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The Antimonopoly Law and Beyond**

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# **China's Competition Policy Reforms: The Antimonopoly Law and Beyond**

Bruce M. Owen, Su Sun and Wentong Zheng\*

## **Abstract**

More than twelve years have elapsed since China began its efforts to enact a comprehensive antitrust law. Today, drafts of the law are still being debated, with no real signs of enactment. Such a protracted legislative process is highly unusual in China, and can only be explained by the controversy the draft law generates. After a brief review of China's current competition policy and the new draft antitrust law, this paper discusses the fundamental issues in China's economy that give rise to the challenges facing China's antitrust policymakers in enacting the new antitrust law. These issues include the role of state-owned enterprises, perceived excessive competition in China's economy, mergers and acquisitions by foreign companies, the treatment of administrative monopolies, and the enforcement of the antitrust law. While those controversies create significant policy issues for China, they do not constitute valid objections to the enactment of the new antitrust law. Meanwhile, it will be important for China to recognize that the new antitrust law alone will not be sufficient to fully realize its goal of promoting competition in its economy; other reforms will be necessary as well. China will be better off by moving swiftly to enact the new antitrust law, while keeping the momentum to engage in those other reforms.

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## I. INTRODUCTION

The Supreme Court of the United States once characterized antitrust law as the “Magna Carta” of free enterprise.<sup>1</sup> By promoting free and fair competition, antitrust law has supported market economies in the West in several important ways. First, it promotes economic efficiency, by making sure that goods are made by the firm which can produce them at lowest cost, and that goods flow to those consumers who value the goods the most. Second, antitrust law seeks to protect customers, both individuals and businesses, against the creation and exercise of undue market power. Third, antitrust law is an aspect of broader competition policy, which seeks to promote private competitive markets as alternatives to state-owned monopolies or regulated monopolies.

For countries that had been operating under centrally planned economic systems, however, “competition” is an unfamiliar concept. In recent years, as more and more centrally-planned economies are making their transitions to market-oriented economies, attention is being paid to the importance of competition as an institution. As a result, those transitional economies are increasingly looking to the antitrust laws developed in Western countries for guidance in designing their competition policies.

As the largest and fastest-growing transitional economy in the world, China currently has many laws dealing with various aspects of antitrust issues. China’s current antitrust rules, however, are fragmented, and lack many essential components of what would be considered a complete set of antitrust policy tools. To address the shortcomings of its current antitrust rules, China in 1994 began its efforts to enact a comprehensive antitrust law, or the so-called Antimonopoly Law (“AML”). In recent years, numerous drafts of the AML have been circulated and commented on, and the draft AML has been placed on the legislative agenda of the National People’s Congress a number of times.

Yet today, more than twelve years later, drafts of the AML are still being debated, without any real signs of enactment. Such a protracted legislative process is highly unusual in China, where the law-making process is controlled largely by the government. In China, important legislation usually can be marshaled through the legislative process very quickly, once

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<sup>1</sup> United States v. Topco Assoc., 405 U.S. 596, 610 (1972).

the leadership reaches consensus on the legislation. The last time China had a prolonged legislative process for an important law was its drafting and enactment of the Securities Law in the 1990s. In the case of the Securities Law, it took China six years to complete the legislative process, and Chinese policymakers characterized the difficulties encountered in enacting the law as “unprecedented.”<sup>2</sup> In enacting the AML, China already spent twice amount the time it spent on enacting the Securities Law, and yet still sees no signs of enactment. Judging from China’s experience with the enactment of the Securities Law, the difficulties behind the AML can only be more substantial.

Many in the West may wonder what those difficulties are. Why is it taking China so long to reach a consensus on an antitrust law, a law considered so important in a market economy? This article aims to answer that question. As we will demonstrate below, the answer to that question lies not with the technical aspects of the antitrust issues commonly found in a mature market economy, but with the fundamental issues arising from China’s historic transformation from a centrally-planned economy to a market economy. Those issues include the role of the state-owned enterprises, perceived excessive competition, mergers and acquisitions by foreign companies, the treatment of administrative monopolies, and antitrust enforcement. Apparently it is those controversial issues—not the debates on the technicalities of the draft law—that are holding back the legislative process for the AML. However, as we will see in the discussions below, the resolution of those controversial issues needs not precede the adoption of the new antitrust law.

Meanwhile, due to China’s unique political, economic, and legal backgrounds, its goal of promoting competition will not be fully realized by using the AML alone. Other reforms, such as reforms of the state-owned enterprises and reforms aimed at limiting the role of the government in the economy, will also be important parts of China’s competition policy reforms.

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<sup>2</sup> See, e.g., *Drafters of the Securities Law Speak on the “Blue Skies” Law*, SECURITIES DAILY, <http://business.sohu.com/2004/07/01/72/article220797217.shtml> (last visited March 28, 2007). China began drafting the Securities Law in 1992, two years after China’s first stock market opened in Shenzhen. During the following six years, numerous scholars and industry experts participated in the drafting process, and a total of several dozens of drafts were circulated internally. Intense debates focused on the relationship between China’s stock markets and China’s “socialist market economy,” the treatment of state-owned capital in the securities market, and the scope of securities regulations. It was not until 1998 that China settled on a final draft and enacted the Securities Law.

China should take an incremental approach and move swiftly to enact the AML, while keeping the momentum to actively engage in those related reforms.

This article is organized as follows. Section II presents a brief overview of China's current antitrust rules as well as a summary of the major components of the proposed AML. Section III discusses China's economic, regulatory, and legal contexts. Section IV focuses on the fundamental issues in China's economy that give rise to the challenges facing China's antitrust policymakers in enacting the AML. Section V concludes.

## **II. CHINA'S CURRENT AND PROPOSED ANTITRUST LAWS**

### **A. China's Current Antitrust Rules**

China's current competition policy is found in a number of specific laws and administrative rules. The most comprehensive of these is the Anti-Unfair Competition Law, promulgated in 1993.<sup>3</sup> The Anti-Unfair Competition Law contains some provisions that are usually found in antitrust law, such as prohibition of tie-in sales in Article 12 and prohibition of price fixing and bid rigging in Article 15. But the Anti-Unfair Competition Law also addresses many other issues, including bribery, deceptive advertising, coercive sales, and appropriation of business secrets. To a large extent, the Anti-Unfair Competition Law is more like a consumer protection law than an antitrust law.

Antitrust provisions are also scattered in more specialized laws. For example, the Commercial Banking Law passed in 1995 includes an article that prohibits banks from engaging in "improper competition."<sup>4</sup> The Price Law passed in 1997 has provisions against "improper pricing behaviors" including price fixing, predatory pricing and price discrimination, to name a

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<sup>3</sup> For the Chinese text of this law, see <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300027909.html> (last visited March 28, 2007). For the English text of this law, see <http://apecweb.apeccp.org.tw/doc/China/Competition/cncom2.html> (last visited March 28, 2007).

<sup>4</sup> See Article 9 of the Commercial Banking Law, <http://www.pbc.gov.cn/rhwg/19981802.htm> (last visited March 28, 2007).

few.<sup>5</sup> The Procurement and Bidding Law passed in 1999 prohibits bid rigging.<sup>6</sup> Most recently, China has revised the 2001 Patent Law for the third time and provisions against patent abuse that excludes or restricts competition have been added under Chapter Six on compulsory licensing.<sup>7</sup>

More often, competition issues are directly addressed by the issuance of administrative rules and regulations. Sometimes administrative rules are used to address new issues that require a quick response. Other times they provide more detailed interpretations of previously promulgated laws. The following are some important administrative rules regarding competition issues:

- In 1993, the State Administration of Industry and Commerce (“SAIC”) issued Rules on Prohibiting Public Utility Companies from Restricting Competition,<sup>8</sup> which was meant to reign in widespread abuse of monopoly positions by public utility companies.
- In April 2001, the State Council, China’s cabinet, issued the Rules on Prohibiting Regional Blockades in Market Economic Activities.<sup>9</sup> This regulation deals with a major form of administrative monopoly where local government agencies deliberately discriminate against products and services provided by other localities and oftentimes simply deny them access to the local market.

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<sup>5</sup> See Article 14 of the Price Law, [http://www.chinacourt.org/flwk/show1.php?file\\_id=29493&str1=%BC%DB%B8%F1%B7%A8](http://www.chinacourt.org/flwk/show1.php?file_id=29493&str1=%BC%DB%B8%F1%B7%A8) (last visited March 28, 2007).

<sup>6</sup> See Article 32 of the Procurement and Bidding Law, <http://www.cin.gov.cn/law/main/1999092101.htm> (last visited March 28, 2007).

<sup>7</sup> For China’s current Patent Law, see [http://www.sipo.gov.cn/sipo/flfg/zlf/200608/t20060831\\_109702.htm](http://www.sipo.gov.cn/sipo/flfg/zlf/200608/t20060831_109702.htm) (last visited March 28, 2007). The third revision is now under review at the State Council Legislative Affairs Office.

<sup>8</sup> See Rules on Prohibiting Public Utility Companies from Restricting Competition, <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300027927.html> (last visited March 28, 2007).

<sup>9</sup> See Rules on Prohibiting Regional Blockades in Market Economic Activities, <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300027985.html> (last visited March 28, 2007).

- Another regulation is the Provisional Rules on Prevention of Monopoly Pricing issued by the State Development and Reform Commission in 2003.<sup>10</sup> The Rules prohibit the abuse of “market dominance” and infer dominance through “market share in the relevant market, substitutability of relevant goods, and ease of new entry.” The Rules also prohibit price coordination, supply restriction, bid rigging, vertical price restraint, below-cost-pricing and price discrimination as abuses of dominance. Finally, the Rules prohibit government agencies from “illegally intervening” in market price determinations.

These regulations generally do not have a clear and credible enforcement mechanism, and their implementation has been largely ineffective.

