THE BUSINESS OF GOVERNING BUSINESS IN CHINA
Institutions and Norms of the Emerging Regulatory State

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Introduction

THE extensive market-oriented reform of the Chinese economy over the past quarter century raises the question of how, in terms of institutions and norms, the Chinese party-state is choosing to govern its markets. The Chinese government clearly will retain a significant role in the market system, and not solely because of its tradition of central planning. Political economy scholarship has argued persuasively that, in even the most market-oriented systems, firms rely extensively on governments using consistent regulatory systems to foster conditions for successful markets.[1] Even the economic *de*regulation that has swept through much of the world in the past two decades involves creating a new role for the state—new institutions, new rules—rather than eliminating its influence.[2] Moreover, as countries deepen their integration into international markets, as China has done, the role of states remains far from minimal.[3]

The question surrounding the governance of China's markets, then, is not *whether* the government will remain involved but, rather, what form the new "regulatory state" will take. The subject is important be-

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[1] Neil Fligstein, "Markets as Politics: A Political-Cultural Approach to Market Institutions," *American Sociological Review* 6 (August 1996); Charles E. Lindblom, *Politics and Markets* (New York: Basic Books, 1977).

[2] Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996); Jacint Jordana and David Levi-Faur, "The Politics of Regulation in the Age of Governance," in Jordana and Levi-Faur, eds., *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham, UK: Edward Elgar Press, 2004).

[3] David M. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review* 72, no. 4 (1978); Dani Rodrik, "Why Do More Open Economies Have Bigger Governments?" *NBR Working Paper*, no. 5537 (April 1996).

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cause the institutions and norms now taking root in China will constitute the foundation for the state's role in the economy for the foreseeable future. This article examines one crucial set of industries toward which the Chinese leadership has turned its regulatory sights: the strategic industries regarded as the "commanding heights" (*jingji mingmai*, or literally, "economic lifeline") of the domestic economy. Since 1992, the State Council (the PRC's executive arm) has established new regulatory organizations for major industries in infrastructure and financial services. In formulating its regulatory system for these industries, the Chinese government has been keenly aware of the international model that has become hegemonic in the past decade: the "independent regulator" model. Indeed, the government has initiated many changes that appear to adhere to this model. Yet how closely do the new organizations actually approximate the independent regulator model, both institutionally and normatively? Do they confirm that a new political economy of regulation is emerging in China, as suggested by some recent work?[4] Or are these organizations merely old wine in new bottles; in other words, do they suggest patterns that conform more closely with the largely discredited model of the East Asian "developmental state"?

The answer lies somewhere in between these two extremes. Drawing from research on six "commanding heights" industries, this article argues that, while impressive changes during the past decade have given the agencies that regulate China's strategic industries the initial *appearance* of independent regulators, the actual *function* of an independent regulatory structure is far from established.[5] Indeed, the relationship between regulators, the rest of the state, and (though, to a lesser degree) the regulated firms remains bound in a Gordian knot. Regulatory independence is constrained by the broader political-institutional context in which the new regulatory bodies are situated, a context that possesses four salient features: continued state ownership of strategic assets; continued dominance of state and party "comprehensive" institutions with authority over economic development; the bureaucratic

[4] See especially Dali L. Yang, *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China* (Stanford, Calif.: Stanford University Press, 2004).

[5] This article does not seek primarily to provide new, sector-specific data about China's regulated strategic industries; a substantial body of work, cited throughout this article, already exists on individual industries, particularly on the securities and telecommunications industries. Instead, the primary goal is to establish a pattern of regulation *across* these industries and to discuss implications of this broader regulatory pattern for China's emergent political economy. Conclusions are based in large part on interviews conducted during the fall of 2002 with regulatory officials, scholars, and industry representatives in Beijing.

origins of regulators in the former line ministries; and the fragmented, ambiguous authority of the regulator.

In addition to structural factors, the Chinese leadership's normative preferences (as revealed in their policy decisions and statements about strategic industries) constrain the development of an independent regulatory model. One central normative preference is to increase competition so as to enhance efficiency, yet at the same time to keep this competition "orderly." The desire to avoid "excessive" competition is related to a second normative preference: limiting the number of firms, which the government achieves through active structuring of firms and control of market entry. The end goal, or "metapreference," is to protect the party-state's considerable financial and social interests in these key assets. In short, the state's interest in continuing to enhance its control over crucial assets significantly reduces the possibility of regulatory independence. The aforementioned characteristics do not precisely mimic those of a developmental state; however, they do provide evidence that the role of the Chinese state in key industries remains strong and calculated—contrary to oft-made assumptions of convergence.

This article begins with brief descriptions of the ideal-typical independent regulator model and its main alternative comparative model, the East Asian developmental state. The empirical sections that follow detail the institutional and normative factors that shape China's regulatory pattern in six strategic sectors in which new regulators have been established: the infrastructure industries of telecommunications (highlighted in the discussion), electric power, and civil aviation, and the financial services industries of securities, insurance, and banking. The article concludes with a discussion of the broader implications of the identified patterns for China's emerging political economy.

Two Models: Independent Regulator versus Developmental State

The Chinese government, while constrained by historical and institutional factors, nonetheless has choices with regard to the path it takes toward regulatory reform. As Rodrik has commented, "The institutional basis for a market economy is not uniquely determined. Formally, there is no single mapping between the market and the set of nonmarket institutions required to sustain it."[6] To frame China's alternatives, it

[6] Rodrik, "Institutions for High-Quality Growth: What They Are and How to Acquire Them" (Paper presented at the IMF Conference on Second Generation Reforms, Washington, D.C., November 1999), http://www.imf.org/external/pubs/ft/seminar/1999/reforms/rodrik.htm (accessed June 26, 2004).

is useful to envision its options as ranging along a spectrum, with the ideal-typical Anglo-American independent regulatory system at one end and the ideal-typical Japanese developmental system at the other.

The Independent Regulator Model

In both established markets and economies transitioning to a market-based system, the "independent regulator" institutional model has emerged as the benchmark. International organizations including the World Bank, the European Bank for Reconstruction and Development, the Asian Development Bank, and the World Trade Organization have strongly advocated this model's emphasis on administrative restructuring of state institutions (streamlining, capacity building, and increasing efficiency and accountability) as a crucial instrument of "good governance."[7] While the model originated in the United States, it has been widely applied in both developed and developing countries, and to state-owned as well as private enterprises.

In this model's ideal form, the regulator is independent from business; that is, the regulator must be separate from and impartial toward the firms it regulates, even state-owned firms. The regulator also should have political independence; that is, it must maintain substantial autonomy from political organs such as the executive or legislature.[8] While political goals and mandates must, of course, be reflected in regulatory actions,[9] ad hoc interference with established regulatory rules from political bodies without clear authority is anathema to the model. High degrees of transparency also are considered vital for maintaining po-

[7] The point here is not that the independent regulator model is normatively or practically best, but that it currently stands as the global standard for regulation. Hence, a major World Bank publication states that "by now it is well accepted that a country should have independent regulatory bodies. . . ." See World Bank, *Building Institutions for Markets: World Development Report 2002* (New York: Oxford University Press, 2002), 158.

Establishment of independent regulators is frequently a condition for funding from or certification by international organizations. For example, the EBRD strongly advocates the establishment of an independent regulator as a condition for investing in telecommunications and utilities industries in Central Europe and Central Asia. The 1997 agreement on basic telecommunications services under the World Trade Organization identifies the creation of an independent regulator as one of six regulatory principles. The Asian Development Bank provided a $500,000 technical assistance grant to the PRC government to create an independent regulator for the electric power industry. Sohail Hasnie, *Technical Assistance to the People's Republic of China for Establishing the National Electricity Regulatory Commission*, Asian Development Bank (September 2002), http://www.adb.org/Documents/TARs/PRC/R200_02.pdf (accessed June 8, 2005).

