

4. China

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1. INTRODUCTION

China has undergone a radical economic transformation since 1978 when the ruling Communist Party of China (CCP) made a dramatic decision to move away from the orthodox Leninist-Stalinist model of economic organization toward a more market-oriented economic system.¹ This decision has transformed China from being an impoverished, predominantly agricultural nation into the dynamic, export-oriented economic superpower that now ranks second only to the United States.² It has been argued that China's economic rise is one of the most significant economic events of our time, and that more people have been lifted out of poverty, more quickly, than by any other set of economic policies ever adopted.³ Internationally, the economic and political effects of this policy shift are now obvious to all: the massive migration of manufacturing capacity to China, the hugely increased presence of Chinese-manufactured products in world markets, surges in commodity prices due to China's anxious worldwide search to secure supplies of raw materials to fuel its continued economic development.

Internally, this breakneck economic development has occurred in an environment that is still subject to an authoritarian government, with a society that lacks a robust rule of law, a completed legal code and

¹ Fairbank, John King (2006), *China: A New History*, 2nd enlarged edn, Cambridge, MA: Belknap Press of Harvard University Press, p. 407.

² According to the data collated by the WTO, China is the largest exporter in the world with 93% (2010) of its exports being manufactured goods. Just 13.8% (2010) of its manufactured goods are consumed by China and Hong Kong. See: China Trade Profile: <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN>.

³ 'China 2030, Building a Modern, Harmonious and Creative High-Income Society' (2012), The World Bank and the Development Center of the State Council of the People's Republic of China. Retrieved from <http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf> (last accessed 4 February 2013).

the effective enforcement of the laws that do exist on the statute book. Surprisingly, there has been very little substantive political change to mirror the metamorphosis of the economy. The CCP still jealously guards its monopoly of political power and controls much of the domestic economy through the state's ownership of majority holdings in most large domestic enterprises. Officially, China practices a socialist market economy, which essentially means that whilst the old state-owned enterprises (SOEs) have been converted into joint stock companies and floated on the domestic and/or international stock exchanges, the state retains an iron grip on the commanding heights of the domestic economy and the CCP evinces no inclination to change the status quo. As a result, whilst domestic private enterprises do exist and flourish, their absolute importance to the internal domestic economy is relatively limited as is the impact of foreign invested enterprises (FIE), though the private sector does have much greater importance in the export sector.⁴

This chapter will seek to outline the relevant political economy factors that distinguish China from its Asian neighbors and to analyze their influence on promoting or impeding China's continued economic rise. The chapter then considers the reasons for and the impact of the Antimonopoly Law, enacted some five years ago, after a prolonged period of debate about the wisdom of the adoption of a comprehensive competition law in China.

The chapter is organized as follows. In the next section, a profile of China is presented, including background factors such as geography, demographics and recent political history. China's formal political institutions are then explained along with a brief assessment of the importance of the central role of the CCP. The existence and exercise of civil and political rights are also mentioned in this context. The role and structure of courts are examined and the effectiveness of the independent exercise of judicial power is assessed. The structure of the economy is outlined, as is the ownership of economic assets. National wealth and its distribution are discussed along with capacity constraints caused by shortages of raw materials, skilled human resources and environmental issues. Finally, competition law and policy are examined and current implementation efforts and future trends considered.

⁴ Yi, Jingtao, Zhong, Yi and Zheng, Qian (2012), 'An Analysis of State-Owned and Private-Owned Enterprises' Export Performance: The Value Chain Perspective', *Journal of Chinese Entrepreneurship*, 4(1), pp. 20–34; WTO (2008), 'Trade Policy Review: China', WT/TPR/S/199 pp. 2–108. Retrieved from www.wto.org/english/tratop_e/tp_r_e/s161-1_e.doc (last accessed 2 February 2013).

2. NATIONAL PROFILE

2.1 Geography and Population

China is the world's third largest country with a land area of 9,569,901 sq. km, which is slightly smaller than the USA. The country has a wide variety of climatic regions from the semi-tropical south to deserts and arctic forests bordering Siberia. China's western and northwestern borders are bounded by impressive mountain ranges with high-level deserts. These geographic features have often caused substantial barriers to trade and interaction with the outside world. Many parts of central, western and northern China have significant water shortages and there are various mountain ranges that inhibit easy internal transportation. The eastern and southern regions enjoy plentiful precipitation and they are the principal producers of rice, which has traditionally been the staple food grain of China, though wheat is grown in the drier, cooler northern provinces.

Historically, the ancient Chinese empire was considerably smaller than the current boundaries of the People's Republic and traditional China was unusual amongst the large, ancient, Asian empires in that it was substantially ethnically homogeneous. Han Chinese still form by far the largest component of the population of modern China at over 91 percent but China officially admits that at least 56 ethnic minority groups live within Chinese territory.⁵ The current population of China is estimated to be 1.3 billion according to the 2011 Official Census.

China has attempted to control its population growth in the last 30 years by using draconian methods, including the 'One Child Policy', which has caused a dramatic decline in birth rates. The policy has also led to several unintended consequences that have significant economic effects. China now has a rapidly aging population. This has led to significant labor shortages in many labor-intensive industries, including agriculture and low-end manufacturing and assembly work that is difficult to automate. This may signal a reduction in export-oriented manufacturing of this type. Labor costs in the export-processing zones have substantially increased and may hasten the move of such industries to lower cost countries such as Vietnam, Cambodia and Bangladesh.⁶

⁵ 'China's Population Mix'. Retrieved from <http://www.china.org.cn/e-groups/shaoshu/mix.htm> (last accessed 2 February 2013).

⁶ 'China's Tricky Wage Dynamics' (2011), *The Economist*, April 5. Retrieved from http://www.economist.com/blogs/freeexchange/2011/04/labour_markets_0 (last accessed 2 February 2013).

The rapidly aging population will cause severe strains on the health care system and the economic burden of caring for the aging population will fall on progressively fewer working age adults. This may cause a slowdown in economic growth as few older workers have adequate pension provision and the state social security net is quite inadequate.⁷

Further, there is a highly unusual sex imbalance in the younger age group caused by selective abortion and female infanticide. Male children are favored over females and this has resulted in extreme male-female imbalances, especially in some rural provinces. By 2020, it is estimated that there will be over 24 million surplus males who will be unable to find a marriage partner.⁸ Social disruption has been forecast as a distinct possibility in light of this demographic peculiarity.

Territorial disputes at China's periphery are multiple. The western regions of Tibet and Xinjiang contain restive non-Han majorities and land border disputes with India, Russia and Vietnam remain unresolved. The status of Taiwan is also highly problematic. Maritime territorial disputes in the South China Sea with all the neighboring states – Vietnam, Cambodia, Malaysia, Brunei and the Philippines – routinely threaten the outbreak of hostilities, partly as a result of nationalistic sentiment but principally due to the possible presence of sizable under-sea oil and gas deposits.⁹

China's size and economic power mean that many of these territorial issues have the potential to cause serious economic disruption if diplomatic solutions are not brokered.¹⁰

2.2 History

China is the only ancient civilization to have survived largely intact for at least four millennia. China has been called a 'Civilization State'. This concept embraces the notion of a continuously evolving culture that embraces a geographical space but is rooted in a shared ethnicity, language and social organization. The Chinese empire was probably the

⁷ 'Getting On' (2011), *The Economist*, June 23. Retrieved from <http://www.economist.com/node/18832070> (last accessed 2 February 2013).

⁸ 'The Most Surprising Demographic Crisis' (2011), *The Economist*, May 5. Retrieved from <http://www.economist.com/node/18651512> (last accessed 2 February 2013).

⁹ A current example of tension over maritime boundaries in the South China Sea concerns the Scarborough Shoal.