To address rising concerns about foreign acquisitions of Chinese companies, six government agencies jointly issued the Rules on Acquisitions of Domestic Enterprises by Foreign Investors (“M&A Rules”) in 2006.<sup>11</sup> Article 51 of the M&A Rules lays out the four conditions under which pre-merger notification to China’s Ministry of Commerce (“MOFCOM”) and the SAIC is required. The four conditions include thresholds that relate to annual sales, the number of enterprises the foreign party has previously acquired in related industries and the merging parties’ market shares. The M&A Rules, however, suffer from a number of deficiencies.<sup>12</sup>

To aid the implementation of the M&A Rules, in March, 2007, MOFCOM posted on its web site the Antitrust Filing Guidelines.<sup>13</sup> The Guidelines in most part resemble similar

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<sup>10</sup> See Provisional Rules on Prevention of Monopoly Pricing, <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200503/20050300028008.html> (last visited March 28, 2007).

<sup>11</sup> See Rules on Acquisition of Domestic Enterprises by Foreign Investors, <http://www.xasmw.com/rule/content.asp?id=254> (last visited March 28, 2007). A Provisional Rule that had essentially the same content on antitrust review was issued in 2003. See Provisional Rules on Acquisition of Domestic Enterprises by Foreign Investors, <http://tfs.mofcom.gov.cn/aarticle/date/i/s/200509/20050900366385.html> (last visited March 28, 2007).

<sup>12</sup> For a brief discussion of some of the problems in the M&A Rules, see Su Sun, *Antitrust Review in China’s New Merger Regulation*, ECONOMISTS INK, Winter 2007.

<sup>13</sup> See Antitrust Filing Guidelines, <http://tfs.mofcom.gov.cn/aarticle/bb/200703/20070304440611.html> (last visited March 28, 2007).

guidelines and procedures adopted by other jurisdictions and are helpful for parties who wish to understand when and what to file. However, the filing requirements in the Guidelines seem to be overly burdensome to merging parties.<sup>14</sup>

## **B. China's Proposed Antimonopoly Law**

As can be seen from the discussion above, China's current laws and regulations dealing with antitrust-related issues are fragmented. Oftentimes, provisions of those laws and regulations are vague and repetitive, and the effectiveness of antitrust enforcement is greatly reduced by the existence of multiple enforcement agencies authorized by different laws. In part as a response to the perceived shortcomings of China's current antitrust rules, China has been trying to enact a comprehensive antitrust law, the Antimonopoly Law ("AML"), to consolidate the antitrust provisions into a uniform set of rules.

The drafting of the AML started in 1994, soon after the 1993 Anti-Unfair Competition Law was promulgated. Two government agencies, the State Economic and Trade Commission ("SETC") and the SAIC were in charge of the drafting. The SETC was abolished in a government restructuring in 2003 and MOFCOM has since taken its place as the main drafter of the AML.<sup>15</sup> By 2002, a draft had taken shape and soon began circulating in small circles for comment. The next couple years saw a number of revisions. In March 2004, a draft was submitted to the State Council Legislative Affairs Office for review. After several more revisions, a draft was submitted to the National People's Congress ("NPC") Standing Committee for review in June 2006. So far, the NPC Standing Committee has done the first reading<sup>16</sup> and more readings are expected later this year.

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<sup>14</sup> The ABA Antitrust Section and International Section have made detailed comments on the Guidelines. *See* [http://meetings.abanet.org/webupload/commupload/IC860000/newsletterpubs/abaprcforeignm&a\\_filingguidelinescommentsfinalcombo.pdf](http://meetings.abanet.org/webupload/commupload/IC860000/newsletterpubs/abaprcforeignm&a_filingguidelinescommentsfinalcombo.pdf) (last visited March 28, 2007).

<sup>15</sup> *See* Ming Shang, *China's Competition Policy and Legislation in Development*, April 22, 2005, <http://tfs.mofcom.gov.cn/aarticle/dzgg/f/200504/20050400081489.html> (last visited March 28, 2007).

<sup>16</sup> The NPC Standing Committee members have made a number of comments on this draft during their first review. *See*



The AML drafting process, though not public and transparent, did involve a small circle of experts and practitioners, both from China and from other parts of the world. Seminars and conferences were held in China and in other jurisdictions including the U.S. and Europe. Foreign enforcement officials, scholars and practicing attorneys frequently spoke at seminars and conferences and commented on the drafts. The ABA alone made several rounds of comments on different drafts of the AML.<sup>17</sup> The various revisions of the draft AML appear to have incorporated comments made by various parties. Through these many rounds of comments and revisions, the draft AML has been improved substantially, and Chinese government officials also seem to have gained more knowledge and better understanding about competition issues generally.

The current draft of the AML, released in June 2006, consists of eight chapters.<sup>18</sup> Chapter one describes the general principles of the AML, including objectives, applicability and coverage. Chapter Two describes which monopoly agreements are prohibited and which are exempted. Chapter Three prohibits the abuse of market dominant position. It provides methods to infer dominance and describes abusive behaviors. Chapter Four provides for agency review of proposed mergers, acquisitions, and joint ventures, specifying the notification thresholds and exemptions, required documents, and review procedures. Chapter Five is devoted to prohibitions of anticompetitive activity by government agencies. This chapter incorporates some of the prior administrative rules and focuses in particular on various forms of local protectionism. Chapter

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<http://www.npc.gov.cn/zgrdw/common/zw.jsp?label=WXZLK&id=350218&pdmc=110106> (last visited March 28, 2007).

<sup>17</sup> See *Joint Submission of the American Bar Association's Sections of Antitrust Law and International Law and Practice on the Proposed Anti-Monopoly Law of the People's Republic of China*, July 15, 2003, <http://www.abanet.org/antitrust/at-comments/2003/07-03/jointsubmission.pdf> (last visited March 28, 2007); *Joint Submission of the American Bar Association's Sections of Antitrust Law, Intellectual Property Law and International Law and Practice on the Proposed Anti-Monopoly Law of the People's Republic of China*, May, 2005, <http://www.abanet.org/antitrust/comments/2005/05-05/commentsprc2005woapp.pdf>; and the July 2005 *Supplement*, <http://www.abanet.org/antitrust/comments/2005/07-05/abaprcat2005-2final.pdf> (last visited March 28, 2007).

<sup>18</sup> We have made detailed comments on a similar earlier draft of AML previously. See Bruce Owen, Su Sun & Wentong Zheng, *Antitrust in China: The Problem of Incentive Compatibility*, 1 JOURNAL OF COMPETITION LAW AND ECONOMICS 123-48 (2005). We are also in agreement with much of the commentaries on the draft law undertaken by the American Bar Association.

Six proposes two enforcement authorities: an Antimonopoly Enforcement Agency that issues guidelines, reviews merger notifications, and investigates suspected anticompetitive behavior in the marketplace, and an Antimonopoly Commission at the cabinet level that conducts policy research, oversees the work of the Antimonopoly Enforcement Agency, and coordinates work among other regulatory agencies and on major cases. Chapter Seven describes liability and penalties for violating the AML. This chapter also provides reduced penalties for voluntarily assisting the enforcement authority's investigation in monopolistic agreement cases. The last Chapter states that trade associations are subject to the AML, agricultural activities are generally exempted, and an intellectual property right is not to be regarded as a per se unlawful monopoly but the abuse of such rights to restrict competition is subject to the AML.

### **III. CHINA'S ECONOMIC, REGULATORY, AND LEGAL CONTEXTS**

Before we turn to the fundamental issues giving rise to the challenges facing China's antitrust policymakers in enacting the AML, a brief discussion of China's economic, regulatory, and legal contexts in which those issues arise is in order.<sup>19</sup> The formulation of competition policy in a country does not happen in vacuum; instead, it is closely tied to the economic, political, and legal contexts of the country. This is particularly so in China, as the AML is being drafted against the backdrop of China's historic transformation from a centrally planned economy to a market economy.

#### **A. China's Economic Context**

When economic reforms started in 1978, China's economy was dominated by the state, and private enterprises played only a negligible role. With factories essentially being units of the state productive machinery, there was little role for competition. At times the government promoted "labor competition" among factories or production units in an effort to indoctrinate the populace with communist ideology, but competition motivated by profits was condemned as a symptom of corrupt capitalist systems.

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<sup>19</sup> A somewhat more detailed but less updated discussion can be found in Owen, Sun & Zheng, *id.*

In 1992, China significantly accelerated its pace of economic reform after the inspection tour of the southern regions by its paramount leader, Deng Xiaoping. In the fall of 1992, the 14<sup>th</sup> Congress of the Chinese Communist Party officially declared that the central goal of China's economic reform is to establish a "socialist market economy." In the following decade, far-reaching reform measures were undertaken to overhaul China's SOE sector, taxation, banking, and foreign currency systems. Private enterprises grew rapidly, and large amounts of foreign investment flowed in.

Now, nearly thirty years after the start of economic reform in 1978, China's economic structures have undergone dramatic changes. One of the most significant changes is the decline of the importance of the SOEs and other state-controlled enterprises and the emergence of the country's private sector. According to a national census on the composition of China's economic entities completed in 2003, among three million enterprises that existed on December 31, 2001, SOEs and enterprises with a controlling share held by the State accounted for 56.2 percent of capital invested and 49.6 percent of annual revenue.<sup>20</sup> Anecdotal evidence indicates that since 2001, further economic reform has lowered the share of SOEs in China's economy to about one-third.<sup>21</sup> This is a remarkable contrast with 1978, when all enterprises were state-owned.

Despite the increasingly important role of the private sector in China's economy, private enterprises in China are mostly small in size. In fact, 99 percent of the enterprises in China are small or medium size, with most of them funded by private investment.<sup>22</sup> According to government statistics, by the end of 2003, China's small and medium sized enterprises consisted of 55.6 percent of the country's GDP, 74.7 percent of industrial production value added, 58.9 percent of retail sales, 46.2 percent of tax revenues and 62.3 percent of exports.<sup>23</sup> Nevertheless,

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<sup>20</sup> See State Bureau of Statistics, *Report on the Second National Census on Basic Economic Entities*, January 17, 2003, [http://www.stats.gov.cn/tjgb/jbdwpcgb/qgjbdwpcgb/t20030117\\_61467.htm](http://www.stats.gov.cn/tjgb/jbdwpcgb/qgjbdwpcgb/t20030117_61467.htm) (last visited March 28, 2007).