[8] Giandomenico Majone, *Regulating Europe* (London: Routledge Press, 1996), 48. Such independence also depends upon the possession of sufficient resources to implement mandates, a requirement that poses a problem in China, as elsewhere.

[9] Governments commonly mandate, for example, the provision of universal services in telephony and electricity, and charge their regulators with enforcing these "universal service obligations."

litical independence. In sum, regulators are likened to referees in a sports game, in contrast to players (firms) or promoters (political advocates).

In addition to the institutional configuration of the independent regulator, this model also embraces normative preferences. The regulator's primary job is to create a level playing field for market actors and to apply rules evenly without regard to *who* those particular actors are, thereby fostering competition and eliminating market failure. Any commercially viable new entrant should have the same opportunity to establish his market position as an incumbent. As a remedy for market failure, antitrust law is a core policy component of this model, as is consumer protection.[10]

The Developmental Model

Another model—no longer in favor—is based on Japan's postwar regulatory system and sits on the opposite end of the spectrum from the independent regulator model.[11] In contrast to the independent regulator system, the developmental state model tolerates substantial government intervention to structure markets, often in favor of particular firms whose failure would impose unacceptable social costs (such firms, though not necessarily state-owned, historically have close ties to the bureaucracy). Hence, the government is concerned with who the specific market actors are, and one of its underlying goals is to enhance the international competitiveness of national firms—in other words, to create "national champions." The model discourages "excess competition" that might reduce profits of favored firms and encourages market stability.

Institutionally, regulators in the developmental model are highly centralized, and cross-functional comprehensive agencies play a powerful role in designing industry strategy. The regulatory bureaucracy is relatively free from political (notably, legislative) oversight, such that there is little public accountability or transparency, but also relatively little political meddling.

Japanese regulatory reforms in the 1980s increased market competition in strategically designated sectors and brought about some privatization, but they did not significantly reduce the government's control

[10] One major critique of the view that independent regulators correct market failures (the "economic theory of regulation") argues that regulators are captured by and pursue the interests of the businesses they regulate. George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 6, no. 2 (1971). A third vein in regulatory scholarship is the institutionalist approach. See Terry Moe, "Interests, Institutions, and Positive Theory: The Politics of the NLRB," *Studies in American Political Development* 2 (1987).

[11] The classic statement is Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975* (Stanford, Calif.: Stanford University Press, 1982).

over business.[12] The formerly powerful comprehensive ministries retained regulatory power and actively resisted the devolution of their authority over industry to independent agencies. Indeed, ministries leveraged the regulatory reform drive to expand their own authority—particularly their authority to license new market entrants. Moreover, the Japanese government employed a number of strategies to ensure the success of certain firms, including the active brokerage of mergers of weaker and stronger firms to sustain the weaker firms.[13] The government carefully structured all increases in competition, attempted to predetermine the number of firms the market could bear, limited entry to that number, and then sought to ensure survival of all entrants through price and service regulations (this was particularly true in telecommunications). While a new wave of regulatory reform has swept through Japan in the wake of the 1997 Asian Financial Crisis, bureaucratic rigidity and continued anticompetitive practices have prevented the adoption of reform sufficient to foster recovery from deep economic recession.[14]

While the development of China's regulatory system remains ongoing, we can begin to locate China between these two hypothetical poles. There is substantial evidence that Chinese reformers are striving to move toward the independent regulator model. While the Chinese government may be ambivalent about the extensive privatization that many governments have implemented in the context of regulatory reform, it nonetheless has attempted extensive administrative restructuring—including the establishment of new regulators—to increase efficiency. The desirability of adopting the independent regulator model is entrenched in the political and scholarly discourse.[15] Chinese regulatory agency officials have facility with the concept; their exposure to foreign models

[12] Vogel (fn. 2), 54–60, 207–213. Other descriptions of Japan's more activist state include Organisation for Economic Co-operation and Development (hereafter cited as OECD), *China in the World Economy: Domestic Policy Challenges* (Paris: OECD, 2002), 365–66; and T.J. Pempel, "Regime Shift: Japanese Politics in a Changing World Economy," *Journal of Japanese Studies* 23, no. 2 (1997).

[13] Vogel (fn. 2), 208. In China, the government's promotion of its WTO accession, especially after 1999, can be seen as serving this same preparatory function; the government warned businesses that they would need to become competitive, either immediately upon accession (December 2001) or a few years later as phase-ins became operative. China's efforts to merge weak firms into stronger ones began several years ago.

[14] Since the late 1980s, further reform has cost comprehensive ministries some of their power. Pempel (fn. 12), 349–57. On the limits to recent regulatory reforms, see OECD, *Regulatory Reform in Japan* (Paris: OECD, 1999); and Sumner La Croix and James Mak, "Regulatory Reform in Japan: The Road Ahead," in Magnus Blomström, Byron Gangnes, and La Croix, eds., *Japan's New Economy: Continuity and Change in the Twenty-First Century* (Oxford: Oxford University Press, 2001).

[15] There is an active discourse among influential scholars in central government think tanks, including the Chinese Academy of Social Sciences, the Development Research Council, and the (defunct, as of 2003) State Committee on Restructuring the Economic System. See, for example, the State Council–commissioned volume, Zhongguo Jichu Sheshi Chanye Zhengfu Jianguan Tizhi Gaige

from international organizations or through bilateral contacts often has influenced them. Moreover, in its WTO agreement on services, China made broad commitments on the impartiality of its regulators.[16]

However, the institutional context of new regulators and the overall normative values governing them cast significant doubt on any claim that China has fully adopted this model. Elements of China's experience, notably the remaining power of comprehensive agencies, the desire to foster national champions, and the related efforts to actively structure and limit competition in favor of incumbent firms, resemble core elements of the developmental model. Still other elements of China's experience—especially the continuing and powerful role of state ownership and of the party, and hence the absence of political independence—mirror neither system. China's multifaceted institutional and normative pattern is described in the following sections.

Chinese Regulatory Institutions and Constraints on Independence

Since market reforms were initiated in 1978, China's economic bureaucracy has been reorganized numerous times to streamline and increase the efficiency of the state bureaucracy. The reorganization spearheaded by Premier Zhu Rongji in 1997–98, when many economic line ministries were either downgraded to the rank of bureau or eliminated, was particularly important and complemented two other reform processes.

The establishment of new regulatory commissions was one of these processes. Since 1992, China's State Council has established regulatory institutions in financial services (securities, insurance, and banking) and infrastructure industries (telecommunications, aviation, and electric power). The diminution or elimination of ministries in the serial reorganizations was, in part, designed to reduce regulatory interference from vested bureaucratic interests and thereby create space for the new regulators.

A concurrent restructuring effort involved spinning off incumbent

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Ketizu (China Infrastructure Industries Government Regulatory System Reform Task Force), *Yanjiu Baogao* (Research report) (hereafter cited as *Yanjiu Baogao*) (Beijing: Zhongguo Caizheng Jingji Chubanshe, June 2002).

16 China committed that in many services, including financial services and telecommunications services, "relevant regulatory authorities would be separate from, and not accountable to, any service suppliers they regulated. . . ." World Trade Organization, *Report of the Working Party on the Accession of China*, Document WT/MIN (01)/3 (Geneva: World Trade Organization, November 10, 2001). In the late 1990s, China's government successfully sought to have its telecommunications regulator certified by the International Telecommunications Union as China's "independent regulator."