¹⁰ See Jacques, Martin (2009), *When China Rules the World: The End of the Western World and the Birth of a New Global Order*, New York: Penguin Press.

longest lasting system of government in world history, though the more recent history of China in the last 200 years is one of a precipitous decline – from superpower status that accounted for 30 percent of global economic output in 1830 to being almost economically irrelevant by the 1960s.¹¹

This position of economic weakness has been dramatically reversed in just 30 years to a position where China now has the globe's second largest economy. This economic roller-coaster has been matched by equally dramatic political upheavals. The decay of the imperial system of government accelerated in the mid-19th century as Western and Japanese imperial ambitions sought a de facto partition of China into spheres of influence and actual territorial concessions. A major civil war, the Taiping Rebellion, also gravely weakened the imperial system of government.

Civil war and domestic instability became chronic after the collapse of the imperial system in 1911, with China fracturing into warlord-dominated fiefdoms that accompanied the collapse of central authority. The weak Nationalist republican government agreed a united front approach with the newly formed Communist Party in the mid-1920s to counter warlord influence and the incipient threat of the Japanese annexation of Manchuria. However, the two factions quickly disagreed and fell into civil war. The Japanese then expanded their incursions into a full-scale invasion to occupy much of China in the 1930s.

At the end of the Second World War, the Nationalists and Communists – supported by the United States and the USSR respectively – recommenced the civil war following unsuccessful negotiations. Ultimately, the CCP – with Russian military assistance – triumphed, and the Nationalists retreated to Taiwan in 1949.¹²

3. POLITICAL SYSTEM

The seizure of political power by the CCP in 1949 brought about an overthrow of the Republican constitution and the imposition of a Soviet model

¹¹ For most of recorded history, China has held a dominant place in the world, both politically and economically. As late as 1830 China accounted for 30% of world manufacturing output. See Jaggi, Gautam, Rundle, Mary, Rosen, Daniel, Takahashi, Yuichi (1996), 'China's Economic Reforms: Chronology and Statistics', Institute for International Economics, Working Paper 96-5. Retrieved from <http://www.iie.com/publications/wp/96-5.pdf> (last accessed 2 February 2013).

¹² Freeberne, Michael et al. (2002), *Far East and Australasia 2003*, London: Routledge, pp. 266–325.

of government. The CCP established a monopoly of political power which enabled the CCP to rule China through the notionally independent organs of the state. This modus operandi has remained essentially unchanged for over 60 years.¹³

Formally, China has all the trappings of a modern nation state, with a constitution that only mentions the leading role of the CCP in its preamble and then proceeds to outline the nature of the socialist state, its political structures and the roles of the executive, the legislature and the courts. However, the Constitution envisages that the organs of government form part of a single harmonious entity and Western enlightenment notions of a tripartite separation of powers with independence guaranteed to each arm of government are eschewed in favor of a united power structure.¹⁴

The Constitution also ostensibly provides guarantees of civil and political liberty and in the last decade China has stated that it will ratify the International Covenant on Civil and Political Rights (ICCPR) into domestic law, but this has not yet been done.¹⁵

Whilst the Constitution is a worthy document which has undergone periodic revisions to substantially change the foundations of the economic system, providing a legal basis for ad hoc advances to liberalize the economy, it remains in many respects an expression of ideals that are often unrealized in practice. This is primarily a result of the dominance of the CCP, which controls the system from behind the curtain of the formal institutions of the state. The lack of political plurality, the rejection of the concept of the separation of powers, and the inability of the legal system to hold government institutions to account through a robust application of the notion of the rule of law all contribute to a system that is, in many respects, dysfunctional. However, despite these manifold imperfections, China has still managed to unleash an economic transformation of unparalleled proportions in the last 30 years. Whether China can move on to escape the middle-income trap, without further fundamental reform of its political and legal institutions and without allowing a much greater role to the private sector in the domestic economy, remains an open question and

¹³ Bernstein, Thomas (2010), 'China Learns from the Soviet Union, 1949–Present', *The China Quarterly*, pp. 1001–31.

¹⁴ Preamble of the English version of the Constitution of the People's Republic of China (Adopted in 1982). Retrieved from <http://english.people.com.cn/constitution/constitution.html> (last accessed 2 February 2013).

¹⁵ UN Treaty Collection: International Covenant on Civil and Political Rights. Retrieved from http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mdsg_no=IV-4&chapter=4&lang=en (last accessed 2 February 2013).

one that has taxed both Chinese and foreign academics as well as Chinese political leaders.¹⁶

4. GOVERNMENTAL SYSTEM

Formally, China is a unitary state. The Constitution mandates that People's Governments at various levels of the state have their own functions but are subordinated to the Central People's Government. However in reality, given China's geographical extent and huge population, provincial and lower levels of government often act with a surprising degree of autonomy. This de facto federalism has had the effect of allowing some provinces to adopt more liberal economic policies at an earlier stage than others and has also fostered keen competition between China's regions for economic success. Political office holders at all levels are appointed by the Organization Department of the CCP, which coordinates their appointment and assessment. The Organization Department also sets performance indicators for officials and, in addition to political loyalty, other metrics of success include the pace of economic development of the region to which the officer has been assigned. This has been a key factor in the promotion prospects of Chinese officials at all levels for over 30 years.¹⁷

Formerly, the apex of the executive arm of central government is the State Council, which coordinates the activities of central government ministries and the various administrative commissions. State councilors often have oversight over broad policy areas, with execution of policy being carried out by specific ministries and commissions. The head of the State Council is the Prime Minister, with state councilors making up this central coordinating body. However, it should be noted that, at this level of government as with all others, there is a parallel system of committees of the CCP – which is the real seat of political power. The top-level CCP organ is the Politburo, which is chaired by the General Secretary of the CCP who is also the President of the People's Republic. This dual control structure is often invisible to outside observers who assume that government ministries act autonomously and in the public interest. This would be

¹⁶ 'China and the World Bank 2030 Vision' (2012), *The Economist*, February 28. Retrieved from <http://www.economist.com/blogs/analects/2012/02/china-and-world-bank> (last accessed 2 February 2013).

¹⁷ Gu, Xiangdong, Higgins, Louise T., Wang, Lixiang, Holt, Xiaoye (2012), 'Civil Service Leadership Selection in China: Historical Evolution and Current Status', *Journal of Chinese Human Resource Management*, 3(1): pp. 67–78.

a significant misunderstanding of the political realities in China, where the CCP retains a tight grip over all the institutions of the state from the State Council to the local village committee.

Below this central government tier, China has a number of layers of local government from the provincial to the municipal to the village or township. As has been mentioned earlier, each of these lower tiers of government often has a significant degree of de facto autonomy. This has had the positive effect of enhancing the pace of economic development, but it has also meant that abuses of power in relation to the unlawful seizure of land, the imposition of local laws which conflict with national policies or legislation and endemic corruption are also hallmarks of the system.

The inability of the central authorities to restrain local abuses of power has become a major political issue in China and has been the subject of innumerable political scandals. Public discontent has increasingly led to the threat of widespread political instability. The most recent example of this phenomenon has been the downfall of the previously very powerful Party Secretary of the Chongqing autonomous municipality, Bo Xi Lai.¹⁸ This case well illustrates the ability of local officials to ignore central government directives and to abuse their untrammelled political power within their fiefdom. Allegations of financial corruption invariably accompany such political downfalls and the size and scope of these abuses are very substantial.¹⁹

China's adherence to a unified notion of government has prevented the development of the culture of transparency or the rule of law, which would otherwise be able to restrain local abuses of power. CCP ideology requires that it alone exercises all effective power in China and it jealously guards this monopoly, which most observers note is at the root of governmental failures in China.²⁰

¹⁸ Xiang, Lanxin (2012), 'The Bo Xilai Affair and China's Future', *Survival: Global Politics and Strategy*, 54(3): pp. 59–68. Retrieved from <http://www.iiss.org/publications/survival/survival-2012/year-2012-issue-3/the-bo-xilai-affair-and-chinas-future> (last accessed 2 February 2013).

