and legal reform in China.

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[\[FN3\]](#). See *infra* II.C.

[\[FN4\]](#). 30% of the 741.32 billion government procurement in 2009. Zhang Hui, Tongji Shuju “Shuo” Chu Falv Shixiao - «Zhengfu Caigou Fa» Shixing Xiaoguo De Jingji Xue Fenxi [Assessing the Effect of Law



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India).

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[FN12]. *Research on the 30 years of China's Economic System Reform*, *supra* note 11, at 70-71; He & He, *supra* note 10, at 138-41 (listing and discussing the various administrative regulations that impedes SMEs development in the different industries).

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[FN23]. *Id.* at Article 14-21 & 35.

[FN24]. *Id.* at Article 23.

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[FN37]. Shigeki Kusunoki, [Japan's Government Procurement Regimes for Public Works: A Comparative Introduction](#), 32 *Brook. J. Int'l L.* 523, 530-31 (2007).

[FN38]. Kidalov, *supra* note 10, at 453-60.

[FN39]. Wang & Zhang, *supra* note 8; Zhang, *supra* note 4. On the other hand, commentators have also noted the low proportion of government procurement in China in relation to overall GDP and government expenditure. Liu Lui, Wanzhan Zhengfu Caigou Falv Zhidu, Yingdui WTO Zhengfu Caigou Xieding [Perfecting Government Procurement Legal System in Response to WTO Agreement on Government Procurement], *Admin. L. Rev.* 25, 26 (2011) (noting that the proportion of government procurement in China in relation to overall GDP and government expenditure is only 2.21% and 17% respectively, which is on the low side compared 14.4%~19.96% and 30~50% of other countries); Ma Yunfei, Wogou Zhengfu Caigou Liti Zouyong Nanyi Fahui De Yuanyin Fenxi Ji Duice [Causes of and Responses to The Limitations in Advancing the Legislative Purpose of Government Procurement Law], *New W.* 69 (2011). This in turn limits the efficacy of government procurement as a tool of achieving policy goals. Tong Xinchao, [Chinese Procurement Law: Current Legal Framework and a Transition to the World Trade Organization's Government Procurement Agreement](#), 17 *Temp. Int'l & Comp. L.J.* 139, 141 & 143 (2003). Indeed, the bulk of public expenditure in China is often in the form of separate investment companies which are stated owned but are not considered as government procurement. Wang, *supra* note 9, at 677.

[FN40]. For discussions of the history of Chinese reform, especially after 1979, see generally *30 Years of Economic Reform in China: Reflecting and Looking Ahead*, *supra* note 11, at 36-42; *Research on the 30 Years of China's Economic System Reform*, *supra* note 11, at 59-64.

[FN41]. Bovis & Hu, *supra* note 18, at 15-16; Tong, *supra* note 39, at 140.

[FN42]. Government Procurement Law, *supra* note 7.

[FN43]. Zhang, *supra* note 4, at 4.

[FN44]. Government Procurement Law, *supra* note 7, at Article 9.

[FN45]. See Bovis & Hu, *supra* note 18, at 21 (Procurement of indigenously innovation products is given priorities at all government levels, from budget approval, bid evaluation preference and payment precedence, and preference for technology transfer in procurement of foreign goods and services).

[FN46]. For general discussions on GPA, see Wang, *supra* note 9, at 665-66 & 668; Mosoti, *supra* note 35, at 624-27. See Anderson & Arrowsmith, *supra* note 1, at 14-20 (tracing the historical development of GPA).

[FN47]. Chao, *supra* note 9, at A11; Mathieson, *supra* note 9, at 240-241 (there is a second accession offer in 2010); Wang, *supra* note 9, at 663-64.

[FN48]. Zhao Ling, *Wogou Jiaru WTO Zhengfu Caigou Xieding De Falv Duice* [[Legal Response to China Accession of WTO Agreement on Government Procurement], 6 *Int'l Econ. Cooperation* 90, 90-91 (2010); Ma Haitao & Jiang Aihua, *Woguo Zhengfu Caigou Zhidu Yanjiu* [A Study on China's Government Procurement Institution] 153-58 (Peking Univ. Press 2007). See Yan Hanping, *Zhengfu Caigou Falv Zhidu Lilun Yu Shiwu* [Theory and Practice of Government Procurement Legal Regime ] 174-78 (Xiyuan Publ'g 2002) (arguing for the adoption of GPA challenge mechanisms).

[FN49]. Linarelli, *supra* note 36, at 453; Wang, *supra* note 9, at 694.

[FN50]. Linarelli, *supra* note 36, at 454.

[FN51]. *Id.* at 453-54.

[FN52]. *Id.* at 454; McCrudden, *supra* note 5, at 218-19.

[FN53]. Ping Wang, *Accession to the Agreement on Government Procurement*, in *The WTO Regime on Government Procurement: Challenge and Reform* 92, 97 (Sue Arrowsmith & Robert D. Anderson eds., Cambridge Univ. Press 2011).

[FN54]. Report of the State Council on Promoting the Development of Small-and Medium-sized Enterprises, *supra* note 34.