<sup>21</sup> See Yingqiu Liu, *The General Trends and Problems of China's Private Economic Sectors*, JOURNAL OF CHINESE ACADEMY OF SOCIAL SCIENCES, June, 2006, <http://www.cpes.cass.cn/viewInfo.asp?id=351> (last visited March 28, 2007).

<sup>22</sup> *See id.*

<sup>23</sup> See *Non-public Economy Blooming in China*, PEOPLE'S DAILY ONLINE, [http://english.people.com.cn/200407/28/eng20040728\\_151132.html](http://english.people.com.cn/200407/28/eng20040728_151132.html) (last updated July 28, 2004).

SOEs remain the largest enterprises in China, largely concentrated in important industries such as electricity, petroleum, railroads, aviation, telecommunications, and banking.

## **B. China's Regulatory Context**

At the same time that China's economic structure is undergoing fundamental changes, the regulatory structure of China is also being transformed to one more compatible with the requirements of a market economy. Before China's economic reforms, China's economic system was modelled after that of the former Soviet Union. For almost every major industry, a corresponding ministry existed within the government to control, manage, and coordinate the production in that industry. There was no need for government "regulation," as the word is used in the Western countries; the industries were already directly owned and managed by the state. It is when China began to reduce central direction of its economy after the commencement of its economic reforms that China faced the question of what industries to regulate, and how.

Realizing the problems associated with undue government intervention in the economy, the Chinese government has made a strategic choice to retreat from such "non-essential" industries as machinery, electronics, chemicals, and textiles. Those industries do not tend to create conditions of "natural monopoly," do not impinge upon national security and public goods, and usually are not regulated in market economies. In several rounds of government restructuring since 1978, China has gradually dissolved the government ministries overseeing those industries and has replaced them with so-called "chambers of commerce" or "industrial associations" representing and coordinating various interests in those industries.<sup>24</sup>

In industries considered key to China's national security and economic development, such as electricity, petroleum, banking, insurance, railroads, and aviation, the Chinese government has chosen to retain or strengthen its dominant roles. In those key industries, the dominant firms remain mostly state-owned. As a result, the government plays two roles: it is both the owner of the major players and the referee, i.e., the regulator. This double-role is now seen as detrimental to the development of China's market economy. Among the steps that have

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<sup>24</sup> Leiming Wang, Lutao Shen & Sheng Zou, *Five Comprehensive Government Restructures 1982-2003*, Xinhua News Agency (Mar. 6, 2003), <http://www.people.com.cn/GB/shizheng/252/10434/10435/20030306/937651.html> (last visited March 28, 2007).

been taken to address this problem, the foremost has been to establish separate regulatory agencies for the key industries and to strip the SOEs in those industries of the regulatory power bestowed upon them in the planned-economy era. In so doing, the Chinese government hopes to separate the government's functions as a player and as a regulator. For example, between 1998 and 2004, China established the Insurance Regulatory Commission, the Banking Regulatory Commission, and the Electric Power Regulatory Commission, which are charged with overseeing the insurance, banking, and electricity industries, respectively. The largest enterprises in those three industries, all state-owned, along with enterprises of other ownership forms that may emerge in the future, are subject to regulation by those new agencies. Furthermore, to strengthen government control over SOEs in key industries and to stop the rapid loss of state assets, China in 2003 established the State Assets Management Commission to oversee the operation of state-owned assets by SOEs.

### **C. China's Legal Context**

As China's economy is being transformed from a centrally-planned one to a market-oriented one, China's legal system is undergoing changes accordingly. The focus of China's legislative in most of the past thirty years has been on economic laws, most notably contract law, bankruptcy law, corporate law, foreign investment law, securities law, and the like. The AML is another example of China's efforts to guide economic behaviors by reliance on well-defined rules of economic law.

Although China has enacted many much-needed economic laws, the enforcement of such laws oftentimes is less than satisfactory. Various government agencies charged with implementing the government's regulatory policies have the authority to enforce economic statutes and regulations in their respective areas. Similarly, enforcement of the AML will be carried out by the Antimonopoly Enforcement Agency, an administrative agency. However, enforcement by administrative agencies in China in many cases is not transparent or predictable. First, the rule making processes at the administrative agencies are not subject to uniform standards, as China has yet to have a law specifying the procedures administrative agencies are required to follow when making regulations.<sup>25</sup> Second, the actions by administrative agencies

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<sup>25</sup> However, efforts to adopt an administrative procedure law have been underway since 2002.

are now subject to judicial review by the People's Courts, thanks to China's enactment of the Administrative Litigation Law in 1989. The quality of the judicial review provided by the Administrative Litigation Law, however, is quite limited. Among the problems with judicial review of administrative actions most cited by commentators are the narrow scope and convoluted procedures of the review, and the persistent bias in favor of government agencies.<sup>26</sup>

The People's Courts have problems of their own keeping up with the demands placed on them by China's burgeoning economy. Although the Chinese Constitution states that the People's Courts shall exercise their judicial power independently, in practice there is no institutional guarantee of judicial independence. Further complicating the matter is the poor quality of the judges. Until recently, a large portion of Chinese judges had been selected from retired military officers. Those judges generally have no legal training or experience, and are ill-equipped to handle complicated cases. Although in recent years the overall quality of Chinese judges has been improving, it remains in doubt whether Chinese judges, most of whom are not trained in economics, will be competent to handle antitrust cases to be brought under the proposed AML. Finally, the lack of *stare decisis* in China will also reduce the effectiveness of the judicial interpretation of the AML. China's civil law tradition leaves no place for "judge-made" law. Although the Supreme People's Court has the power to interpret laws as they arise from legal cases, its legal interpretation cannot be cited by other courts and does not serve the function of precedents as it would in common law countries. This means that potential litigants cannot base expectations of what courts will do under a particular factual circumstance on prior decisions under similar circumstances. Indeed, there is no mechanism for doing so—judges in China generally do not write detailed opinions that are published. Expectations about the behavior of courts are thus difficult to form.

#### **IV. FUNDAMENTAL ISSUES IN CHINA'S COMPETITION POLICY REFORMS**

As we will see below, the most significant competition policy issues in China are inextricably tied to the fundamental issues arising from China's historic transformation from a

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<sup>26</sup> For more details on China's judicial review of administrative actions, see Chris X. Lin, *A Quiet Revolution: An Overview of China's Judicial Reform*, 4 ASIAN-PACIFIC LAW & POLICY JOURNAL 9 (June 2003).

centrally-planned economy to a market economy. It is those underlying issues, such as the role of state-owned enterprises, perceived excessive competition in China's economy, mergers and acquisitions by foreign companies, the treatment of administrative monopolies, and the enforcement of the antitrust law, that pose the most significant challenges to China's antitrust policymakers in enacting the AML. It is also those fundamental issues—and China's responses to them—that will define the parameters of China's future competition policies.

#### **A. The Role of State-Owned Enterprises**

The primary goal of the antitrust law is to encourage competition. It is the lack of competition in China's economy in general and in the state-owned sectors in particular that prompted China to start its efforts to enact a comprehensive antitrust law in the first place. However, as China has also sought to strengthen the role of SOEs in certain key sectors in recent years, how to bring the SOEs in those sectors into the framework to be established by the new antitrust law seems to have posed a challenge to China's antitrust policymakers.

As noted above, when China first embarked on economic reforms in 1978, almost all of the economic entities in China's economy were SOEs. By the early 1990s, despite the significant progress China had made in other aspects of the reforms, SOEs still accounted for an overwhelming percentage of China's economy. In almost every sector, market entry was tightly controlled by the government and consumers were left with no meaningful choices but to patronize state-approved SOEs, leaving those SOEs with what many consider undeservedly high profits. Complaints about the abuse by SOEs of their market power abounded. It is perhaps not a coincidence that soon after China decided to accelerate the market-oriented reforms in 1992, in 1994 China started the legislating process for its first comprehensive antitrust law.

Since the early 1990s, when China was beginning its efforts to enact a comprehensive antitrust law, it also implemented various *ad hoc* measures aimed at introducing more competition into the stagnant sectors controlled by SOEs. The government, as owner of the SOEs, broke up many SOEs into multiple entities intended to compete with each other. The restructuring of China's telecommunication industry serves as an example. Before 1994, China's telecommunication industry was monopolized by China Telecom. In 1994, the Chinese government formed China Unicom, a telecommunication provider that was chartered to compete with China Telecom in mobile phone and pager services. In 1999, China Telecom was broken

up into two separate entities: China Mobile that provided mobile phone services and a new China Telecom that provided landline services. In the same year, the Chinese government issued landline licenses to several newly formed companies to compete with the newly formed China Telecom. In the next round of restructuring in 2002, China Telecom was further divided and integrated with other telecommunication companies to form two “competing” landline providers: China Netcom based in Northern China and China Telecom based in Southern China.

Although those *ad hoc* competition-enhancing measures were successful in breaking up de facto monopolies, the competition they introduced is often very limited. The telecommunications industry again is an example. The two landline providers created by the government in 2002, China Netcom and China Telecom, are based in mutually exclusive territories. And in February 2007, the two companies signed an agreement not to compete for landline customers in the other’s territory.<sup>27</sup>

While China has taken action to reduce the role of SOEs in most economic sectors, in certain sectors deemed to be of strategic importance to China’s economy, the control by SOEs is still very significant, and in many cases has even increased. As of 2006, eighty percent of the assets controlled by SOEs were concentrated in eight “strategic sectors” such as petroleum and electricity generation. SOEs accounted for almost all of the production of petroleum, natural gas, and ethylene, provided all of the basic telecommunication services, generated approximately fifty-five percent of electricity, and flew about eighty-two percent of passengers and cargo through the country’s air transportation system.<sup>28</sup>

Indeed, at the same time that China is drafting the new antitrust law, China has made it a stated goal to maintain the dominant role of SOEs in certain sectors. On December 18, 2006, the State Assets Management Commission announced that seven “strategic” industries, including national defense, electrical power generation and grids, petroleum and petro-chemicals, telecommunications, coal, civil aviation, and waterway transportation, will be controlled by

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27 See *China Telecom and China Netcom Reaching Agreement Not to Compete for Landline Customers*, BEIJING MORNING DAILY, February 27, 2007, <http://tech.sina.com.cn/t/2007-02-27/01011391578.shtml> (last visited March 28, 2007).