¹⁹ Dumbaugh, Kerry and Martin, Michael (2009), 'Understanding China's Political System', Congressional Research Service, p. 15. Retrieved from <http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA512681> (last accessed 2 February 2013).

²⁰ Lawrence, Susan and Martin, Michael (2012), 'Understanding China's Political System', Congressional Research Service, pp. 7–15. Retrieved from <http://www.fas.org/sgp/crs/row/R41007.pdf> (last accessed 2 February 2013).

5. COURTS AND THE LEGAL SYSTEM – LAWYERS, JUDGES, RULE OF LAW

The court structure follows the civilian model and is nationally accountable to the Ministry of Justice. However, the courts at each level of government are funded and staff appointments are made by the corresponding level of local government, guided by the CCP. As a result, the courts have a conflicted position as they are responsible vertically to the Ministry of Justice but horizontally to the local government for funding. Local levels of government and the CCP also appoint judicial personnel.

This bifurcated responsibility system inevitably leads to conflict. The courts, when they carry out their adjudicative functions, are bound to accord national legislation priority over local laws but conflicts arise that create significant problems. Consequently, local courts often neglect to enforce national rules and prefer local legislation. Additionally, in any case that involves political or economic sensitivities, the political committee of the court headed by the Party Secretary will issue advice or instructions to the judge hearing the relevant case as to the verdict that should be rendered. Again, to the casual observer, China appears to have a fully functioning judicial system. But behind the curtain of the formal institution lies the pervasive power of the CCP.²¹

China's current court system is less than 30 years old and it is unrealistic to expect that such a new institution will have yet matured sufficiently to be able to fully carry out its formally allotted functions, especially given the particular political characteristics of China's system.

Many older judges do not have legal qualifications as law schools were closed down in 1959 and did not reopen until 1978. As a result, two generations of jurists were lost and it is only in the last 30 years that the law schools and a culture of legality have been rebuilt.²² The quantity of law graduates now produced is very impressive, but many observers have questioned the quality of much legal education in China. This has a particular impact on complex economic cases in general and in particular

²¹ Backer, Larry Cata (2010), 'A Constitutional Court for China within the Chinese Communist Party: Scientific Development and a Reconsideration of the Institutional Role of the CCP', *Suffolk University Law Review*, 43(3). Retrieved from <https://litigationessentials.lexisnexis.com/webcd/app?action=DocumentDisplay&crawlid=1&doctype=cite&docid=43+Suffolk+U.+L.+Rev.+593&srctype=smi&srcid=3B15&key=db5e0c2d64514458b80cbbd1fc774ead> (last accessed 2 February 2013).

²² Lubman, Stanley (1999), *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Calif.: Stanford University Press.

in relation to competition law. However, the development of high quality lawyers has been progressing rapidly, with many thousands of Chinese students undertaking postgraduate legal study both at home and abroad. Many of them also seek employment in international law firms before transferring to domestic law practices, so the improvement in the overall quality of China's legal profession has been substantial. China also has a functioning system of bar associations but these organizations are ultimately controlled by the CCP to ensure that lawyers do not undertake activities inimical to the continued monopoly of CCP power.

As can be readily appreciated, China's legal system is still at a developmental stage and whether China will ultimately be able to develop an effective rule of law and a legal system that operates impartially is a speculative question. This has important implications in competition law cases where it is likely that many monopoly cases will involve politically well connected state monopolies or the use by local governments of protective measures that impede competition in domestic markets.

As regards competition issues in the domestic market, the courts have not yet been asked to review any administrative decisions and no private enforcement cases have yet been conducted on the merits, so it is impossible to evaluate whether or not the judicial system will be able to effectively overturn decisional errors made by the administrative agencies or to impartially adjudicate competition disputes between private parties.

6. STRUCTURE OF THE ECONOMY

Since 1978 the economy has changed from a traditional Soviet-style centrally planned model to a more market-oriented one. Despite this major policy shift, it would be a fundamental error to imagine that China's current economy or the economic future envisaged by the CCP will be a mirror of Western capitalist models. It appears that Chinese policy is to maintain a state capitalist model. Where the corporatized profit-seeking entities that will dominate the domestic economy and their respective franchises will continue to be protected from effective private sector competition.²³

The first major change in economic structure was the decision in 1977 to dismantle the agricultural communes that had dominated agricultural

²³ Fels, Allan (2012), 'China's Antimonopoly Law 2008: An Overview', *Review of Industrial Organization*. Retrieved from <http://www.springerlink.com/content/e186v04825076143/fulltext.pdf> (last accessed 2 February 2013).

production since the mid-1960s. This system had been imposed upon an unwilling peasantry and had resulted in the stagnation of food production, causing food to be rationed by the mid-1970s. In order to increase agricultural productivity, the CCP concluded that it was necessary to abandon the communal system and instead peasant farmers were allocated individual plots of land to cultivate without a formal ownership interest. Farmers were required to surrender to the state a fixed grain quota but were free to produce in excess of the mandated quantity which could then be sold for private profit. This 'Household Responsibility' system dramatically increased agricultural production and transformed the lives of millions of peasants, particularly in the eastern and southern provinces where the land was more productive.

This reform also led to the establishment and explosive growth of rural production enterprises, usually in the guise of collectively owned businesses. These businesses often involved food processing, but later consumer goods manufacturing enterprises also developed. However, these collectives were often, in fact, a cloak to disguise individual or family-owned enterprises, which were, at that time, prohibited. In the 1980s, these enterprises were legitimated but they still had to rely on their own capital resources since legal financing from the state banking sector was not open to them. These reforms were fundamental to the establishment of China's first modern private enterprises which initially focused on supplying domestic demand, but from the 1990s onwards increasingly entered export markets, often producing export goods on contract for foreign companies.

The two other major aspects of China's economic reform program were, first, allowing foreign investment in China, and secondly, reform of the state-owned enterprise economy. Initially, foreign investment was limited to special economic zones which were located in coastal areas and were expressly created to allow the development of an export-processing industry, initially financed by Hong Kong, Taiwanese, and overseas Chinese capital. Later, foreign investment from multinational companies (MNCs) was permitted to establish joint venture production facilities with Chinese state-owned enterprises. These joint ventures were established largely to produce export goods and to allow modern technology to be introduced into China. Later, MNCs were allowed to establish joint ventures with private sector Chinese firms and ultimately they were allowed to establish wholly owned foreign enterprises. After China's entry into the World Trade Organization (WTO) in 2001 they could also sell their products in the Chinese domestic market, without quantitative restriction.

As regards China's domestic economy, almost all large-scale and urban enterprises were either classified as state-owned enterprises or were cooperatives, notionally owned by the workers employed in such businesses. By

the 1980s, it was accepted that these businesses were highly inefficient and, in most cases, loss making.²⁴ The reform of the domestic enterprise sector began in the 1990s with a policy of de facto privatization of small SOEs and collective enterprises.²⁵ The larger state-owned enterprises were first made more efficient by substantial staff redundancies and by the setting of production and profit targets with tighter financial discipline. The ultimate goal was to transform these enterprises into corporate entities that could be listed on the newly established domestic stock exchanges. This program of corporatization of SOEs has now been in progress for almost 20 years and whole sectors of the economy have been reformed in this way.²⁶ However, it should be noted that as the state corporatized and listed these enterprises it retained a majority equity interest in them. These firms are distinct from their Western counterparts as a result of their implicit and explicit state backing. They receive preferential access to capital provided by the state banks, and many of these businesses remain de facto or de jure monopolies in their respective domestic sectors. Vertically integrated monopolies are also common.²⁷ These structural features have a significant impact on whether the Antimonopoly Law will have any significant effect in increasing actual competition in many Chinese domestic product markets, as a result, competition in many domestic markets is muted or absent because of the continued preeminence of state enterprises.