TABLE 1
REGULATORY BODIES FOR CHINA'S STRATEGIC INDUSTRIES

Regulatory Body	*Industry Scope*	*Year Established*	*Organization Formerly in Control*
China Securities Regulatory Commission (CSRC)	financial services (securities)	1992	People's Bank of China (PBOC)
Ministry of Information Industry (MII)	telecommunications; information	1997	Ministry of Post and Telecommunications (MPT); Ministry of Electronics Industry (MEI)
China Insurance Regulatory Commission (CIRC)	financial services (insurance)	1998	People's Bank of China (PBOC)
General Administration of Civil Aviation (CAAC)	aviation	2002	CAAC (pre-2002 version)
State Electricity Regulatory Commission (SERC)	electric power	2003	Ministry of Electric Power (MEP)
China Banking Regulatory Commission (CBRC)	financial services (banking)	2003	People's Bank of China (PBOC)

business monopolies from the ministries that previously controlled them and breaking up many of these monopolies in order to introduce limited competition. More recently, this effort to separate government and industry (*zhengqi fenkai*) has broadened into a movement to improve corporate governance.[17] Together, these three processes—streamlining the bureaucracy, establishing regulatory institutions, and spinning off state-owned enterprises—laid the institutional groundwork for a new regulatory state.

However, while bureaucratic rationalization and corporatization are important, these efforts have failed to create a context conducive to regulatory independence. The following discussion focuses on four institutional factors that constrain these new regulatory bodies' independence: state ownership; state and party "comprehensive" over-

[17] Calls for reform of corporate governance were made at the Third Plenum of the 16th Party Congress in October 2003. See Xinhua, "Decision on Perfecting the Socialist Market Economic System" (hereafter cited as "CPC Decision"), *Beijing Xinhua Domestic Service in Chinese*, FBIS CPP20031021000187 (October 21, 2003). The relationship between corporatization and regulatory reform is discussed in "Zhengfu Jianguan zai Zhengfu Jingji Zhinengzhong de Diwei," in *Yanjiu Baogao* (fn. 15), 56–69.

sight organizations; bureaucratic origins of regulatory institutions and personnel; and the fragmented, ambiguous authority of the regulator.

State Ownership

The Chinese government's continuing commitment to predominant state ownership of key strategic assets deeply colors the interests of and pressures on the regulator. Whereas regulatory reform in most transition economies has gone hand in hand with substantial privatization, in China, privatization has not been central to the establishment of regulatory institutions for the commanding heights industries. Even when such firms have issued stocks on public exchanges, the parent state-owned firms have firmly retained majority ownership.[18] While it is often argued that regulatory reform is more effective in the context of privatization,[19] the present focus of the Chinese government is to use regulatory reform, in tandem with improvements in corporate governance, to *enhance* the value of state-owned assets. As one scholar writes, ". . . . the state wants to maintain full or controlling ownership in enterprises in several major sectors, and it wants these enterprises to be run along commercial lines in the service of wealth maximisation."[20] State-owned firms governed by regulatory commissions are of great interest to other parts of the government, notably the "comprehensive commissions" considered next.

The Power of Comprehensive Commissions

At the pinnacle of party-state control over the Chinese economy, there are several comprehensive commissions responsible for overseeing the economy. The government commissions for planning and state asset supervision, as well as several party bodies, are most important for the strategic industries. Such comprehensive oversight is a legacy of central planning, even though the extent of government management of industry's day-to-day operations has declined dramatically with the push for corporatization. Contrary to predictions that the role of such agencies would decline during the past several years, their oversight function has actually gained renewed strength.[21] Indeed, the most recent round of bureaucratic restructuring in March 2003 strengthened the

[18] The securities regulator, CSRC, does have functional responsibility for some aspects of privatization. Still, most securities firms themselves are state-owned.

[19] See, for example, World Bank (fn. 7).

[20] Donald Clarke, "Corporatisation, Not Privatisation," *China Economic Quarterly* 7, no. 3 (2003), 27.

[21] On the reassertion of central authority over key functions of the economy, see Kun-Chin Lin, "Corporatizing China: Reinventing State Control for the Market" (Ph.D. diss., University of California, Berkeley, 2003).

state's efforts to maintain authority over strategic assets. While comprehensive agencies have been at the center of many of China's market-oriented reforms and have not uniformly been a conservative force,[22] they still have much greater power in the system than do the country's new regulators and significantly direct the decision making of regulators.

The National Development and Reform Commission (or NDRC, which is the reformulated State Development and Planning Commission, or SDPC) makes basic decisions as to which industries should receive major government investment. The NDRC is deeply involved in key regulatory decisions and even carries out some of the "classic" regulatory functions of price setting and licensing. It also has been deeply involved in the numerous restructurings of strategic industries, and in 2003, the State Council assigned it responsibility for formulation and oversight of industrial policy.[23]

The March 2003 establishment of the State Asset Supervision Administration Commission (SASAC) marked a further effort by the State Council to concentrate authority over strategic industries at the expense of other state bureaucracies. SASAC's brief includes listing a portion of assets of state firms on domestic and overseas stock markets and selling off other state assets. All this activity, however, complements an even more substantial priority: maintaining value in those assets clearly earmarked to stay in the state-owned sector. Thus, SASAC is responsible for enhancing the value of assets of 196 key industrial enterprises directly under the State Council, excluding banks and securities companies.[24] It centralizes numerous functions previously dispersed among different ministries and other agencies;[25] as such, it should, in conception, help define the space for independent regulators to exercise authority.

Last but not least, the Chinese Communist Party remains the ultimate arbiter of regulatory reform, although the exact mechanisms of

[22] For example, central agencies have been crucial to the effort to break down local protectionism, thereby helping to create an integrated national market. Andrew Mertha, "China's 'Soft Centralization': Reasserting State Control over Regional Economies to Combat Local Protectionism, 1998–2002" (Manuscript, Department of Political Science, Washington University, 2003). This trend was predicted in Vivienne Shue, *The Reach of the State* (Stanford, Calif.: Stanford University Press, 1988).

[23] The planning commission's authority increased in 1998 with the elimination of many line ministries and the shedding of many of its responsibilities for routine oversight. In March 2003, the SDPC was strengthened and renamed the NDRC. Lyman Miller, "The 10th NPC and China's Leadership Transition," *China Leadership Monitor* 7 (Summer 2003), 7. (In this article, "SDPC" refers to the institution prior to March 2003, whereas "NDRC" refers to the commission's actions after that time.)

[24] Financial institutions are not on the SASAC list so as to avoid pressure to loan to other state enterprises.

[25] SASAC (Guoyu Zichan Jiandu Guanli Weiyuanhui) centralizes a number of functions previously spread among its weaker predecessor, the State Assets Commission, the Ministry of Finance, and the now-defunct State Economic and Trade Commission (SETC). Two of the few analyses of SASAC are Barry Naughton, "The State Asset Commission: A Powerful New Government Body," *China Leadership Monitor* 8 (Fall 2003); and Yang (fn. 4), 49–54.

party influence continue to be poorly understood. Organizationally, party interests are manifested through several channels. One major conduit is "leading small groups" (*lingdao xiaozu*), which are joint party-state organizations of top officials in a given sector. The Finance and Economics Leading Small Group, for example, is an extremely powerful oversight and coordination body for the securities regulator, CSRC.[26] In 1996, the State Council formed the State Informatization Leading Small Group (SILSG), which is headed by senior officials in the sector and is responsible for national informatization strategy.[27] Twenty-four commissions, ministries, and other interested offices participated in the SILSG at its height, although recently, its role has been pared back in favor of its former subordinate, the State Council Informatization Office (SCIO).[28] There is also a leading small group for electric power reform.

The party further asserts influence through its Organization Department, which continues to have a voice in appointments to top regulatory agency positions, as well as in appointments to top managerial posts at state firms (as illustrated in the next section). In 2003, this appointment power for major nonfinance firms was transferred to SASAC, which now must balance the interests of the State Council and the party in making top-level appointments to state firms.[29]

The Origins of Institutions and Their Personnel: Old Wine in New Bottles?