28 See *Breaking Up Monopolies Key to the Restructuring of SOEs*, LIAOWANG, December 13, 2006, [http://news.xinhuanet.com/politics/2006-12/13/content\\_5480196.htm](http://news.xinhuanet.com/politics/2006-12/13/content_5480196.htm) (last visited March 28, 2007).



SOEs.<sup>29</sup> The government will aim to increase the state capital infusion in those seven industries, and will seek to maintain “absolute control” of them by SOEs.<sup>30</sup> The State Assets Management Commission also announced that it is China’s goal to foster thirty to fifty large “internationally competitive” SOEs in those industries by the year of 2010.<sup>31</sup> In other important industries (but less important than the seven strategic industries), including automobile, steel, and technology, the government will seek to maintain “somewhat strong influence” by state capital on the leading companies.<sup>32</sup>

So how does China’s desire to promote SOEs in strategic and other important sectors fit into its overall antitrust scheme? In particular, will China’s professed goal of forming conglomerate SOEs in certain strategic sectors run afoul of the antitrust law, which, according to the latest draft, will outlaw the abuse of market power by monopolies, regardless of ownership status and sectors? How to reconcile these two seemingly contradictory goals—encouraging competition on one hand and maintaining control by SOEs on the other—is a challenge to China’s policymakers and is likely to have contributed to the prolonged debate on the draft antitrust law.

But in truth it is not at all clear whether China needs to maintain strong controls by SOEs in what it considers to be strategic or important economic sectors. At least one prominent economist has pointed out that the purpose of such state ownership in those sectors can be equally accomplished by strict government regulations and strict law enforcement.<sup>33</sup> But even if China has reasons to believe that state ownership is necessary, that is not necessarily incompatible with encouraging competition. After all, for most industries, China’s goal is only

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29 See State Assets Commission, *Guidance on the Restructuring of State Capital and State Owned Enterprises*, December 18, 2006, <http://finance.sina.com.cn/g/20061218/11133173443.shtml> (last visited March 28, 2007); see also *SOEs to Maintain Overwhelming Control in Seven Sectors*, XINHUA NET, December 19, 2006, [http://news.xinhuanet.com/fortune/2006-12/19/content\\_5504591.htm](http://news.xinhuanet.com/fortune/2006-12/19/content_5504591.htm) (last visited March 28, 2007).

30 See *id.*

31 See *id.*

32 See *id.*

33 See Lawrence Lau, *The Dual Dilemmas of SOE Reforms*, CAIJING MAGAZINE, December 4, 2005, <http://www.e-economic.com/info/4495-1.htm> (last visited March 28, 2007).

to maintain state ownership of the companies, but not to confer monopoly status on any particular company or group of companies. It is entirely possible to have state ownership of the companies in one sector, and yet to have that state ownership distributed in dozens, or even hundreds of SOEs competing against each other and against private firms.<sup>34</sup>

In some sense, this approach—maintaining state ownership yet allowing more competition—is the approach China has taken already with respect to certain sectors. One example is the restructuring of the telecommunications industry, i.e., breaking up an existing SOE monopoly into multiple SOEs and thus introducing more competition. In addition, China has also taken steps to allow private enterprises to enter sectors that were previously off limits to them. On February 25, 2005, China’s State Council promulgated the *Opinions on Encouraging, Supporting, and Guiding the Development of Private Capital and Other Non State-Owned Capital* (“*Opinions*”).<sup>35</sup> The *Opinions* specifically allowed private capital to enter sectors such as electricity, telecommunications, railroad, civil aviation, petroleum, public utilities, financial services, social services, and national defence. More importantly, the *Opinions* allowed market entry by private enterprises as long as such entry is not expressly prohibited by the law, and allowed market entry by domestic private enterprises if foreign investors are allowed such entry.

China’s efforts to introduce more competition in sectors previously monopolized by SOEs and to open up more sectors to private enterprises have yielded some successes. In the civil aviation industry, for example, four private airlines have come into operation since 2005.<sup>36</sup> In the telecommunications industry, one private company has been allowed to provide call center services.<sup>37</sup>

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<sup>34</sup> However, some argue that SOEs may have stronger incentives to act anticompetitively. See David E.M. Sappington & J. Gregory Sidak, *Competition Law for State-Owned Enterprises*, 71 ANTITRUST LAW JOURNAL 479-523 (2003). For SOEs to compete efficiently, competition must be an explicit goal of the government as equity owner in the firms.

<sup>35</sup> State Council Doc. No. [2005]3, February 25, 2005, available at <http://www.china.org.cn/chinese/PI-c/795128.htm> (last visited March 12, 2007).

<sup>36</sup> The four private airlines are Aokai Airlines, based in Tianjin; Chunqiu Airlines, based in Shanghai; Yinglian Airlines, based in Chengdu, Sichuan Province; and Dongxing Airlines, based in Wuhan, Hubei Province.

<sup>37</sup> The private company that was allowed to provide call center services was *Dongxing Guolu*.

These successes notwithstanding, China still has a long way to go in terms of promoting competition in the sectors controlled by SOEs. Although some of those sectors have seen an increase in the level of competition, the competition thus introduced is very often very limited and the consumers are still all too often left at the whim of the SOEs. Subjecting the SOEs in most sectors—particularly in those sectors the government has already allowed foreign and private investors to enter—to the new antitrust law and thus putting those SOEs on the same footing with other companies will best serve China’s goal of encouraging competition. And as analyzed above, this goal of encouraging competition is not necessarily incompatible with China’s goal of maintaining a strong presence by SOEs in certain sectors, provided that China structure the SOEs in ways that ensure both state ownership and competition.

Meanwhile, in the “strategic” sectors where China has vowed to promote the formation of conglomerate SOEs that can compete internationally, the AML does not necessarily pose a hurdle either. Many of those “strategic” sectors, such as electricity and telecommunications, are sectors where what economists call “natural monopoly” may arise and China could, as many developed countries do, opt for direct regulation of those sectors and grant some sort of antitrust immunity to those sectors.<sup>38</sup> Furthermore, even if China were to decide to grant some sort of exclusive status—and thus market power—to the key SOEs in the strategic sectors, such a decision needs not be a license for the SOEs to *abuse* the market power thus granted. In any event, China’s alleged need to have absolute control by SOEs in certain strategic sectors does not provide an excuse for not enacting the antitrust law.

Finally, it is worth noting that although the new antitrust law could play an important role in opening up many of the sectors currently monopolized by SOEs to new competition, it alone would not be sufficient for China to achieve that goal. First, even if SOEs were to be subject to the new antitrust law, the response to market competition by SOEs depends on the other aspects of SOE reforms, particularly the reforms of SOE ownership structures and the SOE management. Second, the lack of competition in SOE-controlled sectors to a large degree is caused by the tight control of market entry by the government. A more effective way of promoting competition,

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<sup>38</sup> For example, the federal law of the United States to various degrees grants antitrust immunity to some regulated industries such as insurance, railroad, and ocean transportation, although these exemptions are often criticized. In addition, most developed countries now regard telecommunications services and large parts of the electricity sector as potentially competitive.

therefore, is for the government to relax its control on market entry. It is unclear whether the new antitrust law could compel the government to permit more market entry—presumably through its prohibition of “administrative monopolies,” a subject we will return to in section IV.D below. But in any event, the problem of market entry can be solved by the government undertaking self-initiated market entry liberalization measures, of which the *Opinions* in 2005 is a notable example. Finally, since the government is the ultimate owner of the SOEs and could restructure the SOEs as it chooses, another effective way of promoting competition is for the government to break up the monopolistic SOEs, without resorting to the new antitrust law, just as it did in the restructuring of the telecommunications industry.

## **B. “Excessive” Competition**

In recent years, at the same time that China is trying to curb the monopolistic abuses of SOEs, China’s policymakers are increasingly concerned about a new threat—the threat of “excessive” or “malignant” competition in many sectors. To many, this contrast is perplexing. It seems to have created another challenge for Chinese policymakers as they ponder how to deal with two problems that pull in opposite directions.

So-called “excessive competition” is widespread in China. A Google search on the Chinese internet using the Chinese characters for “excessive competition” yielded approximately one million hits, most of which are press reports of the intense competition in various industries. The industries covered in those press reports are diverse, including software, foods, travel agencies, household appliances, telecommunications, maritime shipping, pharmaceuticals, insurance, banking, waste recycling, machinery, mortgage, motor vehicles, periodicals, supermarkets, internet services, steel, textile and apparels, and even lotteries. The most egregious examples of “malignant competition” reported by the Chinese media are the following:

- China’s Central TV reported in September 2006 that in the maritime shipping industry that operates between Shanghai and Japan, the level of competition among the shippers reached a point where the shippers incurred losses of \$210 per

smaller container and \$420 per bigger container. That translates into a loss of \$760,000 per week for an average shipper.<sup>39</sup>

- In recent years, the competition among China's producers of dairy products has been so intense that many of them resort to illegal means of cutting costs, resulting in scandalous incidents such as poisonous, recycled, and contaminated milk.<sup>40</sup>
- In China's household appliances industry, there is a widespread practice of engaging in libellous advertisement against competitors in the media to gain market shares.<sup>41</sup>
- In China's travel agency industry, it is not uncommon to have "zero" or even "negative" fees for tours, meaning that many travel agencies are paying customers to take tours with them.<sup>42</sup>
- "Malignant competition" manifests itself not only in China's domestic industries, but also in the country's export sector. In recent years, Chinese products have been the number one targets of antidumping investigations initiated by members of the WTO. Many industry experts and top officials in China blame the excessive competition among China's exporters for this situation.<sup>43</sup>

Needless to say, "excessive competition" has become a major perceived problem in the Chinese economy. Some policymakers believe that most of China's industries, except those

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<sup>39</sup> *Malignant Competition Among SOEs in Shanghai's Maritime Shipping Industry*, <http://news.tom.com/2006-09-22/0016/78319004.html> (last visited March 28, 2007).

<sup>40</sup> *Diary Companies' Trust Crisis*, ECONOMIC REFERENCE NEWSPAPER, July 31, 2005, <http://chanye.finance.sina.com.cn/sp/2005-07-13/256435.shtml> (last visited March 28, 2007).