Another distinguishing feature of large Chinese corporations is that their corporate governance is quite different from that of Western multinational companies. All senior personnel decisions are, in fact, taken by the Central Organization Department of the Communist Party, notwithstanding formal rules that mandate that function to shareholders, though this is of little significance as the state is also the majority shareholder in these enterprises.²⁸

²⁴ See OECD (2009), 'State Owned Enterprises China: Reviewing the Evidence', OECD Occasional Paper, January. Retrieved from <http://www.oecd.org/corporate/corporateaffairs/corporategovernanceofstate-ownedenterprises/42095493.pdf> (last accessed 2 February 2013).

²⁵ OECD (2009), 'Reviews of Regulatory Reform: China – Defining the Boundary between the Market and the State', Paris: OECD. Retrieved from <http://www.oecd.org/regreform/regulatory-policy/42390089.pdf> (last accessed 2 February 2013).

²⁶ Ibid.

²⁷ The petrochemical, electricity, railway and telecommunications sectors are just a few of the vertically integrated state monopolies that proliferate in China.

²⁸ McGregor, Richard (2010), *The Party: The Secret World of China's Communist Rulers*, New York: Harper Collins. See Li, Cheng (2011), 'China's Midterm Jockeying: Gearing Up for 2012', *China Leadership Monitor*, p. 34;

Despite these unusual features, China has had undoubted success in promoting rapid economic growth over the last 30 years. However, various structural features of the domestic economy may inhibit continued economic expansion. A recent high-level study has opined that, unless the reform process is continued and deepened, the status quo may prevent China from escaping the so-called 'Middle Income' trap. This phenomenon has been observed in other developing countries in the past and particularly in Latin America. Countries such as Argentina, Chile and Brazil undertook substantial structural economic reform programs in the 1990s, but unlike other countries in East Asia – such as Japan, South Korea, Hong Kong and Singapore – they have been unable to escape middle-income status. The World Bank recently published a comprehensive report on China's optimal development strategy for the next 20 years and recommended a number of strategic changes.²⁹ The Report noted that:

At its core, this adjustment requires changing the role of government and its relations with the market, the private sector, and society at large. While the government needs to withdraw from direct involvement in production, distribution, and resource allocation, it will need to focus greater attention on designing and implementing the policy and regulatory framework that empowers others to participate in economic decision making so that the desired outcome of rapid, inclusive, and sustainable growth is achieved. To play this role, the government will need to transform itself into a lean, clean, transparent, and highly efficient modern government that operates under the rule of law. In redefining its role, the government will need to accelerate reforms in the state-owned sector and combine it with further development of the private sector. It will also need to advance reforms in factor markets (capital, land, and labor) to help strengthen the foundations of a market economy and promote greater competition and innovation.³⁰

Li, Wen Lin and Milhaupt, Curtis J. (2011), 'We are the National Champions: Understanding the Mechanisms of State Capitalism in China', Columbia Working Paper No. 409, 1 November. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1952623 (last accessed 2 February 2013) (noting that the top positions in 53 central enterprises, including board chairmen, CEOs, and Party Secretaries, are all appointed and evaluated by the Organization Department of the CCP); Lin, Nan (2010), 'Capitalism in China: A Centrally Managed Capitalism (CMC) and its Future', *Management & Organization Review*, 7: p. 63.

²⁹ 'China 2030, Building a Modern, Harmonious and Creative High-Income Society' (2012), The World Bank and the Development Center of the State Council of the People's Republic of China. Retrieved from <http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf> (last accessed on 30 March 2012).

³⁰ Ibid at p. 18.

As regards the continued primacy of state enterprises the Report continued:

The recent global financial crisis in the advanced economies and, in stark contrast, China's continued rapid growth despite the global slowdown, have led some in China to conclude that China's state dominance in key industrial and service sectors should continue (especially in the financial sector). Others, however, counter that China's vision of itself in 2030 as an innovative, high-income society will require markets and the private sector to play a bigger role in resource allocation decisions. They consider the dominance of the state in the economy as potentially inhibiting China's efforts to move up the value chain. This report makes two points: first, that government should encourage increased competition in the economy, including by increasing the ease of entry and exit of firms as soon as possible; and second, that public resources should be used to finance a wider range of public goods and services to support an increasingly complex and sophisticated economy. Reforms of state enterprises and banks would help align their corporate governance arrangements with the requirements of a modern market economy and permit competition with the private sector on a level playing field. This would create the appropriate incentives and conditions for increased vigor and creativity in the economy in support of China's successful transformation into a high-income society.³¹

The Report also concluded that, if substantial structural change was not made, current growth rates would be inhibited, though it conceded that change of this magnitude would be difficult to achieve:

At the same time, the government's continued dominance in key sectors of the economy, while earlier an advantage is in the future likely to act as a constraint on productivity improvements, innovation, and creativity. And the close links between the government, big banks, and state enterprises have created vested interests that inhibit reforms and contribute to continued ad hoc state interventions in the economy.³²

Enhancing the role of competition and the private sector in the domestic economy is seen as a key goal to ensure that China can escape from the 'middle income trap':

More competition – domestic and international – will be the key to improving the efficiency and innovation capability of Chinese enterprises. To increase competition in domestic markets, further reforms will be needed to support private sector firms, such as lowering barriers to firm entry and exit, breaking up state monopolies or oligopolies in key industries (petroleum, chemicals, electricity distribution, and telecommunications), promoting the growth of dynamic SMEs and increasing their access to finance, stimulating much needed

³¹ Ibid at p. 20.

³² Ibid at p. 25.

regional and local specialization, and encouraging spontaneous state enterprise reforms through competition.³³

Consequently, the role of the state as owner, operator and regulator in many sectors of the economy currently creates many substantial or even insurmountable barriers to competition.

In sectors of the domestic economy where private firms compete or where they compete with state enterprises, competitive conditions vary; some are competitive though it is also clear that horizontal collusion between competitors is a common phenomenon in China. Most industries have trade associations, sponsored by government, who often act as fora for collusive activities. Phrases much employed, such as: the maintenance of 'market discipline', 'orderly or fair competition', are usually euphemisms for price fixing or market allocation. Many markets exhibit an oligopolistic structure, where, in the absence of outright collusion, price signaling and established price leadership is common. Given the outright predominance of state enterprises in many markets, monopoly, monopsony and oligopsony are also common features of the industrial landscape.

7. NATIONAL WEALTH AND DISTRIBUTION

China's gross domestic product (GDP) (at purchasing power parity) has seen extraordinary increases in the last 30 years from US\$480 to US\$10,090 today. The annual average growth rate of China's GDP reached 9.4 percent from 1979 to 2002, and even exceeded 10 percent during the 1980s and the first half of the 1990s.³⁴ As previously mentioned, China's economy is now second only to the United States, on the assumption that the European Union is not considered as a single economy. However, income and wealth distribution in China is extremely uneven. As measured by the GINI coefficient, China's income and wealth disparity has been increasing at an alarming rate from 49.64 in 1988 to 60.66 in 2006.³⁵ This increasing inequality has the potential to create substantial

³³ Ibid at p. 27.

³⁴ Hu, Angang (2006), *Economic and Social Transformation in China: Challenges and Opportunities*. London: Routledge, p. 67.

³⁵ Chen, Jiandong et al. (2010), 'The Trend of the Gini Coefficient in China', Brooks World Poverty Institute, University of Manchester. Retrieved from <http://www.bwpi.manchester.ac.uk/resources/Working-Papers/bwpi-wp-10910.pdf> (last accessed 2 February 2013).

social tension in China and the central government has become increasingly alarmed at the prospect of social disturbances.