[FN55]. Shanghai Shi Zhengfu Caigou Chujing Zhongxiao Qiye Fazhan Zhanxing Banfa [Temporary Measures for Promoting SMEs Development in Government Procurement of Shanghai Municipal Government] (promulgated by Shanghai Mun. Dep't of Fin., Shanghai & Shanghai Mun. Comm'n of Econ.

and Info. Tech., Nov. 26, 2009, effective Jan. 1, 2010) (P.R.C.).

[\[FN56\]](#). Temporary Measures, *supra* note 2.

[\[FN57\]](#). *Id.* at Article 4.

[\[FN58\]](#). *Id.*

[\[FN59\]](#). The discount reduces the quantum of the submitted bid during the bid evaluation process, making the submitted bid more competitive. For example, if a 10% discount is granted to small and micro enterprises for a particular government procurement, a \$100 submitted bid by a small enterprise would be treated as a \$90 bid and considered superior to other bids above \$90. The discount affects the evaluation of the bid but not the payment - if the \$100 submitted bid in the example is the winning bid, the small enterprise would still be paid \$100 by the government procurement authority.

[\[FN60\]](#). *Id.* at Article 5.

[\[FN61\]](#). *Id.* at Article 6.

[\[FN62\]](#). *Id.* at Article 8.

[\[FN63\]](#). *Id.* at Article 9.

[\[FN64\]](#). *Id.* at Article 10. The credit guarantee measure seeks to address the default risks of SMEs by providing a mechanism where upon the payment of a guarantee fee by the bidding SME, a third party financial intermediary will compensate the government procuring authority for any breach or default by the SME.

[\[FN65\]](#). *Id.* at Article 11.

[\[FN66\]](#). *Id.* at Article 2.

[\[FN67\]](#). Zhongxiao Qiye Huaxing Biaozun Guiding De Tongzhi [Notice on the Categorization of Medium-Small Enterprises] (promulgated by Ministry of Indus. and Info. Tech., Nat'l Bureau of Statistics of China, Nat'l Dev. and Reform Comm'n & Ministry of Fin., June 18, 2011, effective June 18, 2011) (P.R.C.) Article 2.

[FN68]. They are agriculture, forestry, husbandry and fishery; industrial; construction; wholesale; retail; transport; warehouse storage; postal; hospitality; food & beverage; information transmission; software and information technology; property development; property management; rental and commercial service. Id. at Article 4.

[FN69]. Id. at art. 4(5).

[FN70]. Id. at art. 4(14).

[FN71]. Temporary Measures, *supra* note 2, at Article 2(2).

[FN72]. Id. at Article 7.

[FN73]. Zhengfu Caigou Cujing Zhongxiao Qiye Fazhan Zhanxing Banfa Da Jizhe Wen [Press Conference on Temporary Measures of Government Procurement to Promote Development of Medium-Small Enterprises], Jan. 6, 2012, available at <http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/14416742.html> (last visited June 1, 2012) (hereinafter “Press Conference on Temporary Measures”).

[FN74]. Temporary Measures, *supra* note 2, at Article 5 & Annex.

[FN75]. Dazhong Xiaoxing Gongye Qiye Huafen Biaozhun [Standards for Classifying Large, Medium and Small Industrial Enterprises] (promulgated by Nat'l Econ. Comm'n, Nat'l Dev. Comm'n, Nat'l Bureau of Statistics of China, Ministry of Fin. & Ministry of Labor, Apr. 5, 1988, effective Apr. 5, 1988, ineffective Feb. 19, 2003) (P.R.C.). For a general discussion of the historical evolution of the definition of SMEs, see generally Liu Qinfei, Lun “Zhongxiao Qiye” De Lifa Jieding Biaojun - Cong Bijiao Fa De Shijiao [“Medium-Small Enterprises” Legislative Definition: From a Comparative Perspective ], 30(3) Hebei L. Sci. 99, 102-03 (2012); He & He, *supra* note 10, at 39-42.

[FN76]. They are respectively black metal; color metal; coal; petroleum; petrol chemical, chemical; electric; forestry; machinery; electronics; nuclear; aerospace; aviation; weapon; construction; light industry; textile; medical and tobacco.

[FN77]. Standards for Classifying Large, Medium and Small Industrial Enterprises, *supra* note 75, at Annex.



[FN78]. See *Id.* at Preamble; He & He, *supra* note 10, at 39-40.

[FN79]. Zhongxiao Qiye Biaozun Zanzing Guiding De Tongzhi [Interim Provisions on the Standards for Medium and Small Enterprises] (promulgated by Nat'l Econ. and Trade Comm'n, Nat'l Dev. and Reform Comm'n, Ministry of Fin. & Nat'l Bureau of Statistics of China, Feb. 19, 2003, effective Feb. 19, 2003, ineffective June 18, 2011) (P.R.C.).

[FN80]. *Id.* at Article 3.

[FN81]. Notice on the Categorization of Medium-Small Enterprises, *supra* note 67, at Article 10.

[FN82]. *Id.* at Article 4.