The backgrounds and accompanying biases of the leadership and staff of new regulatory agencies represents a third constraint on regulatory independence. Line ministries formerly responsible for the regulation and control of strategic monopoly sectors are most often the source of the new regulators. For example, the People's Bank of China (PBOC) spun off the independent regulators in financial services—securities, banking, and insurance—between 1992 and 2003. It was predictably controversial to carve off securities regulation from the PBOC, so the

[26] Stephen Green, *China's Stockmarket* (London: Profile Books, 2003), 192.

[27] MFC Insight, *State Informatization Leading Group* (Beijing: MFC Insight, March 2002). Until the March 2003 leadership change, Premier Zhu Rongji led the SILSG; members included now-President Hu Jintao plus the highest-ranking officials in charge of science, education, research, and the economy.

[28] SCIO, formed in 2001, is run by three vice ministers under the SILSG's direction.

[29] The 1998 restructuring reduced the party's nomenklatura power to appoint key industry leaders, with much of the authority to appoint management placed with the State Council's Large Firm Work Committee (*dagongwei*). The party wrested back some of this power by creating the powerful (but little-known) Central Enterprise Work Commission (Zhongyang Daxing Qiye Gongzuo Weiyuanhui). SASAC is the most recent iteration of the party-state power of appointment. Naughton (fn. 25); and author interview with Development Research Center of the State Council scholar, November 26, 2002.

bank fought to keep authority over the burgeoning industry.[30] The telecommunications regulator, the Ministry of Information Industry (MII), was formed in a 1998 merger between the Ministry of Post and Telecommunications (MPT) and the Ministry of Electronics Industry (MEI).[31] Similarly, the electric power regulator, the State Electricity Regulatory Commission (SERC), had its origins substantially in the Ministry of Electric Power (MEP).[32] In civil aviation, the mission of the former ministerial-level body—the General Administration of Civil Aviation (CAAC)—was pared back in 2002 to include only regulatory functions; its owner/operator responsibilities were shifted to a state holding company.[33]

Leaders and staff of regulatory agencies are routinely drawn from these old ministries or incumbent firms. MII is staffed heavily from the two ministries from which it was formed. SERC brings together one commissioner from each of the major governmental bodies that played a significant role in electricity policy at the time of SERC's formation. The financial services regulators have brought over many former staff members from the PBOC. In insurance regulation, many CIRC officials are from the incumbent firm, the People's Insurance Company of China (PICC), as well as the PBOC; in fact, CIRC shares the PICC building in Beijing.

On the one hand, the migration of staff from former ministries is beneficial because it both provides continuity and expertise from those long involved in the sector and facilitates the negotiation of political compromises. On the other hand, this continuity reinforces a cozy relationship between the incumbent firm, the regulator, and the policymaker. In recognition of this problem, and in an effort to enhance the political independence of regulators, the new Hu Jintao government in

[30] Carl E. Walter and Fraser J. T. Howie, *Privatizing China: The Stock Markets and Their Role in Corporate Reform* (Singapore: John Wiley & Sons, 2003), 48.

[31] MII was an exception to the 1998 downsizing trend. Simultaneously, part of the impetus for the formation of MII was to further separate the controlling ministry, previously the MPT, from the incumbent firm, China Telecommunications. See Kenneth J. DeWoskin, "The WTO and the Telecommunications Sector in China," *China Quarterly* 167 (September 2001); and Zhang Xinzhu, "Universal Service Obligations in China's Telecom Sector: Situations, Reforms, and Implementations" (Manuscript, Research Center for Regulation and Competition, Chinese Academy of Social Sciences, Beijing, May 2002), 12–13.

[32] Following the 1997 spin-off of the monopoly incumbent, State Power Corporation, MEP was abolished in 1998. Its oversight functions were transferred first to SDPC, then to SETC before the power regulator was launched in March 2003. Zhang Chi, *Reform of Chinese Electric Power Market: Economics and Institutions* (Stanford, Calif.: Stanford University Program on Energy and Sustainable Development, January 31, 2003), http://iis-db.stanford.edu/evnts/1565/China.pdf (accessed June 1, 2005).

[33] See Jae Ho Chung, "The Political Economy of Industrial Restructuring in China: The Case of Civil Aviation," *The China Journal* 50 (July 2003); and Andy Rothman, *China Aviation Reform: Industry Overview* (Hong Kong: CLSA, 2002), 7.

2003 brought in a number of "outsiders" to lead regulatory agencies. The new heads of MII (Wang Xudong) and SERC (Chai Songyue) are both former provincial governors and are considered more neutral toward the incumbent firms than were their predecessors, who were longtime veterans of the post/telecommunications and electric power bureaucracies, respectively (although Chai worked in the power industry previously, casting a bit of a shadow over his claim of "independence").

A revolving door for personnel has strengthened this tendency toward cozy regulator-firm relationships. One telling example occurred in 2003, when the government forced a one-for-one job swap between a top MII regulator and a top telecommunications business executive; the vice minister of MII (Zhang Chunjiang) was appointed as president of China Netcom, one of the four major telecommunications firms, while the president of China Netcom (Xi Guohua) was given Zhang Chunjiang's former job at MII. Quite a number of MII officials were dispatched simultaneously to substantial positions in industry. As one academic deeply involved in telecommunications restructuring noted, there is still a "take your turn" mentality, in which official postings are preferred to business jobs, and rotations must occur accordingly.[34] As suggested previously, it is the government's efforts to control top leadership of state-owned firms, rather than business efforts to lure away officials, that power this revolving door.

The Fragmented and Ambiguous Authority of Regulators

The fragmentation and poorly defined authority of China's new regulatory institutions contributes to their institutional weakness. In addition to high-level comprehensive ministries, governmental bodies at the same (or nearly the same) level of hierarchy as the new regulators continue to claim authority in regulatory matters. The problem of fragmentation is not unique to China, of course; the U.S. regulatory system, for example, is characterized by fragmentation of regulatory structures.[35] However, the impact of fragmentation on regulatory politics is particularly acute in China because the lines of authority are poorly delineated and implicit divisions of labor are generally not defined statutorily. In the strategic industries, numerous institutions have authority (or their personnel *perceive* themselves to have authority) over different, and

[34] Author interview, Washington, D.C., November 18, 2003. Zhang Chunjiang was reportedly unhappy with this transfer to the business side, and only learned about the transfer upon return from an overseas trip.

[35] Marc Allen Eisner, *Regulatory Politics in Transition*, 2d ed. (Baltimore: Johns Hopkins University Press, 2000), 7. Rather than tampering with existing agencies, new agencies (e.g., the U.S. Department of Homeland Security) are commonly created to administer new policies.

sometimes even the same, issue-areas to which the formal regulator has been assigned. Consequently, the formal division of regulatory authority is unclear and often the subject of dispute.[36] Moreover, while it is relatively easy to grant regulatory authority to a new organization, it has proven to be much harder to revoke authority from organizations that have asserted substantial control in the past. When new issues require regulation, government offices with neither previous involvement in nor explicit authority over these issues have been known to move in to make a "regulatory grab."[37] The frequency of reforms that transfer authority from one agency to another have only exacerbated this jurisdictional confusion.