Another allied issue is the very substantial wealth gap between the urban and rural populations. This is because agricultural prices have been suppressed since the 1990s so that the farming population has not seen significant increases in household income for many years, whilst urban dwellers have become much wealthier on average. Government now accepts the need to address this disparity. Additionally, industrial workers' salaries saw little improvement in wages in real terms over the decade to 2008 until a new labor law mandated a minimum wage which has been progressively enforced and has increased the real purchasing power of industrial workers.³⁶ The government hopes that this will help address the urban wealth gap and will help to reorient the domestic economy toward higher levels of consumption, so bolstering economic growth at a time when exports have stagnated. China's economy has traditionally been distorted by low and falling levels of consumption. In 1990, China had the 10th lowest level of household consumption in the world, which constituted 47 percent of GDP. Twenty years later in 2010, consumption had fallen further to only 35 percent of GDP compared to a world average of 61 percent of GDP. Clearly, this low level of consumption is a major problem since normally, in developing economies, growing domestic consumption boosts GDP growth and creates a more balanced economy. China's reliance on capital spending as a component of GDP has increased from 36 percent in 1990 to 48 percent in 2010. This overreliance on capital spending severely distorts the economy and creates substantial misallocation of resources.³⁷

China's emergence as a major trading nation in the last 30 years has been one of the most visible signs to foreigners of China's economic transformation. From a position of almost negligible trading importance, China is now the largest exporter globally, with an export market worth US\$1.9 trillion.³⁸ This export-oriented trade strategy has inevitably led to trade friction with China's major developed economy trading partners,

³⁶ Däubler, Wolfgang and Wang, Qian (2009), 'The New Chinese Employment Law', *Comparative Labor Law & Policy Journal* 30: p. 395.

³⁷ World Bank national accounts data, and OECD National Accounts data files (June 2012). Catalog Sources World Development Indicators. Retrieved from <http://data.worldbank.org/indicator/NY.GNS.ICTR.ZS> (last accessed 2 February 2013).

³⁸ Central Intelligence Agency (2012), 'Country Comparison: Exports', *The World Factbook*. Retrieved from <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2078rank.html> (last accessed 2 February 2013).

including the United States and the European Union.³⁹ The growth in exports of manufactured products has boomed since China joined the WTO and foreign trade barriers were reduced with respect to its products. Numerous MNCs have relocated their production to China and this has caused domestic political problems in many developed economies. However, it should be noted that consumers in those economies have benefited enormously from the cost reductions associated with the manufacture of such products in China. The global economic downturn, evident since 2008, has limited China's export growth and the government has an avowed policy of reorienting China's economic policy toward higher consumption, but that may be hampered by the high savings rate of the Chinese population that craves economic security in the face of a very weak government social safety net.

China's imports have been largely of industrial raw materials such as iron ore, coking coal, petroleum products and agricultural products such as soya beans, wheat and fruit.⁴⁰ China has also become the world's largest market for luxury consumer products.⁴¹ This expansion of China's imports has had profound implications for international trade, with commodity producers such as Australia, Brazil, Argentina and Canada running substantial trade surpluses with China.⁴² However, the corresponding trade

³⁹ For trade friction with the United States, see Morrison, Wayne M. (2011), 'China-U.S. Trade Issues', *Congressional Research Report for Congress*, September 30. Retrieved from <http://www.fas.org/sgp/crs/row/RL33536.pdf> (last accessed 2 February 2013). For trade friction with the European Union, see Directorate-General for External Policies of the Union (2011), 'EU-China Trade Relations', EXPO/B/INTA/FWC 2009-01/Lot7-14, July. Retrieved from [http://www.europarl.europa.eu/RegData/etudes/etudes/inta/2011/433861/EXPO-INTA_ET\(2011\)433861\(PAR00\)_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/inta/2011/433861/EXPO-INTA_ET(2011)433861(PAR00)_EN.pdf) (last accessed 2 February 2013).

⁴⁰ Merchandise Trade by Product, Region and Major Trading Partner, 2009–2010 – China (2011), *International Trade Statistics 2011*, World Trade Organization. Retrieved from http://www.wto.org/english/res_e/statis_e/its2011_e/appendix_e/a22.xls (last accessed 2 February 2013).

⁴¹ 10th Annual Bain Luxury Goods Worldwide Market Study (October 2011). Retrieved from <http://www.bain.com/about/press/press-releases/worldwide-luxury-goods-market-poised-to-surge-ten-percent-in-2011.aspx> (last accessed 2 February 2013).

⁴² International Trade in Goods and Services, Australia, Jan 2012 (2012), Australian Bureau of Statistics, March 9. Retrieved from <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Previousproducts/5368.0Main%20Features2Jan%202012?opendocument&tabname=Summary&prodno=5368.0&issue=Jan%202012&num=&view=> (last accessed 2 February 2013); Australia's Trade Surplus with China was A\$1.327 billion in January 2012. Ministry of Commerce People's Republic of China (23 March 2012). Retrieved from <http://english.mofco>

deficits run by developed economies with China have inevitably caused diplomatic problems, with suggestions that China is restricting imports from such countries by various means, including artificially maintaining an undervalued exchange rate to stimulate exports and decrease imports.⁴³ The impact of China's continued economic expansion on world trade will only increase, with profound implications for consumption and production patterns worldwide.

China has done reasonably well in increasing the overall competitiveness of its economy, but the constraints discussed above and highlighted in the recent World Bank report illustrate that if China is to achieve the same level of economic development as its Northeast Asian neighbors – Japan and South Korea – further structural reform of the economy is urgently necessary. The World Economic Forum in its annual competitiveness surveys has concluded that China's current ranking is 26 in the world.⁴⁴ In order to improve this, required reforms include improving human capital so that the Chinese economy can become more innovative in terms of the creation of new products and services domestically. According to the United Nations, China's Human Development Index is 0.687, whereas more developed economies have integers that are significantly higher.⁴⁵

8. CAPACITY CONSTRAINTS

China, like other nations, inevitably suffers from capacity constraints in improving its economic performance. However, some of China's constraints are unique and others are very significant. China's particular

m.gov.cn/aarticle/statistic/lanmubb/ChinaEU/201203/20120308032944.html (last accessed 2 February 2013).

⁴³ Wheatley, Alan and Wroughton, Lesley (2010), 'IMF Split in China Yuan Exchange Rate Debate', *Reuters*, July 28. Retrieved from <http://www.reuters.com/article/2010/07/28/businesspro-us-china-economy-imf-idUSTRE66R4W220100728> (last accessed 2 February 2013); Goldman, Julianna and Taleve, Margaret (2011), 'Obama Says "Enough's Enough" on China's Undervalued Yuan as Hu Pushes Back', *Bloomberg*, November 14. Retrieved from <http://www.bloomberg.com/news/2011-11-14/obama-says-enough-s-enough-on-china-s-undervalued-yuan-as-hu-pushes-back.html> (last accessed 2 February 2013).

⁴⁴ World Economic Forum (2011), *Global Competitiveness Report 2011–2012*. Retrieved from http://www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf (last accessed 2 February 2013).

⁴⁵ Human Development Index 2011 (2011), United Nations Development Programme. Retrieved from http://hdr.undp.org/en/media/HDR_2011_EN_Table1.pdf (last accessed 2 February 2013).

demographic problems have already been discussed above, but China also has other equally alarming issues that will have to be addressed if China is to achieve its full potential.

China suffers from an acute water shortage for most of its central and northern provinces. China's climate appears to be drying and this is a significant problem because of increased desertification. Not only is rainfall reducing over much of north-central China but groundwater levels are also depleting at the same time as water consumption per capita is increasing dramatically.⁴⁶ The government has drafted plans to build huge water transfer canals from south China, which enjoys abundant water resources, to the north, but the feasibility of such schemes has been questioned and the financial cost is large. Unless the water shortage issue can be appropriately addressed, it will inevitably impose a significant constraint on the further development of the northern half of the country.⁴⁷

Another environmental concern is the gross level of industrial pollution that prevails in China. As regards air pollution, six out of the ten most polluted cities in the world are in China.⁴⁸ This unenviable record not only illustrates the high levels of such emissions, but also the industrial inefficiencies that require much higher energy input levels to produce a unit of output.⁴⁹ High pollution levels also illustrate the use of outdated

⁴⁶ Water Resources (2011), *China Statistical Yearbook 2011*, China: China Statistics Press. Retrieved from <http://www.stats.gov.cn/tjsj/ndsj/2011/indexeh.htm> (last accessed 2 February 2013).