[FN83]. Commission Recommendation Concerning the Definition of Micro, Small and Medium-sized Enterprises, (EC) No. 2003/361 of 6 May 2003, 2003 O.J. (1124) 36 Article 2 (hereinafter "EU Commission Recommendation").

[FN84]. Small Business Size Regulations, [13 C.F.R. § 121.101](#).

[FN85]. They are agriculture, forestry, fishing and hunting; mining, quarrying, and oil and gas extraction; utilities; manufacturing; wholesale trade; transportation and warehousing; information; finance and insurance; real estate and rental and leasing; professional, scientific and technical services; management of companies and enterprises; administrative and support, waste management and remediation services; educational services; health care and social assistance; arts, entertainment and recreation; other services (except public administration); public administration: see *Id.*

[FN86]. Kidalov, *supra* note 10, at 463.

[FN87]. Small Business Size Regulations, *supra* note 84.

[FN88]. Zeng Xianlin, Guanyu «PZhonghua Renmin Gonghe Guo Zhongxiao Qiye Cujin Fa (caoan)»• De Shuoming [Explanation as to Draft of Law on the Promotion of Medium-Small Enterprises], Nat'l People's Cong. (P.R.C.), Dec. 24, 2001, available at [http://www.npc.gov.cn/wxzl/gongbao/2002-08/05/content\\_5298222.htm](http://www.npc.gov.cn/wxzl/gongbao/2002-08/05/content_5298222.htm) (last visited June 1, 2012).

[\[FN89\]](#). Id.

[\[FN90\]](#). “The standard for classifying small and medium-sized enterprises shall be formulated by the department of the State Council in charge of enterprises work according to the indexes such as the number of employees, the sales value and the total assets of the enterprises and in light of the characteristics of the industries, and the standard shall be subject to the approval of the State Council.”: Law on the Promotion of Medium-Small Enterprises, *supra* note 21, at Article 2.

[\[FN91\]](#). Liu, *supra* note 75, at 102-03.

[\[FN92\]](#). Kidalov, *supra* note 10, at 468.

[\[FN93\]](#). Interim Provisions on the Standards for Medium and Small Enterprises, *supra* note 79, at Article 4.

[\[FN94\]](#). Notice on the Categorization of Medium-Small Enterprises, *supra* note 67, at Article 4.

[\[FN95\]](#). Small Business Size Regulations, *supra* note 84, at § 121.103(a)(1).

[\[FN96\]](#). Id. at § 121.103(a)(2).

[\[FN97\]](#). Id. at § 121.103(c).

[\[FN98\]](#). Id. at § 121.103(d).

[\[FN99\]](#). Id. at § 121.103(e).

[\[FN100\]](#). Id. at § 121.103(f).

[\[FN101\]](#). Id. at § 121.103(g).

[\[FN102\]](#). Id. at § 121.103(h).

[\[FN103\]](#). Id. at § 121.103(i).

[\[FN104\]](#). Id. at § 121.103(a)(3).

[FN105]. Aid to Small Business, [15 U.S.C. § 644\(o\)](#).

[FN106]. Small Business Size Regulations, *supra* note 84, at § 121.103(a)(6).

[FN107]. EU Commission Recommendation, *supra* note 83, at art. 3.

[FN108]. *Id.* at art. 6.

[FN109]. *Id.*

[FN110]. European Commission, *The New SME Definition: User Guide and Model Declaration 23* (European Comm'n Publ'n Office 2005).

[FN111]. EU Commission Recommendation, *supra* note 83, at art. 3(3).

[FN112]. *Id.* at art. 6.

[FN113]. Notice on the Categorization of Medium-Small Enterprises, *supra* note 67, at Article 1.

[FN114]. Temporary Measures, *supra* note 2, at Article 2(2).

[FN115]. *Id.* at Article 7.

[FN116]. Aid to Small Business, *supra* note 105, at [§ 644\(o\)](#).

[FN117]. *Kidalov*, *supra* note 10, at 470.

[FN118]. Press Conference on Temporary Measures, *supra* note 73.

[FN119]. *Gongsi Fa* [Company Law] (promulgated by Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (P.R.C.) Article 58-64. See Chen Jianlin, *Clash of Corporate Personality Theories: A Comparative Study of One-member Companies in Singapore and China*, 38 *Hong Kong L.J.* 425, 434-435 (2008) (discussing the legislative background).

[FN120]. Article 6 provides that “There shall be no investment relationship between the large-medium

large enterprises and other natural persons, legal persons and organizations in the consortium bid; and the small and micro enterprises in the consortium bid.” It is unclear whether “other natural persons, legal persons and organizations” include the small and micro enterprises participating in the consortium bid. While the wording is broad enough to include these small and micro enterprises, the sentence structure suggests their exclusion.

[FN121]. Notice on the Categorization of Medium-Small Enterprises, *supra* note 67, at Article 4. The three categories are construction; property development; rental and commercial service.

[FN122]. *Supra* III.C.1.

[FN123]. Small Business Size Regulations, *supra* note 84, at § 121.103(a)(6).

[FN124]. *Supra* III.C.1.

[FN125]. Kidalov, *supra* note 10, at 469-70.

[FN126]. Zeng, *supra* note 88.