<sup>41</sup> Ge Ling, *Malignant Competition Rampant in China's Household Appliances Industry*, PEOPLE'S DAILY ONLINE, <http://homea.people.com.cn/GB/41394/3379837.html> (last visited March 28, 2007).

<sup>42</sup> *Low Price Competition, Malicious Cycle: What China's 10,000 Travel Agencies Should Do?* XINHUA NET, <http://www.ln.xinhuanet.com/wangtan/djjz/lxsdjjz.htm> (last visited March 28, 2007). This may result from competing away of payments from airlines, tour operators, and others to the agencies.

<sup>43</sup> *See, e.g., Long Yongtu: Excessive Competition Among Domestic Companies the Root Cause of Antidumping Cases*, <http://finance.anhuinews.com/system/2005/06/13/001282695.shtml> (last visited March 28, 2007).

industries in which the government deliberately maintains monopolies by SOEs—are characterized by “excessive competition.”<sup>44</sup>

Partly in consequence of perceptions of “excessive” competition in recent years, the government has taken some measures to rein in “excessive competition.” Most of those measures involve what is called “industrial self-disciplines,” adopted under the direct supervision of the government. Under the practice of “industrial self-disciplines,” the major companies in an industry reach price agreements or other agreements to limit competition, in an effort to stabilize the market.<sup>45</sup> The “chambers of commerce” that were converted from government ministries played important roles in the adoption of those “industrial self-disciplines.” Indeed, this practice was officially sanctioned by the government in 1998.<sup>46</sup> These efforts mirror the experience of the United States’ during the Great Depression, when it was widely believed that excessive competition was responsible for deflationary price pressures and unemployment. At that time, the Roosevelt Administration made various attempts to limit price competition. These policies are now seen as unsound—they were harmful to consumers and probably prolonged the depression, which was not caused by “excessive” competition.

Meanwhile, the government has also stepped up its efforts to limit the competition among China’s exporters to reduce their exposure to antidumping investigations by foreign governments. For instance, in 2003 the government imposed an “advance approval” requirement for the export of thirty-six goods.<sup>47</sup> Under the requirement, exporters must first submit their

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<sup>44</sup> See *Selected Comments on the Draft AML*, NPC Standing Committee, June 30, 2006, <http://www.npc.gov.cn/zgrdw/common/zw.jsp?label=WXZLK&id=350218&pdm=110106> (last visited March 28, 2007).

<sup>45</sup> For example, faced with growing inventory and price drops, China’s nine TV producers held a meeting in southern China in June 2000 to limit TV production and fix prices. The attempted price cartel was not successful, however.

<sup>46</sup> See State Economic and Trade Commission (“SETC”), *Opinions on Self-Disciplinary Prices Adopted by Some Industries*, August 17, 1998, <http://www.law999.net/law/doc/c001/1998/08/17/00107286.html> (last visited March 28, 2007). Ironically, before its abolition in the 2003 government restructuring, the SETC was one of a few government agencies in charge of drafting the AML.

<sup>47</sup> See MOFCOM and Customs Authority Circular 36 of 2003, *Advance Approval Requirement for the Export of Thirty-Six Goods*, November 29, 2003, <http://www1.customs.gov.cn/Default.aspx?TabID=433&InfoID=11070&SettingModuleID=1427> (last visited March 28, 2007).

export contracts to the respective chambers of commerce for approval prior to export. It is immediately obvious to a student of antitrust that policies such as the “industrial self-disciplines” and “advance approval” to a large degree function as government-sponsored price cartels. However, in implementing those policies, the government apparently did not seem to be concerned about their antitrust implications.<sup>48</sup>

In the face of widespread “excessive competition,” some of China’s policymakers have questioned whether China needs to have an antitrust law when the competition in most sectors of China’s economy is already “excessive.”<sup>49</sup> To many, China’s problem is not that there is too little competition, but that there is too much. What China needs, they believe, is to consolidate the smaller companies into bigger and stronger ones that can compete in the international markets.<sup>50</sup>

Although “excessive competition” exists in China’s economy, the implication seen by some policymakers—that China may not need the proposed antitrust law—is misguided. The term “excessive competition” is a misnomer. Competition of the kind the antitrust law is intended to promote can never be “excessive.” Most examples of “excessive competition” found in China’s economy are not examples of there being too much competition; rather, they are examples of competition going awry. Common to almost all those examples of “excessive competition” is the fact that the competitors have engaged in illegal or even criminal acts that violate the existing competition laws, product safety laws and consumer protection laws or would have violated the new antitrust law were it in effect today. The fact that such practices are widespread in China only underscores, rather than detracts from, China’s need to strictly enforce the existing laws and to enact the proposed antitrust law. Only through effective enforcement of such laws can competition be channelled to deliver maximum benefits to consumers.

Therefore, in sectors where “excessive competition” exists, China’s problem is not that there is too much competition, but that such competition is carried out in a less-than-ideal

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<sup>48</sup> Ironically, the antitrust problems associated with those competition-limiting policies were perhaps first brought to the attention of the Chinese policymakers by three antitrust lawsuits filed in the United States in 2005 and 2006 alleging price fixings by Chinese exporters of Vitamin C, magnesite, and bauxite .

<sup>49</sup> *See supra* note 44.

<sup>50</sup> *See, e.g.*, comments by Mr. Zheng Gongcheng, *supra* note 44.

manner, thanks to the absence or lax enforcement of relevant laws, or to market imperfections that undermine the beneficial effects of competition. Competition itself should always be welcomed, especially when it is not good for competitors. This has been a hard-learned lesson for many developed countries. The United States, for example, at one point wondered whether it should strictly enforce its antitrust laws during the Great Depression, when (as noted above) increasing competition and falling prices were causing widespread distresses in its economy.<sup>51</sup> Fortunately, the U.S. Supreme Court eventually held the line.<sup>52</sup>

In sum, in addressing the “excessive competition” prevalent in its economy, China should focus on ways to change the way competition is carried out, not ways to limit competition itself. “Excessive competition” in any event does not constitute a reason for not enacting the proposed AML. Instead, the proposed AML will be an important addition to China’s toolkit as it tries to promote competition that benefits consumers.

Finally, it will be important for China’s policymakers to keep in mind that in addition to strictly enforcing the antitrust laws, broader reforms will be needed to address the root causes of “excessive competition.” First, additional SOE reforms will likely have significant impacts on reducing the disruptive competition that in many cases amounts to predatory pricing. It has been noted that China’s SOEs are the driving forces behind many of the most notorious examples of “excessive competition,” due to their abilities to absorb unlimited losses that purely commercial entities would not be willing or have the ability to absorb. For instance, in the Shanghai maritime shipping example cited above, the Chinese media have noted that all of the firms remaining in the industry are SOEs.<sup>53</sup> Second, Chinese companies have been overly relying on

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<sup>51</sup> Similarly, Article 10 of the current draft of the AML exempts agreements among competitors to resolve slow sales and large inventories during economic downturns.

<sup>52</sup> The U.S. practice had been treating price fixing agreements as *per se* illegal under the Sherman Act. In *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933), however, the U.S. Supreme Court held that the creation of an exclusive joint selling agency by 137 Appalachian producers of bituminous coal was reasonable and therefore did not violate the Sherman Act. In so holding, the U.S. Supreme Court was greatly influenced by the dismal conditions in the industry caused by the Great Depression. Seven years later, however, the U.S. Supreme Court reversed course. In *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), the Supreme Court rejected the approach it took in *Appalachian Coal* and unequivocally reaffirmed the *per se* rule for horizontal price fixing.

<sup>53</sup> *See supra* note 39.



price competition, but not on technological innovation, to attract customers in both domestic and international markets. This puts significant pressures on companies to cut costs, by all means possible, even if such cost-cutting measures would violate product safety laws, consumer protection laws, labor laws or antitrust laws. The lack of technological innovation is a larger problem in China's economy that needs to be dealt with through broader reforms, such as reforms of intellectual property rights protection and even educational reforms. Finally, China's economic growth has been overly relying on investment and export, but not on domestic consumption. Much has been said, rightly or wrongly, about the effect of China's economic growth model on the global structural imbalance, but less attention has been paid to the implications of this economic growth model for China's competition policies. When Chinese consumers consume fewer products or services than producers are willing to supply, the competition among producers can only be expected to intensify. And at a time when China's law enforcement is less than ideal, this intensifying competition will in all likelihood go in the direction of hurting—rather than benefiting—consumers. Broader reforms, such as macroeconomic policy reforms and consumer credit reforms, will likely be helpful in this regard.

### **C. Mergers and Acquisitions in China by Foreign Companies**

Foreign investors have played an important role in China's economic revival since the very beginning of China's economic reforms almost three decades ago. In recent years, however, the role of foreign investment has become more controversial in China, as foreign investors stepped up their efforts to acquire Chinese companies and accelerated their penetration into China's domestic markets. As we will discuss below, this broader debate on the role of foreign investment has important implications for China's antitrust policy.

Upon China's accession to the World Trade Organization in 2001, China agreed to drastically reduced tariff levels and made numerous market access commitments regarding a number of industries. In the years following China's WTO accession, foreign companies increasingly steered their investment in China towards acquiring local Chinese companies, in part by leveraging on China's WTO accession commitments. Increased mergers and acquisitions by foreign companies heightened China's concerns that its industries might be dominated or even controlled by foreign companies. The recent intervention by the government in an attempted acquisition by the U.S. private equity firm Carlyle Group of Xugong Construction

Machinery, China's leading manufacturer of heavy construction equipment, reflected these concerns. It was reported that Carlyle Group initially signed an agreement with Xugong to buy 85% of its shares in October 2005. However, the deal was fiercely opposed by government officials as well as rival companies. About one year later, Carlyle Group agreed to take a less than 50% stake in Xugong in exchange for the government approval of the acquisition.<sup>54</sup>

The new limitations imposed on mergers and acquisitions by foreign companies are part of China's broader efforts to scale back foreign investment in China in certain sensitive sectors. Since China's accession to WTO, although China has more or less fulfilled its market access commitments, it has also revoked some of the preferential treatments previously accorded to foreign investors and, in some cases, has put in place some new restrictions on foreign investment.<sup>55</sup> Coincidentally or not, the flow of foreign investment into China has shown signs of levelling off in recent years.<sup>56</sup>

In light of China's goal of limiting foreign investment in certain sectors, China may be tempted to use competition policy as a tool to achieve that goal. The promulgation of the 2006 M&A Rules is seen by many as the first step in that direction. When drafts of the new antitrust law were being discussed, many multinational corporations feared that they would become the

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<sup>54</sup> See *Carlyle Agrees to Hold Minority of Xugong's Shares*, SOHU BUSINESS ONLINE, October 17, 2006, <http://business.sohu.com/20061017/n245845506.shtml> (last visited March 28, 2007).

