Political Institutions, Resistance and China's Harmonization with International Law*

Andrew C. Mertha and Ka Zeng

ABSTRACT This article looks at two dimensions gaining empirical and theoretical significance in China – harmonization with international laws and institutional reshuffling – in order to determine where political battles over implementation and enforcement of trade agreements occur. Although Beijing is attempting to standardize its legal and regulatory regimes, many localities are reluctant to change laws and regulations which provide preferential benefits to investors, insulate the local economy from competition, and perpetuate the informal power of local officials. Similarly, many sectoral bureaucracies resist giving up the power and privileges they enjoyed under China's semi-reformed planned system. Rent-seeking behaviour by national and local officials threatens to be a major impediment in China's ability to comply with its WTO commitments. This article analyses institutions developed in China to "handmaiden" domestic harmonization of Chinese laws with WTO principles, and the enforcement mechanisms to rein in localities and bureaucratic actors that continue to resist efforts at harmonization.

In the past few years, China has made sweeping concessions in its World Trade Organization (WTO) commitments to open important service markets, including telecommunications, banking, insurance, securities, audiovisual and many professional services. China has agreed to grant trading and distribution rights to foreign firms, allowing them to import and export and engage in wholesale and retail trade, after-sale service, repair and transportation.[1] Compared to China's commitments in other trade areas, these changes are perhaps the most far-reaching. If fully implemented, they would signal a revolution in China's economic transformation.

The key question we examine is: to what extent can the Chinese government live up to these commitments and implement the requisite policy changes that often entail substantial erosion of the relevant functional and geographic bureaucracies' oversight of their own jurisdictions? Bureaus which for years had lived comfortably in the sanctuary of state protection had reportedly threatened to derail China's bid for WTO membership.[2] It is therefore reasonable to expect that bureaucratic

* This paper was originally presented at the "Local and National Issues in China's Politics of Trade" panel at the 61st Midwest Political Science Association Annual Meeting, Chicago, 5 April 2003. We thank our discussant, Mark Frazier, and members of the audience for their comments. Any errors that remain are ours.

1. Nicholas Lardy, *Integrating China into the Global Economy* (Washington, DC: Brookings Institution Press, 2002), p. 66.

2. For example, the minister in charge of the telecommunications industry, Wu Jichuan, reportedly threatened to resign from his post when the terms of China's concessions were first made public.

foot-dragging could pose a major impediment to China's ability to adapt its behaviour within the constraints of formal institutional commitments. This is also true of local governments which enjoyed a tremendous degree of economic and political freedom from Beijing over the course of the reform era. Consequently, Beijing's ability to establish the necessary institutions to keep bureaucracies and local governments from interfering in business operations is central to the prospect of China's compliance with its WTO commitments.

In order to present a credible – if preliminary – answer to this question, we examine the institutional changes taking place at the national level and ongoing attempts to restructure centre–local relations. Specifically, we argue that the Chinese leadership has resorted to a variety of policy tools to strengthen its authority vis-à-vis both sectoral and local interests. Horizontally, mechanisms that have been developed to rein in protectionist bureaucrats include using market competition as a key leverage for change, strengthening the legal framework for regulation and ad hoc leadership intervention. Vertically, in trying to rein in powerful local interests, the central leadership has experimented with policies as diverse as centralization and consolidation. While these measures have brought creeping changes to China's enforcement infrastructure, we also identify a number of challenges to these attempts at administrative rationalization.

This article is organized as follows. The first section provides a rough typology for predicting China's compliance patterns in three key services issue areas. The second part focuses on the dynamics along the centre–local axis.