[FN127]. See, Law on the Promotion of Medium-Small Enterprises, *supra* note 21, at Article 2.

[FN128]. Zhang Zhuwu, Quanguo Renda Falv Weiyuan Hui Guan Yu «PZhonghua Renmin Gonghe Guo Zhongxiao Qiye Cujin Fa (Caoan)»• Shenyi Jiaoguo De Baogao [[Report by National People Congress Legal Committee on the Draft of Law on the Promotion of Medium-Small Enterprises], Nat'l People's Cong. (P.R.C.), June 24, 2002, available at [http://www.npc.gov.cn/wxzl/gongbao/2002-08/05/content\\_5298227.htm](http://www.npc.gov.cn/wxzl/gongbao/2002-08/05/content_5298227.htm) (last visited June 1, 2012).

[FN129]. Zeng, *supra* note 88.

[FN130]. Mathieson, *supra* note 9, at 236; Research on the 30 Years of China's Economic System Reform, *supra* note 11, at 52-58.

[FN131]. Stanley Lubman, [Looking for Law in China](#), 20 *Colum. J. Asian L.* 1, 5-6 (2006).

[FN132]. Bovis & Hu, *supra* note 18, at 15; Mathieson, *supra* note 9, at 235-36 .

[FN133]. Xu Hao, Bubi guanlian jigou zhengfu caigou fa beizhi cun quexian [[No Avoidance of Related Institution - Defects Pointed Out in Government Procurement Law], China Mgmt. Times, Dec. 5, 2011, at A02.

[FN134]. Government Procurement Law, *supra* note 7, at Article 12. Even the elaboration under the proposed implementation regulations merely focuses on conflict of interest between the individuals of government procuring authority and the supplier without restricting investment relationship between the government procuring authority and the supplier. Zhengfu Caigou Fa Shishi Tielie (Zhengqiu Yijian Gao) [Implementation Regulations of Government Procurement Law (Opinion Soliciting Draft)] (promulgated by St. Council, Jan. 11, 2010) (P.R.C) Article 13.

[FN135]. Xu, *supra* note 133.

[FN136]. Notice on the Categorization of Medium-Small Enterprises, *supra* note 68.

[FN137]. Ma & Jiang, *supra* note 48, at 81-82; Aaditya Mattoo, The Government Procurement Agreement: Implications of Economic Theory, *World Econ.* 695, 711 (1996) (this is especially so when compared to the dispersed taxpayers who have little interest and incentive to monitor individual procurement decision).

[FN138]. Daniel I. Gordon, [Constructing a Bid Protest Process: The Choices that Every Procurement Challenge System Must Make](#), 35 *Pub. Cont. L.J.* 427, 429-30 (2006).

[FN139]. Government Procurement Law, *supra* note 7, at Article 52.

[FN140]. *Id.* at Article 53.

[FN141]. *Id.* at Article 55.

[FN142]. *Id.* at Article 13.

[FN143]. *Id.* at Article 56.

[FN144]. *Id.* at Article 58. The main difference between administrative review and administrative litigation is the adjudicating institution and the grounds for review. Unlike in administrative litigation, where the courts are reviewing only the legality of the administrative action, administrative review involves a reviewing body that reviews both the legality and the merits/reasonableness of the administrative actions

being challenged: see Albert Chen, *An Introduction to the Legal System of the People's Republic of China* 293-304 (LexisNexis 4th ed. 2011)

[FN145]. Cao Heping & Zang Jugai, *Qianyi Zhongguo Zhengfu Caigou Guize Yu Gouji Xiangguan Guize Zhi Duijie* [Discussing the Harmonization of China Government Procurement Rules and Relevant International Rules], *Xue Hai* 135, 137 (2011); Liu, *supra* note 39, at 26-27.

[FN146]. An example of a discriminative bid requirement is where the procurement is restricted to products of particular brands/trademark or origin that has no legitimate relation to procurement needs.

[FN147]. The requirement that the supplier must have its “rights and interests harmed” can arguably include suppliers who did not actually participate (and henceforth did not incur expenses) in the government procurement due to discriminatory tender documents or other violations of the Government Procurement Law.

[FN148]. The writings from the legal department of the Ministry of Finance indicates that only suppliers who actually participated in the government procurement or at least purchased the procurement documents are entitled to initiate administrative review. Liu Yuantao & Xie Yao, *Zhengfu Caigou Xingzheng Fuyi Anjian Xiangguan Falv Wenti Yanjiu* [Legal Research on Relevant Problems in Government Procurement Administrative Review], *China Fin. Times*, Dec. 1, 2011, at 4.

[FN149]. *Implementation Regulations of Government Procurement Law (Opinion Soliciting Draft)*, *supra* note 131, at Article 66 (requires direct participation of the government procurement which is being challenged). The implementation of this regulation is reportedly delayed due to disputes over regulatory jurisdictions between the different government departments and ministries. Lin Yongfu, *She Duofang Liyi Dalu Caigou Tiaolie Nanchan* [China Procurement Regulations Delayed Due to Various Vested Interest], *Want Daily*, Nov. 24, 2011, at A7.