<sup>55</sup> For example, on March 16, 2007, China's National People's Congress adopted the amended Corporate Income Tax Law that would abolish the preferential corporate tax treatment currently enjoyed by foreign-invested companies. In December 2005, China's Securities Regulatory Commission imposed a moratorium on new foreign investment in Chinese securities brokerages. In August, 2006, China's Banking Regulatory Commission announced a requirement that foreign banks incorporate their local operations in China if they want to engage in RMB-denominated business with Chinese individuals. While these restrictions technically do not violate China's WTO commitment, foreign investors have criticized them as steps in the wrong direction. See Statement of John R. Dearie, Testimony before the U.S.-China Economic Security Review Commission, August 22, 2006, [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_08\\_22\\_23wrts/06\\_08\\_22\\_23\\_dearie\\_john.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_08_22_23wrts/06_08_22_23_dearie_john.php) (last visited March 28, 2007).

<sup>56</sup> In 2006, China saw a 4% decrease in foreign investment compared with the year before. See Ariana Eunjung Cha, *China Gets Cold Feet for Foreign Investment: New Regulations Spawn Fears of Economic Nationalism*, THE WASHINGTON POST, February 2, 2007, Page D01.

law's first targets.<sup>57</sup> This fear was reinforced when a Chinese court in early 2007 decided to hear antitrust claims filed by a local Chinese company against a prominent multinational company.<sup>58</sup>

The temptation to rely on competition policy to deal with surging foreign investment leads to another challenge facing China's antitrust policymakers: should the new antitrust law be focused primarily on foreign companies, or should it be applied equally to both foreign and domestic companies? The answer undoubtedly is the latter. While China may rightly be concerned about possible aggressive campaigns by behemoth multinational corporations to monopolize Chinese domestic markets, it would be a grave mistake for the new antitrust law to be intended for—or to be strictly enforced against—foreign companies only. The losses to consumer welfare caused by the anticompetitive acts of domestic companies are no less real than the losses to consumer welfare caused by the anticompetitive acts of foreign companies, and indeed, the degree of monopolization by foreign companies, often exaggerated in the Chinese media, is far less than the degree of monopolization in the industries controlled by SOEs. To focus the new antitrust law only on foreign companies, or to strictly enforce the new antitrust law only against foreign companies, would lead to missed opportunities to address a major source of distortion in China's economy. China's antitrust policymakers should be reminded, therefore, that for the new antitrust law to be of any economic significance, it has to be aimed at domestic companies as much as it is aimed at foreign companies.

#### **D. Treatment of Administrative Monopolies**

The most important feature of China's draft antitrust law is the devotion of an entire chapter to the issue of administrative monopolies. Chapter Five of the draft antitrust law sets forth the general principles dealing with governmental actions that have the intent or effect of creating monopolistic conditions. It specifically lists several categories of governmental actions

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<sup>57</sup> See Rebecca Buchman, *China Hurries Antitrust Law*, WALL STREET JOURNAL, June 11, 2004, page A7.

<sup>58</sup> On January 17, 2007, The Shanghai No 1 Intermediate People's Court heard claims by a local Chinese company that Sony and its joint venture in China engaged in unfair competition by designing their digital cameras to shut down when batteries made by competitors are installed. The court did not rule at the end of the hearing and the case is still pending.

that are prohibited under the draft law: designation of deals, regional blockades, restrictions on bidding, restrictions on market entry, and restrictions on competition.

The inclusion of the prohibition of administrative monopolies in the draft antitrust law has a tortuous history. The prohibition appeared in the first several drafts released for comments beginning in 2002. It was reported, however, that in December 2005 the State Council deleted the entire chapter of the draft law dealing with administrative monopolies from an internal draft and only kept a declaratory statement prohibiting administrative monopolies in principle in the general rules section.<sup>59</sup> In June 2006, the State Council officially approved a draft that did not contain the chapter on administrative monopolies.<sup>60</sup> But several weeks later, when the State Council submitted the draft law to the NPC Standing Committee for review, the chapter on administrative monopolies was added back in.<sup>61</sup> These unusual changes in the text of the draft law, more than anything else, reflect what perhaps is the biggest dilemma facing China's antitrust policymakers—i.e., whether China should include provisions prohibiting administrative monopolies in the new antitrust law.

The draft AML does not give a definition of “administrative monopolies.” But suggested by the name, administrative monopolies are monopolies created by administrative agencies. Specifically, in the Chinese context, such monopolies result from the following three kinds of governmental actions:

First, administrative monopolies result from governmental measures that are intended to restrict competition in a particular industry, or from governmental measures that compel certain anticompetitive conduct. For example, in 1999, China's Bureau of Civil Aviation issued an order prohibiting airlines from offering air ticket discounts, citing the adverse effect of price

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<sup>59</sup> See Xiaodong Xie, *Anti-Administrative Monopolies Chapter Deleted in Entirety from Draft Antimonopoly Law*, PEOPLE'S DAILY ONLINE, January 11, 2006, <http://www.people.com.cn/GB/54816/54822/4016799.html> (last visited March 28, 2007).

<sup>60</sup> See *State Council Approves Draft Antimonopoly Law Without Chapter on Administrative Monopolies*, PEOPLE'S DAILY ONLINE, June 8, 2006, <http://finance.people.com.cn/GB/1037/4448654.html> (last visited March 28, 2007).

<sup>61</sup> See Na Liu, *Draft Antimonopoly Law on Schedule for Review; Chapter on Administrative Monopolies Added Back In*, THE ECONOMIC OBSERVER, <http://info.finance.hc360.com/2006/06/25102650097.shtml> (last visited March 28, 2007).

competition on the healthy development of the airline industry.<sup>62</sup> In the draft AML, such governmental measures are declared illegal under Articles 30 and 31.

Second, administrative monopolies also result from governmental measures that mandate the use of products or services by certain producers, which usually are “affiliate companies” of the government agencies. Those “affiliate companies” are in most cases SOEs or former SOEs currently or previously controlled by the government agencies in question. A good example of this practice is that some local civil affair agencies in charge of issuing marriage licenses require applicants to take pictures to be affixed to marriage licenses only at designated photo studios. Such steering of business towards affiliated companies using government power is declared illegal under Article 26 of the draft AML.

Third and most important, administrative monopolies also result from governmental actions that restrict market entry. This problem is more serious at the local level, where the local governments are notoriously known for creating various barriers to firms from other localities. This local protectionism is what is commonly known as “regional blockage” and is declared illegal under Articles 27, 28, and 29.

All of the three variants of administrative monopolies are made possible by the ability of governmental agencies, at both the central and local levels, with or without statutory authority, to require government approvals for a wide range of economic activities. According to a survey conducted by the State Council, as of 2003 there were a total of 4,159 government programs in which approvals of some sort from various governmental agencies were required, and more than 2,000 approval requirements were implemented without any legal basis.<sup>63</sup> To make things worse, in many cases businesses have to navigate through the maze of those approval requirements without clear guidance from the governmental agencies.

How serious is the problem of administrative monopolies in China? The following statistics provide a clue. It is reported that since 1993, the SAIC investigated 5,642 cases of monopolies pursuant to the Anti-Unfair Competition Law, 519 of which were administrative

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<sup>62</sup> However, the ban on discount air tickets was frequently ignored by the airlines, and the ban was finally lifted in early 2003.

<sup>63</sup> See Jianjun Wang, *Special Interests the Greatest Obstacle to Market Development*, LIAOWANG NEWS WEEKLY, [http://news.sohu.com/20061213/n247014585\\_1.shtml](http://news.sohu.com/20061213/n247014585_1.shtml) (last visited March 28, 2007).

monopolies.<sup>64</sup> The same report stated that since its establishment in 2003, MOFCOM has reviewed 432,841 policies of local governments that allegedly contained elements of regional blockades, pursuant to the 2001 Rules on Prohibiting Regional Blockades in Market Economic Activities. Of those 432,841 policies, 301 were modified or annulled by MOFCOM.<sup>65</sup> On the face of the statistics, it may seem that administrative monopolies constitute only an insignificant part of the total cases being investigated or reviewed. However, the source of the statistics observed that this is a result of selection bias, as the government authorities were reluctant to investigate or confront administrative monopolies because of what they saw as the futility of such actions.<sup>66</sup>

In deciding how to approach administrative monopolies in the new antitrust law, China's antitrust policymakers face a real dilemma. On one hand, as the ubiquity of administrative monopolies has made administrative monopolies *the* major source of monopolies in China's economy, China's antitrust policymakers feel obliged to address administrative monopolies in the new antitrust law. Many commentators believe that without provisions prohibiting administrative monopolies, the new antitrust law would necessarily be incomplete and would lose much of its relevance.<sup>67</sup> Furthermore, without a chapter on administrative monopolies, the public may believe that the government does not have the resolve to fight monopolies at all and may discount the credibility of the other provisions of the law.

On the other hand, prohibiting administrative monopolies in the new antitrust law will almost certainly yield few successes in the near future, given China's current economic and political realities. Using the new antitrust law to fight administrative monopolies faces two institutional problems that China's political system is not yet ready to handle:

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<sup>64</sup> See *Anti-Administrative Monopolies Chapter Deleted in Entirety from the AML*, PEOPLE'S DAILY ONLINE, January 11, 2006, <http://www.people.com.cn/GB/54816/54822/4016799.html> (last visited March 28, 2007).