Telecommunications regulation clearly illustrates this problem of fragmentation. Within MII, the Telecommunications Administration Bureau plays the main regulatory role; consequently, the regulator sits on a key policy body in the telecommunications sector.[38] Of even greater concern, multiple government offices outside of MII have a "place at the table" in regulating the industry. Numerous actors have a keen interest in regulatory affairs because the industry promises huge revenues for both the incumbent monopoly (China Telecom) and central and local governments. Competing organizations have a mandate for involvement in telecommunications that, for many of them, predates MII's formation. Their involvement reflects a basic decision made in the mid-1990s to do what many other countries have found it necessary to do: include at the table all interested parties in the development of information technology.[39] As the backbone of both military and societal communications, this sector deals with issues of national and domestic security. Accordingly, in addition to comprehensive organizations such as the informatization leading small group and NDRC, the People's Liberation Army (which oversees national security concerns) and the Ministry of Finance (which oversees revenues and accounting) are also involved in telecommunications.[40] A multitude of

[36] This is a theme in the writings of China's foremost scholars of regulation in *Yanjiu Baogao* (fn. 15).

[37] Author interview, Chinese Academy of Social Sciences scholar, Beijing, September 13, 2002. Such "regulatory grabs" also characterized Japan's regulatory reforms in the 1980s. Vogel (fn. 2), 210.

[38] Xinzhu (fn. 31) suggests that the role of the TAB vis-à-vis other parts of the MII, especially at the provincial level, is far from clear.

[39] On comparative cases, see Kenneth L. Kraemer, Jason Dedrick, Kuk-Hwan Jeong, John Leslie King, Thierry Vedel, Joel West, and Poh-Kam Wong, "National Information Infrastructure: A Cross-Country Comparison," *Information Infrastructure and Policy* 5, no. 2 (1996).

[40] On the competing government offices with a claim on telecommunications matters, see Zhang Xinzhu (fn. 31); Colin Lixin Xu, Christine Zhen-Wei Qiang, and Ying Liang, "The Unfinished Agenda of Telecom Reforms in China" (Manuscript, World Bank, Washington, D.C., October 2000); and DeWoskin (fn. 31).

other interested government parties have become involved in Internet regulation, including those concerned with domestic security.[41] To further confuse matters, key telecommunications regulations do not explicitly designate which body has authority over major regulatory matters; rules issued in 1999 and 2000 repeatedly state that the State Council—not specifying MII—has authority over classic regulatory issues of licensing and pricing for basic services.[42]

As in the telecommunications sector, there are deep, vested bureaucratic and political interests in the electric power sector. Former Premier Li Peng's family, for example, has a long-standing connection to the sector. Electric power also involves huge revenues for the state-owned incumbent firm, as well as for the central and local governments. Power generation lies at the heart of China's industrialization trajectory and is seen as crucial to national security. Key agencies that compete with the new regulator, SERC, include the Department of Power Industry[43] (which issues licenses, establishes standards, and enforces laws), the Ministry of Finance, the State Environmental Protection Agency (which is responsible for environmental regulation), and the State Administration for Industry and Commerce (which approves business activities). In civil aviation, in addition to the formal regulator, CAAC, the incumbent airlines (at the central, provincial, and local levels), the PLA, and the Ministry of Communications all play important roles in restructuring and ongoing regulation.[44]

The problem of fragmentation is less intense for new regulators in financial services, yet can still be powerful. In particular, the PBOC and the Ministry of Finance have ongoing interests in financial sector assets. As will be described subsequently, even though the securities regulator has had some success in solidifying its authority, the same cannot be said for the much younger insurance and banking regulators.

The problematic nature of regulators' authority is compounded by a phenomenon unique to China: most regulators have been given a bureaucratic status that, in the Chinese political system, is neither fish nor fowl. Particularly in the absence of clear codification of regulatory power, an organization's positioning in China's bureaucratic hierarchy

[41] Government agencies with authority over the Internet include the State Administration of Radio, Film, and TV (SARFT); the State Secrets Bureau; the Ministry of Public Security; and the State Administration for Industry and Commerce.

[42] DeWoskin (fn. 31), 640.

[43] The Department of Power Industry, the bureau-level successor (as a result of the 1998 reorganization) to the Ministry of Electric Power, was first located in the SETC, and then in 2003 was moved to the new Ministry of Commerce.

[44] Rothman (fn. 33); and Chung (fn. 33), fn. 79.

strongly influences its negotiating clout. The three financial services regulators and the electric power regulator are each formally designated as *shiye danwei*, a term frequently translated as "service organization." Previously, this designation was reserved primarily for public service, not-for-profit organizations in research, education, and health care. In recent years, however, the *shiye danwei* designation also has been given to a small number of new State Council organizations with unimpeachable administrative functions, including regulators,[45] because such designation can be helpful for subverting normal bureaucratic restrictions. The status does not require the heads of regulatory agencies to be approved by the National People's Congress, unlike heads of ministries and other governmental "organizations." Instead, the designation allows regulatory agencies to circumvent limits on the pay scales of government officials; this is particularly important for financial services regulators that hope to compete for top talent with higher-paying private institutions, such as international investment banks. Moreover, as *shiye danwei,* regulatory agencies avoid the restrictive headcount limits that were placed on the size of government during previous downsizing efforts.

Thus, regulatory institution employees technically are not civil servants; as one interviewee noted, "you are 60% an official if you are in a *shiye danwei*, rather than 100% if you are a civil servant."[46] As this comment suggests, *shiye danwei* regulators have been placed in an odd spot within the bureaucratic hierarchy. While the regulators report directly to the State Council, the traditionally lower status of organizations with this designation has clouded their authority and limited their effectiveness. Indeed, members of their staffs report that they have had insufficient clout for dealing with ministries. In response to this authority deficit, the leaders of all regulatory *shiye danwei* have been granted ministerial rank in recent years.

Beyond this upgrade to ministerial rank, other efforts have been made to rectify the various institutional deficiencies in the authority of regulators. This article has already mentioned the introduction of in-

[45] Traditionally, *shiye danwei* institutions perform nonprofit functions under government direction. *Shiye danwei* are distinguished from governmental "administrative agencies" (*xingzheng jiguan*) such as ministries (e.g., MII) and governmental "organizations" (*jigou*—e.g., CAAC), on the one hand, and profit-making enterprises (*qiye danwei*), on the other hand. Some of these institutions, such as the Chinese Academy of Sciences, have long been under the "direct leadership" (*zhijie lingdao*) of the State Council, but most are located at lower levels of government. Historically, they have been of lower status in the State Council hierarchy than "administrative agencies" and "organizations"; in particular, they are seldom headed by ministers. See Lam Tao-Chiu and James L. Perry, "Service Organizations in China: Reform and Its Limits," in Peter Nan-shong Lee and Carlos Wing-Hung Lo, eds., *Remaking China's Public Management* (Westport, Conn.: Quorum Books, 2001).

[46] Author interview with CIRC official, Beijing, November 27, 2002.

dustry "outsiders" to lead regulatory agencies. The greatest efforts at empowerment have been directed toward the securities regulator, CSRC, which perhaps is not surprising, given that CSRC is reputedly the most market-oriented regulator, as well as because it often has been staffed with Western-trained personnel at its highest levels. Pressure to turn CSRC into "China's Securities and Exchange Commission" (more than just in name) is attributable to the desire to create world-class stock markets in China as well as to have Chinese state-owned firms listed on international stock exchanges. As such, China's securities regulation process is subject to international market discipline. Thus, as of 1997, CSRC was no longer required to share oversight of China's two stock markets, in Shanghai and Shenzhen, with those cities' municipal governments. The 1998 promulgation of the Securities Law constituted another important step because it helped to end the turf war with PBOC over securities regulation by naming CSRC as the sole regulator for securities firms (however, the Finance and Economics Leading Small Group still maintains a powerful, if uncodified, influence).[47] These and related steps, if extended to other industries, would help to solidify the authority of China's regulators.