[FN150]. Cao & Zang, *supra* note 145, at 137; Wang Meili, *Zhengfu Caigou Anjian De Falv Shiyong* [Applicable Law in Government Procurement Cases], 2011(21) *People's Judiciary* 102, 103 (2011).

[FN151]. Liu, *supra* note 39, at 26-27; Wang, *supra* note 9, at 699.

[FN152]. Wang, *supra* note 150, at 103.

[FN153]. *Id.* at 106-07; Cao & Zang, *supra* note 145, at 137-38.

[FN154]. Zhou Lijie, Zhengfu Caigou Xingzheng Fuyi Anjian 7 Nian Yu 200 Jian [200 Cases of Government Procurement Administrative Review in 7 Years], *China Fin. Times*, June 29, 2011, at 1 (In terms of success rate, 57 of the 62 cases were actually heard, with decisions upheld in 33 cases (or 58%), cases settled and/or discontinued in 20 (or 35%), and only 4 resulted in success (7%)).

[FN155]. Wang, *supra* note 150, at 105; Yao Wensheng, *Zhengfu Caigou Falv Zhidu Yanjiu* [Research on the Legal System of Government Procurement] 283 (L. Press 2009).

[FN156]. Government Procurement Law, *supra* note 7, at Art. 71-83.

[FN157]. E.g., *Id.* at art. 72.

[FN158]. *Id.* at art. 76.

[FN159]. While Article 79 is applicable to supplier as well as the government procuring authority, it is a general provision setting out civil liability.

[FN160]. Government Procurement Law, *supra* note 7, at art. 73(1).

[FN161]. *Id.* at art. 73(2). In accordance with the express wording of Article 73(1) and Article 73(2), the aggrieved supplier is ironically better off if the procurement process has concluded but the contract has not been performed. If the procurement process has not concluded, the only outcome of a successful complaint is the termination of that procurement process. There is no requirement that the government procuring authority recommence the procurement process. On the other hand, if the procurement process is concluded but the contract has not been performed, the aggrieved supplier will at least get a chance to be selected when the contract is re-awarded to other qualifying suppliers who have participated in the procurement process. This peculiar outcome penalizes the aggrieved supplier for initiating an early and timely complaint. The official legislative explanation of Article 73 supports this peculiar outcome by envisaging that the government procurement process “can” re-initiate in accordance with the needs of government procurement. Wang Bing et al., *Zhonghua Renmin Gonghe Guo Zhengfu Caigou Fa Shiyi* [Explanation of People's Republic of China Government Procurement Law] 268-69 (Zhu Shaoping ed., China Price Publ'g 2002). This suggests that the recommencement of the government procurement is not mandatory. On the hand, the interpretation by the supervising regulatory authority responsible for handling the administrative appeal (i.e. the Ministry of Finance) avoids this peculiar outcome by requiring recommencement upon termination of the improper government procurement. *Zhengfu Caigou Gongying*



Shang Tousu Chuli Banfa [Measures for Handling the Complaints of Government Procurement Suppliers] (promulgated by Ministry of Finance, Aug. 11, 2004, effective Sep. 11, 2004) (P.R.C.) Article 18 & 19. However, this regulation is arguably inconsistent with the Government Procurement Law, inasmuch as it mandates recommencement even if the government procurement process has been concluded with the contract not performed upon.

[\[FN162\]](#). Government Procurement Law, *supra* note 7, at Article 73(3) & 79.

[\[FN163\]](#). *Infra* IV.B.

[\[FN164\]](#). Government Procurement Law, *supra* note 7, at Article 79. Article 77 only concerns violation by the supplier, and is generally not applicable when a supplier complains about violations by the government procuring authority.

[\[FN165\]](#). *Id.* at Article 79.

[\[FN166\]](#). Contractual and tortious liabilities are the two forms of civil liability envisaged under article 79. See Wang Bing et al., *supra* note 161, at 268-69.

[\[FN167\]](#). Government Procurement Law, *supra* note 7, at Article 43.

[\[FN168\]](#). Hetong Fa [Contract Law] (promulgated by Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999) (P.R.C.).

[\[FN169\]](#). See Ben A. De Rubeis, *Public Procurement in Canada - A Comparative View of Remedies and the Tendering Contract*, 2011 J. Can. C. Constr. L. 307, 319-26 & 330-35 (2011) (discussing the relevant cases in these jurisdictions); Fiona Banks & Michael Bowsher QC, *Damages Remedy in England & Wales and Northern Ireland*, in *Public Procurement Law: Damages as an Effective Remedy* 61, 64 (Duncan Fairgrieve & Francois Lichere eds., Hart 2011).

[\[FN170\]](#). Wu Hongyu, *Zhengfu Caigou Hetong Gexin De Xingzheng Fa Guancha* [[Innovating Government Procurement Contract from the Perspective of Administrative Law], 2011(5) Yunnan Admin. Faculty J. 99, 100 (2011); Wang, *supra* note 150, at 105 (there remains divergence in views over the nature of government procurement contract); Yao, *supra* note 155, at 281-83 (noting but disagreeing with the argument).