Sectoral Analysis of China's WTO Compliance Prospects

This section provides a tentative assessment of the extent to which Beijing will be likely to live up to its WTO commitments in the services sector on the basis of recent trends in the relationship between the centre and the key bureaucracies overseeing China's economic development. The leadership has demonstrated a commitment to market liberalization, as shown by recent institutional reshuffling which elevated the importance of internationalist bureaucracies over those oriented towards the status quo, intervention by top leaders to break impasses at critical points to tilt policy in a more liberal direction, and Beijing's strong rhetorical commitment to the principles of market competition.[3] Nevertheless, strong institutional memory, combined with concerns about retaining control over sensitive sectors and about exposing uncompetitive domestic firms too rapidly to the effects of market competition, may render the path towards compliance with WTO agreements a bumpy one.

3. See, for example, "Can the Chinese state meet its WTO obligations? Government reforms, regulatory capacity, and WTO membership," *American Asian Review*, Vol. 20, No. 2 (Summer 2002), pp. 194–95; Dali Yang, "Survival of the fittest?" *World Link*, March/April 1998; Lardy, *Integrating China*, pp. 147–155.

Table 1: **Sectoral Assessment of China's WTO Compliance Prospects**

Concerns about retaining national control or about creating financial instability	*Bureaucratic resistance*	*Prospects for compliance*	*Examples*
Overwhelming	High	*Least* likely	Banking
Strong	High	Prospect not bright, but bureaucratic resistance not insurmountable; compliance *possible*	Telecommunications
Some concerns; not overwhelming	Bureaucratic interests not as entrenched	*Most* likely	Retail and Distribution; Insurance

A tale of three sectors. China's progress to date in the services sector has been uneven. Using the telecommunications, banking and services sectors as examples, we suggest an analytical framework for understanding potential cross-sectoral variation that may emerge in China's WTO compliance behaviour and offer evidence that China's compliance record in these three sectors so far varies in a way predicted by our theory. Specifically, our theoretical conjecture emphasizes the combination of bureaucratic resistance and leadership concerns about rapid market liberalization leading to financial instability. We speculate that in those sectors (such as banking services) in which there exist strong concerns about the repercussions of market liberalization for fiscal stability, the prospects of China's compliance with its WTO obligations may be the most difficult. Such prospects will be enhanced in those sectors where concerns about creating major financial instability are less prominent. Even though such sectors may still offer strong bureaucratic resistance, intervention by a central leadership committed to market liberalization may help to tilt policy in a more liberal direction. The telecommunications sector is a case in point. The most drastic changes may also be seen in those sectors with little established institutional structure such as distribution or insurance, because of the absence of co-ordinated bureaucratic obstruction. The key challenge to ensuring compliance in these sectors thus rests in developing a regulatory framework adequate to meet the requirements of the WTO membership. Table 1 summarizes this argument and presents a typology of expectations about Chinese commitments.

Telecommunications. The telecommunications sector provides an example of an issue area with strong vested bureaucratic interests. Developments to date indicate that despite entrenched bureaucratic interests in favour of protection, the central leadership has frequently intervened to mould the evolution of policy in the telecom sector into a more liberal direction. Most important, the central leadership has sought to clarify contending lines of authority and encourage competition among domestic players which, in due course, created a dynamic environment in which it is difficult for protectionist bureaucracies to flex their muscles. The centre also intervened at critical junctures to shape the basic direction of telecom development in China. While leadership intervention tends to be personal and sporadic, efforts to encourage greater market competition has proven to be more durable, producing an institutional environment that makes it increasingly difficult for the telecom authorities to reassert their control.

The bureaucracy in charge of telecom development, known to be closely associated with the centrally planned system, had at various times frustrated the centre's attempts at market liberalization.[4] Given the bureaucracy's protectionist bias, the central government has adopted a multi-pronged strategy to break down administrative barriers, streamline regulatory functions and encourage domestic competition. First, to rein in the competition between the Ministry of Post and Telecommunications and the Ministry of Electronics Industry which had in the past impeded policy implementation and co-ordination, the government restructuring in 1998 merged these two bureaucracies into a single bureau – the Ministry of Information Industry (MII) – to oversee telecom development. By depriving the Ministry of Electronics Industry of the ability to veto draft legislation, this move helped to consolidate regulatory power into the MII, thus making regulation of telecom competition more even-handed and facilitating the passage of legislation governing telecommunications services.[5]