⁴⁷ Lei, Chen (2011), 'Coping with Global Climate Change by Enhancing Water Security Capacity – Speech at High-Level Roundtable Meeting on Strategy of Coping with Extreme Weather in China' Speech of Minister of Ministry of Water Resources of the People's Republic of China, April 22. Retrieved from http://www.mwr.gov.cn/english/speechesandarticles/chenlei/201104/t20110426_262629.html (last accessed 2 February 2013); 'Chinese Vice Premier Urges Increased Efforts to Build South-to-north Water Diversion Project' (2010), *Xinhua News*, October 10. Retrieved from <http://www.globaltimes.cn/china/chinanews/2010-10/580445.html> (last accessed 2 February 2013).

⁴⁸ Wheeler, David R., Deichmann, Uwe, Pandey, Kiran D., Hamilton, Kirk E. (2006), 'Air Pollution in World Cities', The World Bank. Retrieved from <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:20785646~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html> (last accessed 2 February 2013).

⁴⁹ In the 12th Five-Year Plan (2011–15), China plans to close down inefficient plants. See Tuo, Yannan, Lan, Lan (2012), 'China on the Path to Efficient Use of Energy', *China Daily*, February 28. Retrieved from http://www.chinadaily.com.cn/business/2012-02/28/content_14710763.htm. 'China 2030: Building a Modern, Harmonious, and Creative High-Income Society' (2012), World Bank. Retrieved from <http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf> (last accessed 2 February 2013).

technologies. Air pollution also imposes a huge disease burden on China's urban population.⁵⁰ Other forms of environmental pollution are also at alarmingly high levels and the state seems incapable of mitigating this phenomenon due to a lack of enforcement of environmental protection laws.⁵¹

China also suffers from a distinct lack of indigenous raw materials. In particular, it has negligible onshore oil resources, it lacks iron ore and good quality deposits of coking coal and copper ore. These commodities are essential for continued industrial expansion and China is reliant on overseas suppliers for these commodities, and this thirst for secure oil and gas supplies is the principal reason for China's extravagant territorial claims in respect of the South China Sea, which may contain large submarine hydrocarbon deposits.

Energy is another key constraint. Electricity production has often failed to keep pace with increased demand and China is attempting to move away from highly polluting coal-fired power stations to greater reliance on hydroelectric schemes in the centre and west of the country, though these dam projects are highly controversial and may not be cost effective.⁵² China has also signaled its intention to dramatically increase its production of electricity from nuclear power stations, but again this is controversial as a result of a poor safety record in China's industrial sector, the fact that many areas are prone to earthquakes, and given the absence of domestic supplies of uranium.

A further endemic capacity constraint in the Chinese economy is the ubiquity of corruption. Corruption levels in all parts of the economy are extremely high. According to Transparency International, in 2011 China ranked 75 out of 182 countries on the Corruption Perception Index.⁵³ Endemic corruption at all levels of government is also an accepted fact and can clearly have a distorting effect on economic decision making. The CCP has repeatedly stressed that corruption in China is a major threat not only to economic development but to its own survival as China's governing

⁵⁰ World Health Organization (May 2008), 'WHO-China: Country Cooperation Strategy, 2008-2013', Retrieved from http://www.who.int/country_focus/cooperation_strategy/ccs_chn_en.pdf (last accessed 2 February 2013).

⁵¹ OECD (2006), 'Environmental Compliance and Enforcement in China - An Assessment of Current Practices and Ways Forward'. Retrieved from <http://www.oecd.org/dataoecd/33/5/37867511.pdf> (last accessed 2 February 2013).

⁵² Du, Juan (2011), 'Nation to Build New Hydroelectric Power Plants', *China Daily*. June 23. Retrieved from http://www.chinadaily.com.cn/cndy/2011-06/23/content_12756229.htm (last accessed 2 February 2013).

⁵³ Corruption Perception Index 2011 (2011). Retrieved from <http://cpi.transparency.org/cpi2011/results> (last accessed 2 February 2013).

institution.⁵⁴ However, despite numerous anti-corruption campaigns over the last 30 years, the rate and extent of corruption appears only to have increased in line with the economic opportunities that have been presented by China's economic expansion.

Currently, corrupt Chinese officials are initially subject to internal party disciplinary procedures. Errant officials are arrested and detained by Party discipline and inspection organs whilst allegations are investigated. The process is secret and opaque. The Party Central Discipline and Inspection Commission acts as investigator, prosecutor and jury. Once a decision is announced – usually expulsion from the Party – the official may or may not be handed over to the state judicial organs for criminal charges to be brought and tried. The official may then be subjected to a highly publicized show trial, with the infliction of imprisonment or even execution. The outcome of such a process is driven wholly by political rather than judicial considerations. This modus operandi will remain unchanged until the CCP itself is either removed from power and a more plural political system introduced or the Party commits itself to the rule of law. Full transparency by freeing the media and allowing the legal system the necessary independence to enforce the law equally is also clearly required if the public is to be convinced that Party officials are not above the law. Needless to say, these outcomes are unlikely to be adopted in the foreseeable future.

9. NATURE OF COMPETITION POLICY

At the outset of its economic reform program, the Chinese government accepted that blockages to competition and monopolistic conduct in the market were a problem. As early as 1980, the State Council issued regulations seeking to encourage a competitive economic environment, to ban regional economic protectionism and to unify the national market.⁵⁵ However, it took China until 2007 to enact a comprehensive competition law. The long gestation period was caused by a range of factors which included ideological opposition to the notion of moving toward a market-

⁵⁴ Full Text of Hu Jintao's speech at CPC anniversary gathering (2011), *China Daily*, July 1. Retrieved from http://www.chinadaily.com.cn/china/cpc2011/2011-07/01/content_12818048.htm (last accessed 2 February 2013).

⁵⁵ Provisional Rules on the Development and Protection of Socialist Competition was issued by the State Council on October 17, 1980; see http://www.law-lib.com/law/law_view.asp?id=2155 (full text in Chinese) (last accessed 2 February 2013).

based economy and sectoral opposition from entrenched economic interests, in particular the major SOEs and their sponsoring ministries.

As a result of several extensive consultation rounds on various drafts of the proposed law, an internal compromise was ultimately achieved as to the scope, nature and enforcement regime that was ultimately adopted. As in any law that is the result of extensive compromise, the Chinese Antimonopoly Law is deficient in several major respects, though the law does formally contain the three major prohibitions generally thought to be necessary in a robust pro-competition statute – the prohibition of the abuse of market power, anti-competitive agreements and anti-competitive mergers.⁵⁶

A common issue that concerned consumers, private Chinese producers and foreign entrants to the domestic Chinese market was to ensure that SOEs were not exempted or afforded special treatment under the law. The compromise ultimately achieved was that, whilst SOEs were notionally included within the ambit of the law, their special status would be taken into account when enforcement decisions were made. This uneasy compromise has created substantial ambiguity as to whether the law can ever be fully effective when the structural dominance of many SOEs is effectively protected by the government's majority ownership stake in all domestic large-scale industries.⁵⁷

A second major concern during the drafting process was that the 'administrative monopoly' issue should be effectively addressed. This is a particularly Chinese phenomenon, where government, at all levels, uses or abuses its legal or regulatory powers to prevent, restrict or distort competition in particular markets. This phenomenon has many facets and includes regional protectionism, whereby local governments seek to protect enterprises based within their jurisdiction which are often the largest local employers or taxpayers by erecting barriers to free internal trade. Other discriminatory measures that governments have imposed include discriminatory taxes, administrative instructions requiring local government and its agencies to purchase goods or services from nominated suppliers that are connected to that government and the misuse of administrative powers of quality inspection or sanitary or phytosanitary rules to prevent the import of products to a local area.⁵⁸

⁵⁶ See Chapters II to IV of the Antimonopoly Law of China.