Regulatory Norms: Structured Competition, Limited Firms

In addition to institutional structure and delineation of formal powers, normative preferences also significantly influence the independence and authority of China's regulators. In China, there is neither an overarching regulatory agency (as distinct from policy authority) nor a national competition policy that clearly states the dominant norms regarding economic regulation. Across the strategic industries, however, policies, policy statements, and comments by Chinese leaders and regulators reveal a normative vision for those industries. This section considers two norms that are central to China's regulatory regime: preference for "orderly" competition and preference for a small number of dominant, state-owned players in the market. These preferences, in tandem with the institutional structures discussed previously, have encouraged protectionism of incumbent industries against new domestic and foreign competitors.

Before examining these preferences in detail, it is important to con-

[47] Walter and Howie (fn. 30), 62. These authors also detail the centralization of regulatory power over securities under CSRC in Beijing and its branches, and away from provincial governments. See also Green (fn. 26), 159–60.

sider further the Chinese leadership's "metavision" for the country's industrial future. The party-state wishes to achieve several overlapping financial/strategic and social/political imperatives through these industries. The financial/strategic goals reflect the view that, in contrast to the image of state-owned firms as moribund and unproductive, many strategic industries consist of highly productive—or potentially productive—assets and are important both to control via ownership and to manage well.[48] In particular, telecommunications and electric power firms are "crown jewels" of the state-owned system; state-owned banks and other financial institutions, while far from profitable, are also seen as crucial to China's economic security. In other words, those with broad authority over the Chinese economy consider the strategic industries to be too politically and economically important to leave to an ideal of evenhanded, politically insulated, arm's-length regulation. Many of these firms are integral to achieving the oft-stated goal of creating internationally competitive industries capable of strong competition in world markets—"national champions." In the post-WTO entry environment, moreover, the desire to avoid being crushed by foreign competitors has taken on new urgency. Whereas some believed that the early 1990s emphasis on "pillar industries" would lessen dramatically after the Asian Financial Crisis, such emphasis—particularly as concerns the telecommunications and electric power industries—still exists.[49]

Moreover, the government relies upon these industries to help it achieve certain social/political goals seen as central to maintaining social stability. Many strategic industries are important sources of employment; huge banks and the telecommunications firms employ large numbers of people directly, while new service industries such as insurance and securities have provided new sources of employment. Fur-

[48] A major policy of state-owned enterprises in the last five years has been *zhuada, fangxiao*, or, "grasp the big and let go of the small." The policy calls for closing down or selling off small- and medium-sized state assets, while taking better control of the large ones—including most of those governed by the new regulators and/or on the SASAC list. Clarke (fn. 20).

[49] Telecommunications's role as a "pillar industry" is stated in the Tenth Five-Year Plan for Telecommunications (2001–2005). MII's summary of the plan declares the "information industry as a pillar industry in the national economy" and "a strategic industry fundamental to national security." See Telecommunications Research Project of Hong Kong University (hereafter cited as "TRP"), "China: Summary of the Tenth Five-Year Plan (2001–2005)—Information Industry," http://www.trp.hku.hk/infofile/china/2002/10-5-yr-plan.pdf (accessed January 25, 2004).

On electric power as a "pillar" industry, subject to extensive planning by the NDRC, see Zhang Chi (fn. 32). On renewed emphasis on "national champions," see Eric Thun, "Industrial Policy, Chinese-Style: FDI, Regulation, and Dreams of National Champions," *Journal of East Asian Studies* (Fall 2004). As a rule, industrial policy is not WTO-incompatible, although certain tools commonly used in industrial policy are. The belief that the Asian Financial Crisis would snuff out industrial policy in China is expressed in Nicholas Lardy, *Integrating China into the Global Economy* (Washington, D.C.: Brookings Press, 2002), 152.

thermore, these firms engage in many "public" expenditures of revenue, such as the building construction that each provincial telecommunications company carries out. In its Tenth Five-Year Plan (2001–2005) for Information Industry, the government committed unambiguously to a universal services obligation (USO), with the goals of providing all citizens and regions equal access to telephony and of safeguarding state information security.[50] Similarly, since the late 1990s, it has increased efforts to provide lower electricity prices to rural areas (which, in 2000, were 45 percent higher than in urban areas) as well as to develop and expand power transmission capacity in Western China (part of the Tenth Five-Year Plan).[51] The insurance industry is seen as crucial to offloading from the state budget the previous burden of providing certain forms of social security.

This metavision—which consists of the need to control and maintain a revenue stream from major state assets, the creation of national champions, and the achievement of employment, universal services, and social security goals—has contributed to regulatory preferences for controlled competition among a limited number of firms.

Preference for Controlled and Orderly Competition

Pressure to increase market competition for China's state-owned enterprises has come from the highest levels of government. Competition, officials argue, will help firms to become more efficient and profitable. The lead-up to China's WTO accession convinced policymakers that increased competition in the domestic market would strengthen Chinese firms prior to the onslaught of foreign competition. Yet they continued to regard unfettered competition as harmful and decided accordingly that competition in strategic, state-owned industries should be "orderly." A major CCP statement on the economy issued in 2003 reiterated that the state should "restrain disorderly competition," a goal voiced repeatedly in statements by regulators in both network industries and financial services.[52]

The experiences of the 1990s strengthened this preference for mar-

[50] On the social/political goals of telecommunications, see Zhang Xinzhu (fn. 31) and TRP (fn. 49).

[51] See OECD (fn. 12), 414; Zhang Chi (fn. 32); and Songbin Zhu and Xiaolin Li, "China Powers Up," *China Business Review* 30, no. 3 (May–June 2003).

[52] See "CPC Decision" (fn. 17). Concern for market stability in insurance was voiced by former CIRC head Ma Yongwei. See "China to Tighten Insurance Regulation," *People's Daily* (online), February 9, 2002, http://english.people.com.cn/200202/09/eng20020209_90184.shmtl (accessed June 13, 2005). The Tenth Five-Year Plan in telecommunications encourages "orderly competition." TRP (fn. 49). On limits on competition in China during the entire reform period, see Peter Nolan, *China and the Global Business Revolution* (Hampshire, UK: Palgrave, 2001); and Dorothy J. Solinger, *From Lathes to Looms: China's Industrial Policy in Comparative Perspective* (Stanford, Calif.: Stanford University Press, 1991).

ket order in strategic industries; rapid increases in competition led to extreme price-cutting at the local level and frustration over the inability of central regulators to halt it. Officials have expressed concern about excessive price competition by local telecommunications firms, such as (illegal) sales of phone calling cards at prices below face value.[53] CAAC's concern over the revenue slide across the airline industry compelled it to restrict discount ticketing.[54] A revenue imperative is therefore clear in the desire to limit competition. Too much competition, if it encourages cutthroat pricing, leads to lower revenues for these major sources of state revenue and thus harms the market position of major state firms. The response to excessive competition from early market experiences and the concern to protect revenues are further reflected in the use of price floors (as opposed to price caps, which are employed in many countries to protect consumers). These concerns also help explain the decision to have the NDRC retain authority over pricing in electric power and telecommunications.[55]

Preference for a Limited Number of State-Owned Competitors

To enhance competition in the last decade, the Chinese government has spun off state-owned monopolies from government ministries and broken them up. Yet the simultaneous desire to avoid "harmful" competition has effectively narrowed down the number of major competitors to a select few *state-chosen*, state-owned firms,[56] as the State Council has directed the market structuring plans. Often, monopolies have been divided along either geographic or business lines. Given the poor integration in many sectors of the domestic market, geographic restriction tends to create regional monopolies rather than foster genuine head-to-head competition.

What market structures, then, have emerged in the strategic industries? In the infrastructure industries of telecommunications, electric power, and civil aviation, five or fewer dominant firms comprise the market. To some degree, this structure reflects preferences found internationally for network industries, which have characteristics of natural monopoly.[57] China, however, is distinct in that the state makes such

[53] Peter Waters and Bernadine Lai, "The Importance of Being Well-Connected," *MFC Insight* (February 28, 2003).