A second plank of the government's strategy to circumvent bureaucratic opposition was to create a level playing field at home. While an important objective was to foster domestic competition and therefore strengthen the position of domestic players in the market prior to the onset of foreign competition, the proliferation of market players increased the difficulties the telecom authorities faced in reasserting central control. To this end, the government first sanctioned the establishment of Unicom (*Zhongguo liantong*) and Jitong as key market players to challenge the monopoly position of China Telecom (*Zhongguo dianxun*). To further break up the monopoly of China Telecom, in 1999 the company was divided into four separate service providers, with primary responsibility for fixed telecommunications, mobile telecommunications, paging and satellite telecommunications. China Mobile (*Zhongguo yidong*) emerged out of this restructuring as another key challenger to China Telecom. The intention of this round of reform was to liberate domestic telecom

4. Kenneth DeWoskin, "The WTO and the telecommunications sector in China," *The China Quarterly* (September 2001), p. 630; Lardy, *Integrating China*, p. 153; "Face value: the minister of arbitrary power," *Economist*, No. 357 (9 December 2000), p. 76.

5. Dali Yang, "Can the Chinese state meet its WTO obligations?" p. 197. Note, however, that such mergers are far from a panacea from an organizational and enforcement point of view, as we argue later.

operators from regulators and to strengthen China Unicom's infrastructure and its ability to compete, by injecting new assets into it.

However, even this failed to boost the ability of the smaller players to challenge China Telecom's monopoly in domestic telephony services (as noted below). The stage was set for a third round of reforms to introduce meaningful competition. This round focused on the public listing of China Telecom, intended not only to raise much-needed capital, but to place the management of a state-owned monopoly under international scrutiny so as to improve efficiency and to create a culture of accountability to shareholders. In 2002, in a move to introduce much-needed competition to China's fixed-line service, China Telecom was further split into two companies, China Telecom and China Netcom (*Zhongguo wangtong*).[6]

In conjunction with government restructuring and the encouragement of market competition, Beijing sought to strengthen the legal underpinnings of the regulatory framework. For example, the Telecom Regulations, issued in October 2000 in anticipation of China's obligations under the WTO, established the welcome principle of separating government administrative duties from enterprise business. They also committed the regulator to breaking up monopolies, encouraging competition, and promoting openness and transparency.[7]

Other reforms currently on the agenda include the establishment of a consolidated national telecommunications industry administrator, the China Communications Regulatory Commission, as the industry watchdog.[8] This reform, if implemented, will take away the MII's supervision and administration rights over the industry, thereby further constraining the ability of protectionist bureaucrats to impede market liberalization.

The trends of development outlined above suggest that even in a sector such as telecommunications in which the Chinese leadership may continue to resort to central planning and management,[9] the fast opening to domestic competitors has already taken on a life of its own that may have gone beyond the original intent of Chinese leaders. It is reasonable to expect that such market competition will increase the difficulties faced by the Chinese government in reasserting central control.

Banking services. The road to compliance in the banking sector may be more haphazard than that in the telecom sector due in large part to the weakness of China's own banking industry and concerns that opening the market too quickly may strain China's fiscal resources and produce

6. Dali Yang, "China in 2002: leadership transition and the political economy of governance," *Asian Survey*, Vol. 43, No. 1 (2003), pp. 32–33.

7. "Hong Kong: overview of the new telecoms and internet regulations in the PRC," *Mondaq Business Briefing*, 16 March 2001.

8. "China to set up telecom industry regulatory commission," *Sinocast*, 7 September 2004.