⁵⁷ Owen, Bruce M., Sun, Su, Zheng, Wentong (2005), 'Antitrust in China: The Problem of Incentive Compatibility', *Journal of Competition Law and Economics*, 1(1): p. 123, at p. 126; Wu, Zhengu (2008), 'Perspectives on the Chinese Anti-Monopoly Law', *Antitrust Law Journal*, 75: p. 73, at p. 99.

⁵⁸ Zhao, Suisheng (2011), 'The China Model and the Authoritarian State'. *East*

Central government ministries also abuse their administrative powers in order to favor state-owned incumbent businesses or to shield them from incipient private sector competition, even where the sector is notionally open to new entrants. Various administrative rules also foreclose markets on multifarious grounds, all of which have chilling anti-competitive effects.

The highest level of government, at the State Council, fully appreciated that such abuses of administrative power were inimical to a unified national market. Such local protectionism prevented industrial consolidation and the enjoyment of economies of scale and scope, so enhancing economic efficiency and ultimately national competitiveness. As a result, China intended to introduce the first effective national legislation to specifically outlaw administrative monopoly conduct by any arm of government. The original proposals included an effective enforcement mechanism that would allow an independent regulator, directly accountable to the State Council, to nullify infringing regulation or to require delinquent state bodies to desist from anti-competitive conduct. However, as a result of effective lobbying by vested interests at various levels of government, the final text was watered down. In the final version of the Antimonopoly Law, such conduct is specifically prohibited, but the enforcement mechanism has been weakened to a point where it has been rendered completely ineffective.⁵⁹

Another area of concern with regard to the new Antimonopoly Law was the imposition of a merger and acquisition control regime that might prevent industrial consolidation. Somewhat surprisingly, many Chinese industries have a very low concentration ratio as a result of deliberate policy decisions made in the 1950s and 1960s to disperse industry as widely as possible so that each province would be economically self-sufficient should China be invaded by a foreign power. This dispersal policy meant that many industries in China were duplicated on a province-by-province basis. For example, most provinces had a vehicle manufacturing plant or

Asia Forum, 3(2): p. 12, at p. 13; Zheng, Wengton (2010), 'China's Antimonopoly Law – One Year Down, Part 7 – “The Emperor is Far Away”': Administrative Monopolies in China' January 13. Retrieved from http://lawprofessors.typepad.com/antitrustprof_blog/2010/01/chinas-antimonopoly-lawone-year-down-part-7-the-emperor-is-far-away-administrative-monopolies-in-chi.html (last accessed 2 February 2013).

⁵⁹ See Chapter V of Antimonopoly Law of China and Provisions for the Suppression by Administrations for Industry and Commerce of Acts of Abuse of Administrative Authority to Eliminate or Restrict Competitive Acts, promulgated by the State Administration for Industry and Commerce on December 31, 2010 and effective as of February 2011.

steel production facilities so that they would be able to have the resources to continue to resist an invading enemy even if the coastal provinces were occupied.

By the 1990s this policy was seen to have had a number of negative effects, including promoting regional protectionism and the entrenchment of inefficiencies as a result of an inability of producers to reach economically viable levels of production. Many industries argued that a merger and acquisition control rule would inhibit the ability of China to restructure their industries so that larger and more viable units could be formed. This, of course, was not true as the very low concentration levels in most industries would not prevent consolidation as a result of antitrust concerns.

Foreign MNCs were also concerned about the adoption of merger control. Foreign MNCs wished to expand their domestic presence in the China market by acquiring established Chinese businesses and fretted that this might be prevented. They were worried that a merger control rule would introduce a trade barrier to entry into those sectors that domestic vested interests wished to protect. MNCs were also concerned that, even if the rules were not discriminatory on their face, they would not be applied impartially.

A merger and acquisition regime was adopted and it has been largely applied to foreign-related transactions, many of which have only a peripheral connection with the domestic China market but are caught by the relatively low turnover thresholds which trigger mandatory notification to the Chinese authorities. Despite the concerns of international business that the regime would be used as a discriminatory tool against them, those cases that have been decided show that this has not been the case, with only one notification resulting in an outright ban, though several have only been approved subject to the imposition of conditions.⁶⁰

The last major concern about the Antimonopoly Law was the structure of the enforcement agency. The original proposals provided for a single, powerful enforcement authority answerable directly to the State Council, so providing it with a bureaucratic rank at the same level or superior to most other government bodies. This position would have given the agency

⁶⁰ ‘National Commercial Conference on Anti-monopoly 2012 Held in Beijing’ (2012), Ministry of Commerce of People’s Republic of China, January 17. Retrieved from <http://english.mofcom.gov.cn/aarticle/newsrelease/significant-news/201201/20120107931142.html> (last accessed 2 February 2013); ‘China Summarises 2011 AML Enforcement, Promises Action on Failures to Notify a Concentration in 2012’ (2012), *Newsletter of McDermott Will & Emery*, January 26. Retrieved from <http://www.mondaq.com/x/162390/Trade+Regulation+Practices/China+Summarises+2011+AML+Enforcement+Promises+Action+On+Failures+To+Notify+A+Concentration+In+2012> (last accessed 2 February 2013).

sufficient bureaucratic weight to require compliance with its decisions at all levels of government and even by the most powerful SOEs. However, this was not to be. The final draft of the law divided enforcement responsibilities between three enforcement agencies as a result of an intense turf war between those incumbent agencies. The compromise solution was not to create a new agency or to designate one of the three contenders as the sole enforcement agency, but instead to divide up enforcement responsibilities between them.⁶¹ However, their work is supposed to be overseen and coordinated by an Antimonopoly Commission of higher bureaucratic rank which is directly accountable to the State Council.

This structure is inherently problematic as the divisions, particularly between the responsibilities of the State Administration for Industry and Commerce (SAIC) and the National Reform and Development Commission (NRDC), are unclear and may well cause confusion with regard to the substantive antitrust standards adopted by the two agencies and their interpretation of the law and its enforcement in abuse of dominance and restrictive agreement cases. The Ministry of Commerce (MOFCOM) was allotted the role of merger and acquisition enforcement authority. MOFCOM also has responsibility for foreign trade and traditionally had a more external focus. Given that its role was discrete and the majority of filings under the law have been from foreign enterprises, any problems that have arisen in respect of its enforcement decisions have been relatively modest. However, a number of mergers and amalgamations in the domestic SOE sector have taken place and would appear to be notifiable but none of them seem to have been scrutinized by MOFCOM.⁶²

As a result of the above discussion, legitimate questions can be asked as to the real level of commitment by the Chinese government to pro-competition policy. The inherent nature of the industrial structure in China's domestic economy, with the state retaining control of most major industries, coupled with the problems alluded to above with the competition statute, all seem to point to a lack of resolve to effectively implement a pro-competition policy. The same point was raised by a recent World Bank study that alluded to the fact that China's pro-market reforms are still far from complete. This view is bolstered by the fact that China has an

⁶¹ Ross, Lester (2008), 'Enforcement Challenges of China's Antimonopoly Law', *The Online Magazine for Global Competition Law*, August. Retrieved from <https://www.competitionpolicyinternational.com/file/view/5537> (last accessed 2 February 2013).

⁶² Chin, Yee Wah (2010), 'M&A under China's Anti-Monopoly Law – Emerging Patterns', *Business Law Today*, September. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1627327 (last accessed 2 February 2013).

industrial policy to create a smaller number of industrial groups that will consolidate major sectors of Chinese industry in order to create national champions. These firms will continue to be majority owned and controlled by the state. This policy may well be a legitimate one, but it clearly runs the risk of being incompatible with more market-oriented pro-competition objectives.