[\[FN171\]](#). Wu, *supra* note 170, at 102; Wang, *supra* note 150, at 102. See also Wang et al., *supra* note 161, at 301 (official legislative explanation of the draft).

[\[FN172\]](#). Wu, *supra* note 170, at 102; Wang, *supra* note 150, at 102.

[\[FN173\]](#). Yao Wensheng is optimistic that pre-contractual liability under Chinese Contract Law could be effectively extended to cover government procurement. However, the successful litigation Yao refers to involved an egregious refusal by the government procuring authority to sign a contract after the contract had been awarded via tender. The conduct would have fallen under Article 42(1) and would in any case represent only a minor expansion on prohibited bad faith conduct. See Yao, *supra* note 155, at 282-83. C.f. Yang Huihui & Yang Peng, *Zhongguo Zhengfu Caigou Falv Fagui Yu GPA Duibi Fenxi* [[Comparative Analysis of GPA and China Government Procurement Laws and Regulations], *China Gov't Procurement* 52, 57 (2011) (noting that the government authority has other public law obligations in the government procurement process that are not included under the umbrella of contractual principles).

[\[FN174\]](#). Liu, *supra* note 39, at 26-27; Cao & Zang, *supra* note 145, at 137.

[\[FN175\]](#). Cao & Zang, *supra* note 145, at 138.

[\[FN176\]](#). Yao, *supra* note 155, at 173.

[\[FN177\]](#). Liu, *supra* note 39, at 26-27; Wang, *supra* note 9, at 699.

[\[FN178\]](#). Wang, *supra* note 150, at 107.

[\[FN179\]](#). Liu, *supra* note 39, at 25-29; Yang & Yang, *supra* note 173, at 52; Cao & Zang, *supra* note 145, at 135.

[\[FN180\]](#). *Supra* II.C.

[\[FN181\]](#). *Supra* IV.B.

[\[FN182\]](#). For example, “bad faith colluding with a supplier and/or procuring agency” under article 72(1) is arguably a more severe form of “holding consultation or negotiation with bidders during the tender process under Article 71(5).

[\[FN183\]](#). Wang et al., supra note 161, at 263.

[\[FN184\]](#). Government Procurement Law, supra note 7, at Article 4.

[\[FN185\]](#). Supra IV.A.1.

[\[FN186\]](#). A large enterprise suffers (unfairly) if it loses out to another large enterprise that managed to win the bid with the help of an SME discount (obtained via masquerading as an SME).

[\[FN187\]](#). Temporary Measures, supra note 2, at Article 5.

[\[FN188\]](#). Press Conference on Temporary Measures, supra note 73.

[\[FN189\]](#). Government Procurement Law, supra note 7, at Article 77(1).

[\[FN190\]](#). Temporary Measures, supra note 2, at Article 15.

[\[FN191\]](#). Government Procurement Law, supra note 7, at Article 53.

[\[FN192\]](#). Id. at Article 13.

[\[FN193\]](#). Government Procurement Law, supra note 7, at Article 56; Measures for Handling the Complaints of Government Procurement Suppliers, supra note 161, at Article 20.

[\[FN194\]](#). Government Procurement Law, supra note 7, at Article 57; Measures for Handling the Complaints of Government Procurement Suppliers, supra note 161, at Article 22.

[\[FN195\]](#). Government Procurement Law, supra note 7, at Article 81; Measures for Handling the Complaints of Government Procurement Suppliers, supra note 161, at Article 22.

[\[FN196\]](#). Article 13 of the Government Procurement Law stipulates that the “various branches of Peoples' Government and other relevant departments should fulfill their relevant supervisory and management duties in accordance with the law.” However, the timeline of seven days (Article 53) and thirty days (Article 56) are applicable only to the government procuring authority and the supervisory authority, respectively. On a practical note, it seems reasonable for the time limit to begin after the SME regulatory authority actually receives the request for certification. Since this is likely to be a later date than the actual

complaint or appeal, a timing inconsistency has arisen that was neither envisaged nor dealt with under the current Government Procurement Law.

[FN197]. The Temporary Measures only refers to “regulatory authority in charge of SMEs” without specifying the particular regulatory authority. Temporary Measures, *supra* note 2, at Article 15. However, the specialized SMEs department of the Ministry of Industry and Information Technology is likely to be the SME regulatory authority referred to under the Temporary Measures given that the Temporary Measures is jointly promulgated and interpreted by the Ministry of Industry and Information Technology. The other possible candidate, the State Administration for Industry & Commerce, can be ruled out. While the State Administration for Industry & Commerce is responsible for enterprise registration, it has no specialized department on SMEs. Organization Structure, State Administration for Industry & Commerce of the People's Republic of China, <http://www.saic.gov.cn/zzjg/jgsz/> (last visited, June 1, 2012). It is also unlikely that regulatory responsibility is imposed on the State Administration for Industry & Commerce without its input.

[FN198]. Gongye He Xinxu Hua Bu Zhuyao Zhize Neishe Jigou He Renyuan Bianzhi Guiding [Regulations on the Major Institutional and Personal Organization of the Ministry of Industry and Information Technology] (promulgated by Ministry of Indus. and Info. Tech., July 11, 2008, effective July 11, 2008) (P.R.C.) Article 3(8).