9. For example, recent regulatory pronouncements make clear how China's top leadership plans to continue close management in order to preserve the state's commercial interests in this sector. All basic network operations will continue to require approval from the central regulatory authority and cannot suffer a reduction of state ownership below 51%.

instability with negative repercussions for the rest of the economy. Consequently, current government policy is designed to strengthen banking regulation and oversight so as to improve the performance of the state-owned banking industry, and central regulators are less inclined to undertake rapid liberalization that exposes the weaknesses of China's own domestic players. Given the cautious approach the Chinese government has adopted in dealing with financial reform, prospects for compliance in the banking sector may be less good than in other sectors.

Despite this, the Chinese leadership, especially since the Asian financial crisis, has come to recognize the perils of an unreformed financial sector and has subsequently adopted incremental measures to enhance central bank regulation and supervision, stimulate commercial behaviour by major state-owned banks, and boost the level of bank solvency.[10] However, the leadership has an equally strong interest in preventing the collapse of the state-dominated banks. Consequently, in spite of the positive steps taken to rejuvenate the banking sector, current financial reforms in China generally shy away from drastic financial measures for fear of creating additional instability in the financial sector. Instead, the thrust of China's current policy was to strengthen regulatory oversight and supervision over the banking sector and to undertake controlled market liberalization so as to make it more competitive. As the approach towards banking reform is cautious and controlled, it is reasonable to expect behaviour inconsistent with China's WTO commitments.

Reforms of China's financial sector have traditionally lagged behind industrial reform. It was not until the Asian financial crisis fully revealed the risks of weak supervision and poor corporate governance that the Chinese leadership, having in the past put off financial reform out of political convenience, started to attach greater seriousness to banking reform. Moreover, even with the spate of activity that has taken place in the past few years as China prepares its domestic banks for impending market liberalization, China is still subject to a set of institutional constraints that may slow down the process of recovery. Not only does it lack a bankruptcy law which could guarantee sufficient financial recovery by creditors and the asset management companies, it also lacks the pension funds, mutual funds and insurance companies that could help increase equity ownership by households via the provision of diversification and professional management. More important, to finance the rehabilitation of China's financial system, the Ministry of Finance will have to sell bonds amounting to as much as 30 per cent of GDP in order to make up for the shortfall between the face value of the bonds that the asset management companies have been issuing to the banks and the

10. Yiping Huang, *China's Last Steps Across the River: Enterprise and Banking Reforms* (Canberra: Asia Pacific Press, 2001); "New law justifies banking watchdog," Xinhua News Service, 27 December 2003; John P. Bonin and Yiping Huang, "Foreign entry into Chinese banking: does WTO membership threaten domestic banks?" *The World Economy*, Vol. 25, No. 8 (August 2002), pp. 1087–90; "World Bank: state bank reform in China welcomed but takes time," Xinhua News Agency, 16 January 2004; "Beijing plans to pull out of two big banks," *New York Times*, 14 January 2002.

proceeds they will be able to accrue from the sale of equities swapped from bank loans.[11] Even in the best case scenario in which the asset management companies established to handle reform of the state-owned industries proceed smoothly and the aforementioned institutional constraints have been overcome, the Chinese government would still be left with a formidable fiscal challenge in providing for the large amount of funds that would be necessary to recapitalize the banks. In particular, given the low share of government revenues in GDP, the considerable growth in both treasury and non-treasury government debt, and the possible emergence of new non-performing loans, banking reform may require injections of capital well in excess of the state's fiscal capacity.[12] Based on examinations of a few alternative scenarios for assessing the fiscal challenge of bank restructuring, Lardy concludes that successful bank recapitalization may require the government to maintain a debt level that exceeds 50 per cent of output.[13]

Given the substantial fiscal challenge that bank recapitalization is likely to pose to the Chinese government, it is foreseeable that Beijing's approach to financial sector reform will remain cautious and controlled. While recent initiatives such as those aimed at converting state-owned banks for joint stock listing illustrate the seriousness the central government attaches to preparing domestic banks for the scheduled opening of China's financial sector, the considerable strain that bank restructuring may impose on central government coffers could slow down the process of financial liberalization in line with China's WTO commitments. This is especially true when fiscal and institutional constraints, along with considerations for financial stability, outweigh concerns for the reputational harm that may result from reneging on China's international obligations.