10. NATURE AND STRUCTURE OF COMPETITION AGENCIES

As has been previously mentioned, enforcement of the Antimonopoly Law has been divided amongst three agencies. The NRDC is tasked with dealing with so-called 'price monopoly' cases, which would appear to include both unilateral conduct cases and those involving agreement between two or more parties that restrict price competition in the market. SAIC is tasked with dealing with non-price-related issues, which again would appear to include some anti-competitive agreements and some unilateral conduct cases. However, it might be argued that all anti-competitive conduct influences price directly or indirectly and so, the distinction is arbitrary and may lead to overlap and confusion as to which agency has jurisdiction or whether both agencies have partial jurisdiction in the same cases. This issue of jurisdictional conflict is supposed to be dealt with by inter-agency collaboration and potentially by joint investigations, but whether this will prove an effective remedy remains unclear. Further, the two agencies have already produced implementing procedures and some substantial rules that are mutually incompatible. This raises the possibility of the same conduct being treated differently by the two agencies.

In the five years since the promulgation of the Antimonopoly Law, there has been little enforcement activity by either agency and therefore it is difficult to tell whether, in the future, they will have an important impact on improving domestic competition conditions. To date, both agencies have spent their very limited resources on devising procedural rules and the only high-profile enforcement action has been a complaint raised against the two incumbent state telecommunication companies in relation to a 'margin squeeze' whereby the telecom companies sought to protect their dominance in the internet backbone services market. The investigation was launched in October 2011 and to date there has been no official notification of a resolution of the case.⁶³

⁶³ See 'Anti-monopoly Probe into Telecom Giants Confirmed' (2011),

MOFCOM has jurisdiction over merger and acquisition cases, both domestic and foreign-related. The ministry has been the most active of the three agencies and has processed several hundred merger notifications in the last five years. The quality of decision making has been criticized for excessive brevity and the lack of reasoned decisions. However, the deficiencies of early decisions are being progressively remedied to some extent and its young and competent administrative staff appear to have a genuine desire to reach globally accepted standards of decision making. In politically sensitive cases their ability to make independent judgments may be restricted by the nature of the Chinese political-administrative system and nationalistic public opinion may also play a role in preventing foreign acquisitions of iconic domestic brands. Indeed, such forces may well have been at play in the only merger application so far rejected.⁶⁴

The Antimonopoly Commission is a committee of the State Council, and this body is tasked with the coordination of state policy among the three agencies. To date its activities have been limited save for participation in the creation of a new National Security Review regime for foreign-related acquisitions in strategically sensitive sectors that is separate and distinct from any antitrust assessment,⁶⁵ and the promulgation of rules on merger thresholds⁶⁶ and market share calculation.⁶⁷

China Daily, November 9. Retrieved from http://www.chinadaily.com.cn/business/2011-11/09/content_14066568.htm (last accessed 2 February 2013); Ning, Susan, Yiming, Sun, Jia, Liu (2011), 'Earlier Rumour Confirmed: China Telecom and China Unicom under Antitrust Investigation', *China Law Insight*, November 14. Retrieved from <http://www.chinalawinsight.com/2011/11/articles/corporate/antitrust-competition/earlier-rumor-confirmed-china-telecom-and-china-unicom-under-antitrust-investigation> (last accessed 2 February 2013); Ning, Susan, Yiming, Sun, Jia, Liu, Ranran, Yin (2011), 'China Telecom and China Unicom Seek to Settle Antitrust Probe', *China Law Insight*, December 12. Retrieved from <http://www.chinalawinsight.com/2011/12/articles/corporate/antitrust-competition/china-telecom-and-china-unicom-seek-to-settle-antitrust-probe> (last accessed 2 February 2013).

⁶⁴ MOFCOM decision on Coca-Cola Corporation (Coca-Cola) and China Huiyuan Fruit Juice Group Limited. Unofficial Translation: Announcement of Ministry of Commerce of the People's Republic of China [2009] No. 22, March 18, 2009. Retrieved from <http://www.mwechinalaw.com/documents/mofcom09-22.htm> (last accessed 2 February 2013).

⁶⁵ Article 9 of Antimonopoly Law of China.

⁶⁶ 'Provisions of the State Council on Thresholds for Prior Notification of Concentrations of Undertakings', No. 529 Decree of the State Council of the People's Republic of China, adopted at the 20th Executive Meeting of the State Council on August 1, 2008 and is effective as of the date of promulgation.

⁶⁷ Guidelines on the Definition of Relevant Market, issued by the Antimonopoly Commission of the State Council on May 24, 2009.

The enforcement regime adopted by the Antimonopoly Law is an administrative one, with the possibility of a judicial appeal to the Higher People's Court.⁶⁸ To date no such appeals have been made. The Antimonopoly Law also provides for private rights of action whereby aggrieved citizens or businesses can seek damages or injunctive relief in relation to anti-competitive injury. In the five years since the promulgation of the law, several cases have been filed, but none has been successful in obtaining judgments against defendants for various reasons, a major hurdle being the standard of proof required to prove dominance or agreement, especially where Chinese civil procedure rules do not provide for disclosure of documents or other evidence from the opposing party.⁶⁹ The prospect of private litigation being a substantial source of enforcement activity seems to be unrealistic, at least in the foreseeable future.

11. CONCLUSION

This chapter has attempted to sketch the political-economy factors that make China's situation unique amongst Asian nations. China's huge domestic market, impressive economic reform program over the last 30 years and its transformation into an economic superpower on the international stage set China apart from its Asian neighbors. Despite China's undoubted economic successes, there are a number of structural impediments to China's successful transition to a higher-income economy – policy ambiguity, structural barriers to competition in the domestic market and the development of a more market-oriented economy represent only some of the challenges.

China has made significant strides towards creating a functioning legal system and adopting a more market-focused economy but the present refusal to countenance political reform to weaken the power of the CCP and the Party/state's symbiotic relationship with major domestic industries means that furthering and deepening economic reform along market lines will be particularly problematic.

⁶⁸ Article 53 of Antimonopoly Law of China.

⁶⁹ Zhao, Yanan and Li, Jiabao (2012), 'Top Court Focuses on Monopolies', *China Daily*, May 9. Retrieved from http://www.chinadaily.com.cn/china/2012-05/09/content_15242426.htm (last accessed 2 February 2013); Chan, Henry L.T. (2012), 'Civil Litigation under China's Anti-Monopoly Law', March 28. *Newsletter of McDermott Will & Emery*. Retrieved from <http://www.natlawreview.com/article/civil-litigation-under-china-s-anti-monopoly-law> (last accessed 2 February 2013).

China has adopted a competition law, but its commitment to a comprehensive pro-competition policy remains uncertain. China's enforcement regime contains several substantial deficiencies, and there appears to be a limited desire to tackle many of the anti-competitive impediments that exist in the Chinese economy. The factors explained in this chapter in relation to China's political and ideological commitment to a fully marketized economy make it difficult to be sure that China has a clear pro-competitive agenda. At present, China's competition policy does not seem to be aligned with the norms considered orthodox by the OECD, the World Bank or the International Competition Network. To date, China has chosen not to join the ICN or to officially participate in its deliberations, which seek to develop internationally accepted standards and enforcement priorities. This is unsurprising given the particular domestic circumstances of the Chinese political-economy system.

Unless and until China undertakes substantial political reform and commits to enhancing the role of the private sector in the domestic economy, including the full privatization of major state industries and their restructuring to enhance competition within those sectors, it is unlikely that China's full economic potential will be realized. The benefits of a more competitive economy – greater efficiency, innovation and consumer choice – are unlikely to be achieved in the absence of further substantial structural reform.

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