[FN199]. Indeed, there is a conspicuous absence of any mention of the Temporary Measures on its updated website even five months after the effective date of the temporary measures. Small and Mid-Sized Enterprises, Ministry of Industry and Information Technology of the People's Republic of China, <http://qys.miit.gov.cn/n11293472/n11295074/index.html> (last visited Mar., 2013).

[FN200]. *Supra* IV.A.1.

[FN201]. Since the subject matter of review is the decision of the supervisory authority, and since the government procuring authority is to defer to the decision of the SME regulatory authority on the issue of SME certification, the decision of the supervisory authority cannot be impugned even if the issue of SME certification was wrongly decided.

[FN202]. Article 77(1) of the Government Procurement Law (“provision of false information to win bid”) will arguably cover the circumstances where there is such pre-mediated intention and/or pre-bid arrangement to illegally subcontract.

[\[FN203\]](#). Gordon, *supra* note 138, at 429-30.

[\[FN204\]](#). *Supra* II.B.1.

[\[FN205\]](#). Liu, *supra* note 39, at 25-29.

[\[FN206\]](#). Yang & Yang, *supra* note 173, at 52.

[\[FN207\]](#). Cao & Zang, *supra* note 145, at 135; Zhao, *supra* note 48, at 90, 93-94; Tong, *supra* note 39, at 139.

[\[FN208\]](#). Arie Reich, *The New Text of the Agreement on Government Procurement: An Analysis and Assessment*, 12 *J. Int'l Econ. L.* 989, 1015-17 (2009).

[\[FN209\]](#). Marrakesh *The WTO Agreement on Government Procurement*, Apr. 15, 1994, [http://www.wto.org/english/docs\\_e/legal\\_e/gpr-94\\_e.pdf](http://www.wto.org/english/docs_e/legal_e/gpr-94_e.pdf).

[\[FN210\]](#). Mattoo, *supra* note 137, at 713.

[\[FN211\]](#). *Supra* IV.A.2.

[\[FN212\]](#). De Rubeis, *supra* note 169, at 325-28.

[\[FN213\]](#). *Id.* at 332-35.

[\[FN214\]](#). *Id.* at 329-30 (The Canadian International Trade Tribunal, the institution to which Canadian bidders bring complaints, only received, on average, 75 complaints a year, out of thousands of solicitations within its scope. Fifty percent of the complaints are accepted for inquiry, of which 30% to 40% are decided in favor of the complainant).

[\[FN215\]](#). *Id.* at 348.

[\[FN216\]](#). *Id.* at 348.

[\[FN217\]](#). *Id.* at 331.

[\[FN218\]](#). Supra IV.A.

[\[FN219\]](#). Xinglin Zhang, Constructing a System of Challenges Procedures to Comply with the Agreement on Government Procurement, in *The WTO Regime on Gov't Procurement: Challenge and Reform* 483, 491 (Sue Arrowsmith & Robert D. Anderson eds., Cambridge Univ. Press 2011).

[\[FN220\]](#). The major issue concerns the scope of the GPA, namely whether non-central government agencies and numerous state-owned enterprises are subjected to the GPA. This reflects the core interests of China but is also unsurprisingly resisted by current signatories. Chao, supra note 9, at A11; Mathieson, supra note 9, at 240; Wang, supra note 9, at 667-68; Boumil, supra note 29, at 775-76.

[\[FN221\]](#). Supra II.B.2.

[\[FN222\]](#). Supra notes 151-56 and accompany text.

[\[FN223\]](#). Gordon, supra note 138, at 431; Christopher F. Corr & Kristina Zissis, [Convergence and Opportunity: The WTO Government Procurement Agreement and U.S. Procurement Reform](#), 18 *N.Y.L. Sch. J. Int'l & Comp. L.* 303, 312 (1999); Mattoo, supra note 137, at 713.

[\[FN224\]](#). Ma & Jiang, supra note 48, at 81-82; Ma, supra note 39, at 69.

[\[FN225\]](#). Wang & Zhang, supra note 8; Qu, supra note 8.

[\[FN226\]](#). Government Procurement Law, supra note 7, at Article 77(1).

[\[FN227\]](#). Id. at Article 77(3).

[\[FN228\]](#). Yu, supra note 18, at 181.

[\[FN229\]](#). He & He, supra note 10, at 43-48 (discussing the statistics that reveal a lower standard of education, expertise, research expenditure, and other measures of human capital and viability among the SMEs). Poor corporate governance is a common problem afflicting SMEs. Wang, supra note 20, at 143. Bad faith business practices is also not uncommon in SMEs. 2011 Survey and Research Report on China SMEs, supra note 19, at 12; Zhang, supra note 20, at 65. From an economic perspective, the reputation constraints of small firms are also weaker when compared to large enterprises. John Kay et al., *Regulatory Reform in Britain*, *Econ. Pol'y* 285, 321-22 (1988).

[\[FN230\]](#). E.g., Qu, *supra* note 8 (the suppliers for the 2011 Wenzhou high speed train disaster are all listed companies).