Insurance. Compared to the two sectors described above, chances for China's compliance with its WTO commitments may be best in those sectors with a shorter history of operation and less entrenched bureaucratic interests. Here, even though Chinese firms are still faced with a competitive disadvantage, the lack of strong bureaucratic interference may ease the difficulties associated with market liberalization.

Between 1949 and 1988, China's insurance market was dominated by a single state-owned player, the People's Insurance Company of China. The establishment of a shareholder-owned company, PingAn Insurance Company, in 1988 finally broke this monopoly. In subsequent years, the entry of a greater number of domestic and foreign shareholder insurance companies resulted in a more diversified market structure.[14] With the

11. Nicholas Lardy, "When will China's financial system meet China's needs?" in Nicholas C. Hope, Dennis Tao Yang and Mu Yang Li (eds.), *How Far Across the River? Chinese Policy Reform at the Millennium* (Stanford: Stanford University Press, 2003), p. 73.
12. *Ibid.* pp. 74–78.
13. *Ibid.* p. 78.
14. Specifically, the reorganization of the PICC into a holding company and the establishment of three more independent state-owned insurance companies in 1999 have helped to revive market competition.

establishment of the China Insurance Regulatory Commission in November 1998, the Chinese government has accelerated the pace of issuing new licences to foreign insurers. Increased foreign participation in China's insurance market promises to foster the development of a competitive environment in the insurance sector.[15]

Nevertheless, the insurance industry in China remains underdeveloped largely because of inexperienced corporate management and the public's generally low awareness of the importance of having adequate insurance. Prior to 1988, the industry lacked an overarching bureaucratic supervisory body; instead, the People's Insurance Company of China was relegated to the status of a small department in China's central bank, the People's Bank of China. Combined with the low profile of the industry itself, this means that bureaucratic interests in this sector remained far less overbearing.

Thus, in the insurance sector, efforts to boost development have centred on establishing a regulatory framework and curbing local anticompetitive practices. To construct the regulatory foundation for the industry, the Chinese leadership passed the Administration Regulations of Representative Offices of Foreign Insurance Institutions in 1999, the Administration Regulations of Insurance Companies, and other related regulations.

To establish market order, the China Insurance Regulatory Commission launched a nation-wide programme to clean up the country's insurance market in 1999. This programme was aimed in part at correcting the illegal business activities of foreign representative offices and unlicensed foreign insurance intermediaries. In mid-2001, the China Insurance Regulatory Commission again launched a similar campaign, targeting ten areas of the insurance industry development, including the establishment of operating institutions, qualifications of senior management, group insurance, activities of representative offices of foreign insurance institutions, and the insurance agent market.[16]

The State Administration of Industry and Commerce spearheaded the drive to improve market order. Wang Zhongfu, its director general, in his address to the national conference on rectifying and standardizing the economic order held in 2001, emphasized that its priorities included curbing local protectionism and anticompetitive practices in a wide range of industries that had become the subjects of numerous complaints by China's media and increasingly assertive consumers.[17] In Beijing, the Municipal Administration of Industry and Commerce undertook a drive to improve market order by targeting the insurance industry for various practices, such as forcing mortgage borrowers to buy mortgage insurance. It also began investigations of insurance products marketed jointly with railways, airlines and hospitals for potentially anticompetitive practices.

15. For a detailed account of the evolution of China's Insurance Industry, see Stephen P.D. Acry and Hui Xia, "Insurance and China's entry into the WTO," *Risk Management and Insurance Review,* Vol. 6, No.1 (2003).

16. Dali Yang, "Can the Chinese state meet its WTO obligations?" p. 216.

17. *Beijing qingnian bao* (*Beijing Youth Daily*), 11 April 2001.

In the case of car insurance, it criticized companies for forcing car users to undertake repairs at designated shops or to buy parts with certain brand names. After an initial effort to defuse attention, the Beijing Insurance Industry Association entered a dialogue with the Municipal Administration of Industry and Commerce on these issues.