<sup>65</sup> See *Id.*

<sup>66</sup> See *Id.*

<sup>67</sup> See, e.g., Ya Jie, *Antimonopoly Law Must Address Administrative Monopolies*, China Industrial & Business Times, available at <http://biz.163.com/06/0419/10/2F2JT1NE00021RH4.html> (posted on April 19, 2006; last visited on March 12, 2007).

First, at the central government level, if the various governmental agencies of the central government are made subject to the new antitrust law, the proposed Antimonopoly Enforcement Agency will be required to bring antitrust enforcement actions against government agencies of the same or even higher rank. Unless China has a government system based on clearly defined rules of law—which China currently does not—such an institutional arrangement will inevitably create confusion within the political system and set off disruptive power struggles among different government agencies.

Second, at the local government level, prohibiting administrative monopolies in the new antitrust law will have serious implications for the relationship between the central and local governments. Enforcing the new antitrust law against local governments, whether by the proposed Antimonopoly Enforcement Agency or by the courts, will only exacerbate the so-called “central versus local governments” problem, i.e., the problem with enforcing the orders and policies of the central government at the local level. The “central versus local governments” problem has existed in China since the first days of the Middle Kingdom.<sup>68</sup> “The mountain is high and the Emperor is far away.” “Where there are policies from above, there are counter-policies from below.” These old Chinese sayings speak vividly to the troubled relationship between the central and local governments. If China uses the new antitrust law to address local protectionism and “regional blockade,” will it be able to overcome the “central versus local governments” problem that it has not been able to overcome in the last 3,000 years? The answer is obvious.

Moreover, if China does include administrative monopolies in the draft AML, it will face another kind of credibility problem, this time pointing in the opposite direction. If the government knows that it will not be able to enforce the prohibition of administrative monopolies and yet still includes it in the law, it may send a signal to the public that it does not

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<sup>68</sup> The relationship between the central and local governments has been problematic since the Zhou Dynasty (1,122 B.C.—225 B.C.) and has remained so until today. One of the most dramatic episodes of the “central versus local governments” problem is the civil war waged by Emperor Kangxi of the Qing Dynasty in the 1670s against three feudal lords, who were granted their fiefdoms as rewards for their contributions to the establishment of the Qing Dynasty but who later grew defiant of the orders of the Emperor. The war, spanning eight years and spreading to almost half of China’s territory at the time, ended with a complete victory of the Emperor.

expect to strictly enforce every provision of the law. As a result, the public may discount the government's resolve in enforcing the new law as a whole.

However, supporters of the prohibition on administrative monopolies in the AML would quickly point out that some variants of the prohibition are already contained in China's current antitrust rules. Article 30 of the 1993 Anti-Unfair Competition Law prohibits restrictions on competition by using administrative power. The 2001 Rules on Prohibiting Regional Blockades in Market Economic Activities specifically bans regional blockades. Therefore, including the prohibition in the AML will not be something that is completely out of the ordinary and will be consistent with public expectations. Indeed, supporters of the prohibition may argue that, although enforcement of the prohibition under the current antitrust rules is not very effective, including the prohibition in the new antitrust law is the only way to preserve continuity in the treatment of administrative monopolies in the antitrust law.

No matter whether the prohibition of administrative monopolies is included in the AML or not, it is clear that China's antitrust policymakers will face difficult issues either way. These difficult issues may have been the primary reason behind the current gridlock on the draft AML. But whatever decision China's policymakers may make with respect to administrative monopolies, they need to be fully aware of the consequences and implications of their decision.

On one hand, if China's antitrust policymakers eventually decide to exclude administrative monopolies from the AML, it will be important for them to keep in mind that such a decision will not be an endorsement of administrative monopolies, and nor will it be a decision to do nothing about them. It will simply be an acknowledgment of the fact that the AML cannot cure all evils in one swoop, at least not at this time. A decision to not address administrative monopolies in the AML will not make the AML irrelevant, either. Although administrative monopolies undoubtedly are the major source of monopolistic behavior in China's economy today, anticompetitive acts by economic entities that do not have government power are nonetheless very significant, and more importantly, are growing. As the government further retreats from the economy, antitrust issues will be created increasingly not by the government, but by economic entities such as commercialized SOEs, private enterprises, and foreign companies. By focusing on antitrust problems arising from economic behavior at this time, China essentially would start on a path with the least resistance, as it did with its general economic reforms three decades ago. The hope is that the early success of reforms will create



benefits to a wide swath of society and rebalance the distribution of vested interests in society, so much so that reforms that were previously unconceivable may become realistic goals later. That is the essence of the Chinese-style incremental improvements that have worked so well in China's general economic reforms so far. When it comes to antitrust, the same incremental approach may be worth a try.

On the other hand, if China's antitrust policymakers eventually decide to address administrative monopolies in the AML, it will be important for them not to expect immediate success. Administrative monopolies are such a problem in China that any success in dealing with them is likely to come about only incrementally. It is also important for the Chinese policymakers to not see the AML as the sole vehicle or even the most important vehicle through which to address administrative monopolies.<sup>69</sup> The nature of administrative monopolies means that their elimination will necessarily require other reforms, such as constitutional and government structure reforms. Indeed, in most developed countries, such as in the United States, administrative monopolies are dealt with in the general antitrust law only to the extent that they are a result of the action of the state as market participant. In dealing with monopolistic conditions created by the state as sovereignty and market regulator, the United States generally leaves the job to the democratic legislative processes at both the federal and state levels, while using certain important legal mechanisms—such as the “Dormant Commerce Clause”<sup>70</sup> and the federalism doctrine<sup>71</sup>—to correct any failures of the democratic processes in this regard.

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<sup>69</sup> It seems that China's antitrust policymakers are well aware of this point. Article 6 of the current draft AML points out that the furtherance of reforms of the government functions are needed to rein in the abuse of administrative power that harms competition. This seems to indicate a recognition among Chinese authorities that administrative monopolies are not something that will be cured by the AML alone.

<sup>70</sup> The U.S. constitution grants Congress the power to regulate interstate commerce in the so-called “Commerce Clause.” By negative implication, the U.S. Supreme Court holds that states do not have the power to regulate interstate commerce. This so-called “Dormant Commerce Clause” doctrine played a vital role in striking down state regulations that were aimed at or had the effect of blockading the commerce of other states. *See, e.g.,* *Gibbons v. Ogden*, 22 U.S. 1 (1824) (invalidating New York's grant of steamboat monopoly); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) (holding that New York may not protect its local interests by limiting access to local markets by out-of-state milk sellers); *Philadelphia v. New Jersey*, 437 U.S. 617 (1978) (invalidating a New Jersey law which prohibited the importation of most solid or liquid waste which originated or was collected outside of the territorial limits of New Jersey); *Granholm v. Heald*, 544 U.S. 460 (2005) (ruling that New York and Michigan laws allowing in-state wineries

## **E. Antitrust Enforcement**

### **1. Which Agency?**

An important consideration in drafting any law in any country is how the law is going to be enforced. This is more so in China, where enforcement of a law in many cases is a larger issue than the law itself.

The responsibility for enforcing China's current antitrust rules is shared by at least three agencies: the SAIC as authorized by the 1993 Anti-Unfair Competition Law, the National Development and Reform Commission as authorized by the 2003 Provisional Rules on Prevention of Monopoly Pricing, and MOFCOM as authorized by the 2006 M&A Rules. In particular, SAIC and MOFCOM are the two main candidates to house the new Antimonopoly Enforcement Agency. An alternative to having SAIC or MOFCOM enforce the AML is to create a new agency.

Earlier drafts of the AML proposed the establishment of the Antimonopoly Enforcement Agency under the State Council. There was speculation that the Antimonopoly Enforcement Agency would be created within an existing ministry. Given the prominent roles SAIC and MOFCOM play in enforcing the current antitrust rules, these two agencies naturally become the

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to ship wine to consumers directly but prohibiting out-of-state wineries from doing the same is unconstitutional).

<sup>71</sup> Under the federalism doctrine, the U.S. federal government can only exercise power granted by the U.S. Constitution. The U.S. Supreme Court has used the federalism doctrine to invalidate federal laws that had the purpose or effect of limiting competition. Most notably, in 1935, in the “sick chicken” case, the U.S. Supreme Court struck down one of the most dramatic efforts by the Roosevelt Administration to stabilize the U.S. economy during the Great Depression—the National Industrial Recovery Act of 1933 (“NIRA”). *See Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). Enacted to combat falling prices and intensifying competition during the Great Depression, the NIRA authorized the President, ordinarily upon application by trade associations, to promulgate “codes of fair competition” for the trade or industry. Several hundred codes were adopted in accordance with the NIRA. The codes usually contained provisions concerning minimum wages and prices, maximum hours, and unfair trade practices. In 1935, the Supreme Court struck down the entire act, holding that in enacting the act, Congress exceeded its commerce power and unconstitutionally delegated its legislative power. Interestingly, there seems to be a striking resemblance between the “codes of fair competition” authorized under the NIRA and the “industrial self-disciplines” authorized by the Chinese government today. *See* discussion of the “industrial self-disciplines” in section IV.B.

leading candidates to house the future Antimonopoly Enforcement Agency. SAIC is primarily charged with the micromanagement of the market activities, ranging from business and trademark registration to street market regulation. SAIC has branches in virtually every city in China. At the central level, SAIC has a Bureau of Fair Trade, under which there is an Antimonopoly Division. However, this division has only five staff members.<sup>72</sup> In March 2004, SAIC released an investigative report that described multinational companies' alleged anticompetitive behavior in China.<sup>73</sup>

The other candidate enforcement agency is MOFCOM, a powerful ministry created during the government restructuring in 2003 that combined the former Ministry of Foreign Trade and Economic Cooperation and many functions of the former SETC. In late 2004, MOFCOM established an Antimonopoly Investigation Office under the Department of Treaty and Law.<sup>74</sup> This office now has about the same level of staffing as its counterpart in SAIC. Both agencies were designated as the agencies to review foreign acquisitions of domestic companies in the 2006 M&A Rules.<sup>75</sup> However, the Antitrust Filing Guidelines accompanying the M&A Rules was issued by MOFCOM alone. Neither office seems to have enough manpower or resources at present to handle potentially vast amount of antitrust work under the AML. The amount of resources needed is likely to be large given the size of China's economy and the amount of anticompetitive activity currently present in the marketplace. Even if staffing levels can be increased quickly, the relevant knowledge, skills and experience take time to build.