[\[FN231\]](#). *Supra* III.C.

[\[FN232\]](#). *Supra* IV.B.3.

[\[FN233\]](#). Qu, *supra* note 8. Post-award inspection of contractual performance is also a weak link under the current regime that neglects the importance of such inspection. Yang Wenli & Tong Shuzhan, Zhengfu Caigou Buneng Zhong Caigou Qing Yanshou [Government Procurement Must Not Neglect Post-Contract Inspection ], *China Collective Econ.* 54 (2012).

[\[FN234\]](#). In violation of Article 2, Temporary Measures, *supra* note 2.

[\[FN235\]](#). Public enforcement via administrative supervision by the supervising regulatory authority is the primary form of enforcement envisaged by the Temporary Measures: see [original] notes 134-36 and accompany text.

[\[FN236\]](#). Government Procurement Law, *supra* note 7, at Article 13.

[\[FN237\]](#). Guanyu Jingyi Bu Jiaqiang Zhengfu Caigou Guanli Gongzhou De Yijian [[Opinions on Further Strengthening the Management of Government Procurement] (promulgated by St. Council, Apr. 10, 2009, effective Apr. 10, 2009) (P.R.C.) Article 1.

[\[FN238\]](#). *Id.* at Article 2.

[\[FN239\]](#). *Id.* at Article 3.

[\[FN240\]](#). *Id.* at Article 4.

[\[FN241\]](#). *Id.* at Article 5.

[\[FN242\]](#). *Id.* at Article 6.

[\[FN243\]](#). *Id.* at Article 7.



[FN244]. See Guanyu Jingyi Bu Jiaqiang Zhengfu Caigou Jiandu Guanli Gongzhou De Yijian [Opinions on Further Strengthening the Supervision and Management of Government Procurement] (promulgated by Qingdao City Gov., Feb. 23, 2012, effective Feb. 23, 2012) (P.R.C.).

[FN245]. Opinions on Further Strengthening the Management of Government Procurement, *supra* note 237, at Preamble.

[FN246]. Ma, *supra* note 39, at 69.

[FN247]. E.g., Zhang Hui, Wogou Zhengfu Caigou Fa Shixing Xiaogou Kaocha [[Study on the Effectiveness of the Implementation of China Government Procurement Law], Tianjin Fin. Univ. Rev. 120 (2012).

[FN248]. While SMEs participation in government procurement is arguably easy to quantify and is indeed required under Article 12 of the Temporary Measures, these statistics do not take into account the possibility of circumvention of the Temporary Measures. Over emphasis of these statistics will also further exacerbate the perverse incentives of the government procuring authority in overlooking violations that will prop up the numbers. See *supra* IV.D.1.

[FN249]. At a meeting at the White House in January 2011, the President of China agreed to equal treatment on innovations, leading the Chinese government to abolish procurement preferential policies to support indigenous innovation in July 2011: Ai Bing, Oumei guojia zhengfu caigou cujing zizhu chuanxin de jinyan yu qishi [Experiences and Lessons from Promotion of Indigenously Innovation Under European and American Government Procurement], Marco Econ. Research 13, 13 (2012).

[FN250]. Zizhu Chuanxin Chanpin Zhengfu Caigou Pingshen Banfa [Measures on Evaluation of Government Procurement of Indigenously Innovated Products] (promulgated by Ministry of Fin., Apr. 3, 2007, effective Apr. 3, 2007, ineffective July 1, 2011) (P.R.C.) Article 12.

[FN251]. *Supra* IV.B.2.

[FN252]. Linarelli, *supra* note 36, at 448-50.

[FN253]. Pierce, *supra* note 10, 549-61.

[FN254]. For a discussion on the legal hierarchy in China. See Albert Chen, *An Introduction to the Legal System of the People's Republic of China* 144-50 (LexisNexis 4th ed. 2011).

[FN255]. C. David Lee, [Legal Reform in China: A Role for Nongovernmental Organizations](#), 25 *Yale J. Int'l L.* 363, 414-19 (2000).

[FN256]. Xiaofei Zhe Quanyi Baohu Fa [Law on the Protection of Rights and Interests of Consumers] (promulgated by St. Council) (effective Jan. 1, 1994) Article 32(4).

[FN257]. *Id.* at Article 32(6). This is usually in the form of legal advices or arranging law firms for consumers. C. David Lee, *supra* note 255, at 417.

[FN258]. *Supra* II.C.

[FN259]. 30% of the 741.32 billion government procurement in 2009. Zhang, *supra* note 4.

[FN260]. Lubman, *supra* note 131, at 5-11. See Chen, *supra* note 254, at 218-25 (discussing the historical and contemporaneous context for the inadequacies in terms of quantity and quality of persons in Chinese legal institutions).

[FN261]. Lubman, *supra* note 131, at 27-28. For a discussion of the law making process in China, see Chen, *supra* note 254, at 125-42.

[FN262]. For example, during the drafting of the Government Procurement Law, a special overseas study mission was commissioned to study the government procurement regime in U.S., Australia, and Korea. Wang et al., *supra* note 161, at 303-12.