[54] Chung (fn. 33), 77.

[55] The NDRC allows electricity prices to fluctuate within a 10-percent band. By international standards, the state-set price of electric power in China is high.

[56] Nolan (fn. 52) discusses the balance between increasing competition and state industry consolidation.

[57] See Oz Shy, *The Economics of Network Industries* (Cambridge: Cambridge University Press, 2001).

pronounced efforts to not only identify the state firms, but also to continually and in very short sequence reorganize them, presumably in an attempt to find the optimal structure.

The most dramatic example of state-driven creation of market structure is in telecommunications services, which the State Council has restructured several times in the past decade. As of 2004, there were four dominant carriers (the China Telecom Group, China Netcom, China Unicom, and China Mobile) and one smaller carrier (China Railcom).[58] Ten years earlier, the monopoly incumbent China Telecom was spun off from MPT; that same year, the State Council directed the formation of China Unicom to provide it competition (this duopoly was modeled explicitly on Britain's telecommunications deregulation policy). Nonetheless, by 1998, the incumbent China Telecom still controlled about 99 percent of the fixed and mobile markets.[59] China Telecom justified its anticompetitive behavior both by stoking the fear of price wars and by bemoaning the fact that it had been required to assume the entire financial burden for providing universal services.

Subsequent restructurings mandated by the State Council in 1999 and 2000 created five carriers. In early 2002, under the rationale that the existing structure and MII's favoritism had created insufficient competition, the State Council forced yet another round of restructuring. The still-behemoth descendant of China Telecom, the China Telecom Group, was divided into two companies that, initially, were each based in distinct geographic regions—the profitable south and some western provinces. A reformulated China Netcom added rights to operate in the northern ten provinces formerly controlled by the China Telecom Group. Together with Mobile, Unicom, and Railcom, these five firms are the players that presently constitute the telecommunications landscape. The government, outside of MII, is still trying to "get the market right" and avoid further wasting of assets; a May 2004 proposal floated, reportedly by SASAC, to merge the four dominant telecommunications players into two fully integrated carriers reflects this continuing concern.[60]

The State Council has directed, in detail, each of the restructuring packages in telecommunications, often facing resistance from the regulator, MII, which has sought to protect its former "child," China Telecom.

[58] This discussion applies to basic service providers in telecommunications. The market structures of equipment providers and value-added services are more diverse.

[59] On market concentration as well as the serial restructurings in telecommunications, see Xu et al. (fn. 40), 4, 7; and Zhou Qiren, "Building Up a More Competitive Telecommunication System in China" (Paper presented at the University of Maryland, College Park, November 18, 2003).

[60] Kan Kaili, "Bu Paichu Youren Zao Shi" (Don't rule out that some create the force), http://it.sohu.com/2004/06/15/22/article220542253.shtml (accessed June 20, 2004).

A case from November 2002, involving an initial public offering of China Telecom Group stock in Hong Kong, illustrates this all-too-common dynamic of protectionism that the State Council is trying to combat. MII ordered the offering to be delayed because of concerns that the tender would not sell well; the delay was preceded by MII's last-minute directive to China Telecom to dramatically hike rates on long-distance calls between Hong Kong and China to make the stock offering more attractive.[61] Whereas a truly independent regulator charged with setting firm-neutral rules to promote competition would not have attempted to adjust the stock market for a single company, MII continued to favor the incumbent even after several rounds of restructuring.

In the electric power industry, a Politburo-approved SDPC plan in late 2002 broke up the State Power Company—the incumbent monopoly and the largest capacity power producer in the world. (State Power had been separated from its parent Ministry of Electric Power in 1997.) The breakup, and particularly the separation of generation facilities from the transmission grid, represented an effort to enhance efficiency and profitability in the sector. This move created five separate power producers/generators as well as two main grid networks, each with a regional base. (There is one grid each in the north and the south.) Of the five generation firms, each of which was given roughly equal generating capacity, three remain under the control and ownership of a holding company with roots in State Power.

The reorganization of the civil aviation sector has differed from that of both the telecommunications and electric power sectors, but the resulting market structure remains familiar. An intensified breakup of the industry began in the late 1980s and early 1990s, as provinces and regions were authorized to form their "own" regional airlines, leaving China with one of the most fragmented airline industries in the world.[62] The resulting dismal profitability and great market disorder inspired a series of restructuring moves. A limited and largely unsuccessful round of restructuring in 1999, aimed at halting the hemorrhaging of revenues, was followed in 2002 by another sweeping government ef-

[61] This hike reportedly had been approved by MII and the State Council in 1999, but it was not implemented until it was needed to support the IPO. Premier Zhu Rongji was sharply critical of these events. Tony Munroe and Vicki Kwang, "China Telecom Delays IPO because of Weak Demand," *Reuters*, October 31, 2002. MII also acted on behalf of China Telecom in its 1998 dismantling of Sino-foreign joint ventures involving Unicom. DeWoskin (fn. 31). Xu et al. (fn. 40) argue that "MII still acts protectively for Telecom on all regulatory decisions" (p. 9).

[62] The number of registered airlines expanded from just one (CAAC) to thirty-four. By the late 1990s, China had two-thirds the number of airlines as the U.S. did, and had less than 20 percent of the market size. Rothman (fn. 33), 3.

fort to restore profitability. By the fall of 2002, the ten carriers that had remained directly under CAAC were merged into three groups, which collectively control 80 percent of the aviation market;[63] local governments, primarily, own the remaining firms. These moves left CAAC as the industry regulator. A government-controlled holding company overseen by SASAC took ownership of the newly merged carriers.

Restructuring in the infrastructure sectors of telecommunications, electric power, and civil aviation has therefore led to five major (but not fully competing) telecommunications firms, three major airlines, five electricity generators, and two transmission grids. The government has taken a somewhat different approach in its policies toward the financial services sector. The market structure of the commercial banking industry more closely resembles that of the infrastructure industries in that it is dominated by four state-owned firms. Banks are weak and saddled with well-documented problems from nonperforming loans.[64] Neither the State Council nor the new banking regulator is yet prepared to break up these banks, nor is either inclined to stimulate extensive competition. In both securities and insurance, the number of firms the government allows is greater than for the industries discussed previously; barriers to entry are naturally lower and there is less effort to limit entry.

Nevertheless, due to concerns about the weak performance of the financial services sector (as well as fears over excess competition), the government has been active in structuring the market and determining who the market players are. In securities, in part because the industry is new, initially there was stronger market competition than in other industries and, as a result, there was also more frequent failure of firms. To stabilize the industry, CSRC hopes to encourage consolidation into eight to ten nationally competitive firms and has overseen (and, in many cases, organized) mergers of large and small firms.[65] In insurance, PICC, the PBOC-based incumbent formed in 1949, began to face competition in geographically restricted markets in the late 1980s; by 1996, eleven domestically owned insurance companies had licenses to operate. Industry restructuring in 1999 spun off three, separate state-owned companies

[63] The three groups are Air China (China National Aviation), China Eastern Airlines, and China Southern Airlines. Two other companies were formed in related businesses. Chung (fn. 33), 76–78; and Tang Min, "Restructuring Puts Air China in Advantageous Position," *China Daily*, November 29, 2002, 1. The 1999 restructuring involved raising prices and reducing the number of domestic flights.

[64] Lardy (fn. 49), 128–130; Green (fn. 26), 22. The four commercial banks are: Industrial and Commercial Bank of China, Agricultural Bank of China, Construction Bank of China, and Bank of China.