An early 2004 draft proposed to establish the Antimonopoly Enforcement Agency under the MOFCOM, but later drafts have retreated from that position. The current draft only states that an Antimonopoly Enforcement Agency will be established, without specifying where it will

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<sup>72</sup> See SAIC, *Functions, Organization, and Staffing of the Bureau of Fair Trade*, [http://www.saic.gov.cn/zhzjg/jig\\_3.html](http://www.saic.gov.cn/zhzjg/jig_3.html) (last visited March 28, 2007).

<sup>73</sup> See SAIC, *Multinational Companies' Competition Restricting Behavior and Counter Measures*, SAIC Pub. No. 5, 2004.

<sup>74</sup> See *MOFCOM Establishes Antimonopoly Investigation Office*, CHINA NEWS NET, September 17, 2004, <http://www.china.org.cn/chinese/2004/Sep/661853.htm> (last visited March 28, 2007). Noticeably, this was a few months after the release of the SAIC report.

<sup>75</sup> See *supra* note 11.

be established.<sup>76</sup> No matter who will become the Antimonopoly Enforcement Agency, however, it will be wise to have one instead of two enforcement agencies, as a single enforcement agency avoids the potential inconsistency that may be created in a dual enforcement structure.

In addition to the Antimonopoly Enforcement Agency, the current draft AML proposes the establishment of an Antimonopoly Commission directly under the State Council. The Antimonopoly Commission is intended to be an advisory body staffed by high level officials from different government agencies. The day-to-day AML enforcement activities will be carried out by the Antimonopoly Enforcement Agency.

The establishment of the new Antimonopoly Enforcement Agency will necessarily result in diminished roles for the agencies currently responsible for antitrust enforcement and regulatory supervision. Perhaps to reduce the resistance from these agencies, the current draft makes the compromise that monopolistic activities subject to the AML that are also within the scope of other regulatory agencies' investigative power based on other laws and administrative regulations will be investigated by those other agencies, and these other agencies are required to report their enforcement results to the Antimonopoly Commission. The Antimonopoly Enforcement Agency investigates such matters only when they are not investigated by other agencies. However, this compromise would eliminate one of the major advantages of the AML over the current fragmented antitrust laws—i.e., a uniform enforcement agency that can be counted on enforcing the antitrust law in a consistent and predictable manner. Similar provisions of US law have not been successful in promoting competition in regulated industries. Because of regulatory capture, regulators often seek to protect regulated firms from outside entry and from competition among themselves. Giving these regulators exclusive jurisdiction to enforce antitrust law within their jurisdictions will likely result in competition taking a back seat to industry interests.

## 2. Which Enforcement Priorities?

Given the limited institutional capability and resources at least at the initial stage, China's future Antimonopoly Enforcement Agency will need to set priorities for its enforcement goals.

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<sup>76</sup> See Article 5 of the current draft of the AML.

A good start is to focus first on horizontal restraints of trade, especially cases of price fixing and bid rigging, where large benefits can often be obtained for consumers by breaking up the cartels and introducing competition. Enforcement in this area has high payoffs because it is likely to deter behavior that harms consumers and unlikely to erroneously deter competitive behavior that benefits consumers.

In countries with new competition policies, there is often a tendency to focus on complex vertical relationships because of complaints about these matters filed by competitors, and consumer protection issues because of great popular appeal. Oftentimes, certain contracts or contractual terms, or pricing schemes in general, may strike people as unfair, even if they actually promote economic efficiency. Examples include vertical price restraints, unilateral refusals to deal, certain tying arrangements, “unfairly high price in selling or unfairly low price in purchasing,” predatory pricing, and price discrimination.<sup>77</sup> In societies that are skeptical of the legitimacy of markets, enforcement focusing on these issues often illustrates the popular or ideological basis for the skepticism. Antitrust action in these areas requires painstaking investigation and analysis, not merely to decide whether the behavior in question is harmful or beneficial to consumers, but to avoid creating unintended deterrent effects on future economic activity that is beneficial to consumers. In general, it is important to resist the temptation to give priority to investigations that consume a vast amount of resources but have minimal benefits.

Although the antitrust review of proposed mergers, acquisitions and joint ventures is a very useful device to avoid anticompetitive concentration without the messy complication of ex post disassembly of a consummated transaction, the amount of work involved can easily be overwhelming. Unfortunately, the current draft AML applies to all consolidations that meet the sales thresholds rather than just consolidations of competing firms. The effect could be to unnecessarily burden the Antimonopoly Enforcement Agency and increase the delays associated with obtaining agency clearance for mergers with little or no potential for anticompetitive effects, including many beneficial mergers. It is important for the Antimonopoly Enforcement Agency to give quick clearance to mergers that do not pose a competition issue and focus on

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<sup>77</sup> See current draft AML, Articles 8 and 15.

those that have clear overlaps. This implies the need for a limit on the amount of time transactions are held up pending agency decisions on enforcement.

### 3. The Importance of Transparency and Consistency

For the AML to influence business behavior in the intended way, businesses need to form both correct and clear expectations about enforcement. An earlier draft of the AML states that “the enforcement authority *should* publish its decisions,” a requirement that makes sense only if the published opinions are intended (as they should be) to influence future behavior of business firms. Publication of decisions and the reasoning behind them, however, is a necessary but not sufficient condition for effective deterrence. It is also necessary to have a rule that serves the purpose, in a common law system, of “*stare decisis*.” That is, the enforcement authority must to some extent be bound by its prior decisions and reasoning. If prosecutors (or courts) can decide each case without regard to the ways in which similar facts have been analyzed and treated in the recent past, private firms have no basis to form expectations about the consequences of their actions. The effect of this is to increase the risks of doing business, thus discouraging investment by ruling out investment projects that do not have a sufficiently high expected return to compensate investors for taking on the risk of (erroneous) antitrust prosecution.

The requirement to publish enforcement decisions would be a good first step to implement the AML in a transparent and consistent way. However, the current draft has changed this language to “the enforcement authority *may* publish its decisions.” This subtle change seems to reflect a reluctance of the Chinese authorities to commit to full disclosure of its future antitrust decisions, which is not helpful for private firms attempting to form expectations about the Antimonopoly Enforcement Agency’s actions. This retreat from a firm commitment to transparency and consistency may reflect the consideration that China’s antitrust authorities may well take into account other non-competition factors, such as public interest and the health of the national economy, in deciding competition cases, as stated in the draft AML. But here as well, making the enforcement agency responsible for such broad considerations may be a mistake. The agency’s decisions will be subject to political review, and it is in that review process that such considerations may enter.

More generally, unless antitrust enforcers are to attempt to examine every transaction in the economy, deterrence is the principal vector by which antitrust (and most other) laws achieve

their effects on economic behavior. Deterrence of anticompetitive behavior, however, has a dark side: inadvertent deterrence of efficient behavior. The deterrent effect of a law or regulation is affected by the probability of detection and successful prosecution (itself a function of enforcement resources), the firm's understanding of the law, and the penalties expected to result from successful prosecution. Very effective deterrence of anticompetitive behavior will also deter pro-competitive behavior if the law is unclear to private decision-makers or if private decision-makers anticipate frequent errors by prosecutors and judges.<sup>78</sup> Thus, transparency and consistency in enforcement are important in helping businesses form the right expectations.

The proposed law clearly contemplates reliance on administrative rather than judicial machinery as its primary enforcement mechanism, and calls for the enforcement agency to issue detailed rules and regulations to implement the law. In the end, given China's legal environment, as discussed in section III.C, it is these rules and their enforcement that will matter most. It would be inappropriate to evaluate the proposed law as if it were, as it would be in the U.S., a set of instructions intended for the judiciary to interpret.

In the current draft AML, private parties are given the right to judicial review if they are not satisfied with the Antimonopoly Enforcement Agency's decisions. Private parties are also entitled to recover damages resulting from monopolistic behavior. In the context of China's current legal system, it remains unclear whether this right increases or decreases the predictability of the process and therefore the potential for promotion of economic efficiency and growth. It is not clear what level of the courts will handle such appeals and lawsuits or whether the courts' decisions will be final. In general, the courts' ability to adjudicate antitrust cases is doubtful at this time, as they do not seem to have the necessary expertise.

China's antitrust policymakers are aware of the inadequate capacity of the courts in adjudicating antitrust cases under the AML. In some earlier drafts, civil liabilities and recovery of damages through litigation were emphasized. One draft even suggested a detailed methodology of computing damages. Later drafts, however, minimized direct mentions of the courts' role. Apparently there is hesitance to rely on the judicial system to handle antitrust cases.

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<sup>78</sup> See generally, Kenneth Heyer, *A World of Uncertainty: Economics and the Globalization of Antitrust*, U.S. Dept. of Justice, EAG Working Paper 4-11 (Washington, U.S. Dept. of Justice, 2004).

To the extent administrative agencies are more competent in carrying out the AML enforcement, it makes sense at least in the short term to rely more on administrative decisions and remedies.

## **V. CONCLUSION**

China has come a long way since the drafting process of the AML began in 1994. Compared with China's current antitrust laws, the draft AML made significant progress in terms of comprehensiveness, clarity, and consistency with economic principles. Despite the progress, China's antitrust policymakers still face significant challenges in reforming the country's competition policies. Those challenges implicate many of the most fundamental issues arising from China's transformation from a centrally-planned economy to a market economy. The resolution of those issues, however, needs not precede the adoption of the new AML.

Meanwhile, while the AML will be an important tool to carry out China's competition policy reforms, it is not the only one. Other reforms, such as SOE reforms, market entry reforms, constitutional and government structure reforms, and legal reforms, to name a few, will be indispensable to China's goal of promoting competition in its economy. In light of the complexity of the issues in China's competition policy reforms, it will be important for China's antitrust policymakers to not expect the AML to cure all evils in one swoop. Rather, China will be better served to take an incremental approach and enact an AML that is tailored to China's current realities, while keeping the momentum to engage in other reforms necessary to fully implement China's competition policy goals.