[65] The firms are primarily state-owned (13 percent of assets were private at the end of 2002), mostly by local governments. Green (fn. 26), 78–84, 96.

from PICC.[66] In anticipation of foreign competition following WTO accession, by mid-2001 twenty domestic firms were licensed in the Chinese market, and CIRC officials suggested that five new licenses would be issued per year.[67] Although there are significantly more firms operating in insurance than in other strategic industries, as of 2000, the three largest companies held a 95.5 percent share of the life insurance market and a 97.1 percent share of the nonlife market, and the regulator, CIRC, appears to be using its licensing powers very carefully to preserve PICC's value.[68]

As the previous discussion suggests, the government uses licensing powers extensively across industries to direct policy and restrict market entry, rather than merely to set minimal conditions for doing business. When combined with considerable discretion on the part of the regulator and the absence of a thoroughgoing competition law to ban exclusionary practices, China has learned what Korea and Japan have long known: licenses are a powerful tool for restricting market entry of both foreign and domestic firms.[69] In addition to CIRC's aforementioned issuance of insurance licenses, the awarding of licenses for third-generation (3G) technology in mobile telephony (decisions in which the NDRC is deeply involved) will be crucial for the future of market structuring in telecommunications.

The corollary of the need to continue to protect a limited number of firms is that regulators, reflecting the norms of the State Council and party, *must* care which firms succeed and which fail; it is politically imperative that the party-state not turn a blind eye to the failure of a major state firm. While the failure of firms, particularly former incumbents, is difficult to bear in any political system, the need to protect them is acutely felt in China.

CONCLUSION

This article has identified the core patterns in China's emergent regulatory state as manifest in the most strategic sectors of the economy. It

[66] The 1996 restructuring created three groups under one PICC holding company. On the market structure of the Chinese insurance industry, see OECD (fn. 12), 274–75.

[67] The National Bureau of Asian Research, "China: Insurance Industry and WTO Liberalisation," http://www.nbr.org/wtoforum/MaYongwei.html (accessed November 23, 1999).

[68] Only five companies have been granted licenses to operate nationwide. OECD (fn. 12), 276, 280.

[69] OECD (fn. 12), 399. China's use of licensing to determine market entry is reminiscent of Japan's strategy for protecting industry. Yul Sohn, "The Rise and Development of the Japanese Licensing System," in Lonny E. Carlile and Mark C. Tilton, eds., *Is Japan Really Changing Its Ways?* (Washington, D.C.: Brookings Press, 1998). China's 1993 Unfair Competition Law and 1999 Price Law do not ban many exclusionary practices, though they do prohibit overt, anticompetitive protectionist actions by local governments. OECD (fn. 12), 38, 397, 421.

has argued that both the institutional context and the normative preferences of the top leadership are important constraints on the emergence of truly independent regulators. Institutionally, the continued influence of ministries and comprehensive commissions, insufficient status, and the fragmentation of the regulatory mandate limit the effective authority of new regulators. State ownership of strategic firms also remains highly salient. Normatively, the leadership's metavision—which focuses on state control of key sectors, the desire to create profitable new "national champions," and continued commitment to certain social and distributive goals—is crucial. As a result, the government's emerging vision of the market for strategic industries endorses only limited competition and restricts market entry to a few huge, market-dominating state firms.

It would be obviously erroneous, however, to claim that there has been insubstantial movement toward the global benchmark of the independent regulator in the development of China's regulatory state. Especially if we consider the highly time-compressed nature of the reforms, which occurred across a number of major industries over the span of ten to fifteen years (and accelerated during the past five years), we should be astonished at what *has* occurred. The State Council has tried to insulate the new regulators by creating, with the exception of the telecommunications regulator, organizations separate from the old ministries that ran the businesses. The creation of SASAC and the establishment of the *shiye danwei* rank, though problematic at times, have aided this effort. These institutions have been formed, moreover, with the goal of greatly increasing the professionalism and capacity of state efforts to govern the economy—a feat few developing countries have accomplished.[70] Furthermore, steps have been taken to overcome shortcomings as they appear, including raising the status of *shiye danwei* regulators to the ministerial level and bringing in heads of regulatory organizations that were not as deeply implicated in the old systems as the regulators they replace. CSRC has led the way; major statutes have codified its authority. The international financial market discipline that led to this clarification is arguably much weaker in other sectors, particularly in infrastructure industries. Nevertheless, greater successes in securities regulation may provide a useful model.

Considering these various facets of China's experience, what conclu-

[70] This has been a major goal of China's regulatory development. On international efforts at capacity building, see Merilee S. Grindle, "Ready or Not: The Developing World and Globalization," and Elaine Ciulla Kamarck, "Globalization and Public Administration Reform," both in Joseph S. Nye and John D. Donahue, eds., *Governance in a Globalizing World* (Washington, D.C.: Brookings Press, 2002).

sions can be drawn about China's regulatory system and, more broadly, about governance of its markets? At the level of the firm, the process of change undeniably has enhanced regulatory risk, particularly for new entrants. The absence of codification, compounded by the massive shifts in both the regulatory environment and corporate structure, create risk. Even though the constant reforms reflect efforts to create a more efficient system, continuing uncertainty has spurred incumbent firms' efforts to minimize risk by drawing on protective ties with either regulators or other government patrons. Opportunities for corruption also abound.[71] At the level of the state, China's emerging experience offers us a reminder of the familiar lesson: creation of markets and market governance is a highly political process and continues to be so despite the globalizing influences of the WTO and other international economic institutions. Indeed, the state has positioned itself as a crucial player at the commanding heights of China's economy; in that realm, regulatory reform has sustained, rather than attenuated, government control.

Ultimately, scholars must reconcile the finding of a continued role for strong state control over China's "lifeline" industries with pervasive images depicting a highly competitive Chinese economic system. Such models of China's political economy frequently predict or imply a convergence of the economic institutions and norms toward capitalism and, as a corollary, a continuing reduction of the central state's role,[72] while other models emphasize the decentralization of the economy and the entrepreneurial role of the local state.[73] These models have some validity; the picture of vibrant competition between myriad firms, subject to little intervention by the central state, in highly productive private and collective sectors represents an important trend in parts of the economy—most notably, the agricultural and export-driven sectors, as well as many consumer goods and retail firms.

[71] Regulatory risk is risk to firms for which regulatory changes will harm business. Risk is higher in natural monopoly industries, where sunk costs are high. Governments may try to reduce risk by monitoring changes in rules and processes to encourage transparency. Andrei Shleifer and Robert W. Vishny, *The Grabbing Hand: Government Pathologies and Their Cures* (Cambridge, Mass.: Harvard University Press, 1998).

[72] This view of China's political economy is well illustrated by Wing Thye Woo, "The Real Reasons for China's Growth," *The China Journal* 41 (January 1999), 115–137; and Yang (fn. 4). Woo does note in passing (136) that nonconverging elements are evident in some places in the economy due to reformers' compromises with conservatives. On increasing competitiveness in the PRC economy, see Lardy (fn. 49).

[73] Pictures of a substantially decentralized system are found in, for instance, Thomas G. Rawski, "Reforming China's Economy: What Have We Learned?" *The China Journal* 41 (January 1999), 139–56; and Jean C. Oi, *Rural China Takes Off: Institutional Foundations of Economic Reform* (Berkeley: University of California Press, 1999).

However, models that emphasize convergence or decentralization are not uniformly useful for understanding China because they fail to recognize the emergence of a tiered economy, which consists of levels that feature substantially different systems of governance and market characteristics. To flesh out the picture, as is being done by newer studies, including this article, we must illustrate a reformulated role for strong state oversight at the highest levels—despite monikers (such as that of "independent regulator") that suggest convergence.[74] At the helm of a diverse, continental economy, China's government can be expected to develop a variegated set of regulatory forms for different types of sectors; any emerging model of China's political economy must recognize this diversity.

[74] This latter picture emerges clearly in recent studies by younger scholars, including Lin (fn. 21), Mertha (fn. 22), and Thun (fn. 49). See also Nolan (fn. 52).