In 2003, the Chinese government accelerated regulatory reform in the insurance sector. In particular, Beijing contemplated or has adopted such measures as shareholding reform and public flotation of several state-owned companies, diversification of the capital structures of the shareholding insurers by bringing in more private and foreign capital, introduction of more foreign insurers, strengthening regulations against illegal and counterproductive practices, and measures to encourage more innovation.[18] Consequently, despite Beijing's lingering concerns about protecting the insurance sector from foreign competition, the lack of an entrenched institutional structure and China's relatively short regulatory history in this sector could help to ease the difficulties associated with market liberalization.

High Mountains and Distant Emperors

Adding to the complexity of the challenges facing China in meeting its WTO commitments across institutions at the national level are those along the centre–local continuum. The following sections analyse these problems in the specific context of China's WTO accession, consider the institutional changes that are taking place to resolve these difficulties, and offer a discussion on the unintended consequences associated with these institutional developments.

Local protectionism/implementation bias. Local protectionism (*difang baohu zhuyi*) is not a new phenomenon. The term itself involves some controversy. Some define it as a closing of local markets, preventing the scale economies necessary for China to compete with foreign companies domestically and internationally. Others use it interchangeably with Naughton's "implementation bias"[19]: local leaders shape national laws and regulations to fit their own preferences (often at a variance with their original intent). Still others see it as indistinguishable from corruption. We see no need to choose among these definitions, as each of them has a bearing on the ability of China to follow through on its WTO commitments. However, given this broad definition, it is also important to keep in mind that it often varies greatly by locality, product and policy area.

The structural causes of the rise in all these forms of local protectionism are an outcome of what Shirk has called the "political logic" of reform combined with efficiency arguments for economic decentralization.

18. "China plans massive reform of insurance industry in public listing push," *AFX European Focus*, 26 January 2003.

19. Barry Naughton, "The decline of central control over investment in post-Mao China," in David Lampton (ed.), *Policy Implementation in Post-Mao China* (Berkeley: University of California Press, 1987).

The goal of decentralization was to increase the power of local leaders, thus chipping away at Beijing's initial opposition to economic reform.[20] It also reflected the recognition that, at least as far as establishing functioning markets, local governments know more about local conditions than do national-level bureaucrats in Beijing.[21]

To simplify, most of China's functional bureaucratic systems operate under this latter type of decentralized (*kuai*) leadership relations[22] to maximize their sensitivity to local conditions when implementing policy. For many bureaucracies, this was the case even before reform.[23] During the planned economy, the central government could ultimately rein in any local excesses by withholding valuable production inputs; this is no longer the case.[24] Local governments under reform not only provide personnel allocations (*bianzhi*) and staffing, budget and property rights allocations (*rencaiwu*) as they had in the past, they now do so with far less oversight. This has allowed them to wield more power over these functional bureaus and has increased their ability to bend the policy stream in a direction more consistent with their own preferences.

Therefore, even though the post-1979 reform era is a testament to the overall success of this strategy in terms of China's economic growth levels,[25] the disadvantage has been the perpetuation of – indeed, the increase in – local protectionist tendencies.[26] With this fragmentation of the Chinese political system, it is practically impossible for the leadership in Beijing to maintain sustained and systematic monitoring across China, with the possible exception of a handful of key issues,[27] because enforcement costs are prohibitive.[28] As local governments are well aware of this fact, there is little incentive to comply when doing so conflicts with their own goals and priorities.

Of course, what China is now facing is the classic trade-off between centralization and decentralization. On the one hand, politics and economics have become increasingly sensitized to local conditions; on the

20. Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993).

21. Andrew Wedeman makes an intriguing case that not simply decentralization but local protectionism itself was an important handmaiden to reform. See Wedeman, *From Mao to Market: Rent Seeking, Local Protectionism, and Marketization in China* (New York: Cambridge University Press, 2004).

22. Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structures, and Processes* (Princeton: Princeton University Press, 1988), pp. 148–49.

23. See, for example, *Zhongguo difang zhengfu tizhi gailun* (*The General Outline of Chinese Local Government Structure*) (Beijing: Zhongguo guangbo dianshi chubanshe, 1998), pp. 1–22.

24. Edward Steinfeld, *Forging Reform in China: The Fate of State-Owned Industry* (New York: Cambridge University Press, 1998).

25. Dali Yang, *Beyond Beijing: Liberalization and the Regions in China* (London: Routledge, 1997).

26. Barry Naughton, "How much can regional integration do to unify China's markets?" in Hope, Young and Li, *How Far Across the River?* pp. 204–232. Others, like Wedeman, argue that local protectionism was actually beneficial to China's economic reform, particularly with regard to China's movement away from price subsidies.

27. Lieberthal and Oksenberg, *Policy Making in China*.

28. Douglass North, *Structure and Change in Economic History* (New York: Norton, 1981).

other, Beijing constantly sees its policies implemented in a suboptimal fashion. Recent structural changes in important Chinese institutions attempt to control some of the effects of decentralization with the newly-centralized bureaucracies taking on increased and effective regulatory functions which had long been neglected, supine and opaque.

Institutional complexity and opaqueness. Recent efforts to increase transparency notwithstanding, the structure of Chinese institutions remains opaque and the actual political process even more so. It is often not clear where the power relations, turf battles and symbiotic relations exist among and between government units in China. They do not appear on organizational charts and officials are often reluctant to discuss them with outsiders. As a result Chinese and foreign actors exogenous to these institutions often cannot understand how they really function.

The case of telecommunications is but one of countless examples. In 1997, long before the institutional changes discussed above, a State Council document (*Guowuyuan guohan* No. 37 [1997]) sanctioned competition between the longstanding China Telecom (hitherto a monopoly held by the then Ministry of Posts and Telecommunications) and the newly-formed China Unicom:

> The Ministry of Posts and Telecommunications … should, in accordance with the principles of separating government and enterprises to expedite reform, and in order to create conditions of fair competition in the telecommunications industry, treat China Unicom and China Telecom in the same manner, strengthen guidance, work towards harmonizing tasks, and to a certain degree, give China Unicom even more support.

What happened was exactly the opposite. The former posts and telecommunications bureaucracy, the traditional "gatekeeper" of the interconnection hubs that allowed for local calls to be patched through to non-local networks, undermined its rival. China Unicom depended on the openhandedness of the posts and telecommunications bureaucracy to allow Unicom to plug into these interconnection gateways, but China Telecom was never quite ready to do it.[29] To those on the outside adversely affected by this, it was unclear whether China Unicom was incompetent, whether China's telecommunications infrastructure could not handle these new demands, or whether local governments were somehow undermining the process (the outcome would be the same in each case). In fact, the real explanation was none of the above: it was the all-but-invisible bureaucratic turf battles between China Telecom and China Unicom at all levels of the telecom *xitong*.

Without background knowledge of the specific institutional arrangements between these government actors, there is no way that those

29. Interview 98CQ25, 3 September 1998.

https://doi.org/10.1017/S0305741005000214 Published online by Cambridge University Press

outside this process could possibly understand what exactly was happening.[30] The political battles, alliances and institutional changes – in this case, between such competing units as the Ministry of Posts and Telecommunications/China Telecom, China Unicom and their local units – do not appear anywhere except as hints and inferences in internal government documents. Policy in China is refracted through a fragmented bureaucratic apparatus, adapted to meet the parochial organizational goals and shaped by official and unofficial incentives of those directly charged with enforcing the policy. But without an adequate understanding of how this system works, critical information is denied to those foreign actors who often need it most and ultimately will judge China on its WTO compliance record.

Institutional change. How is the Chinese government attempting to combat these problems? Two underreported trends unfolding in China today specifically addressing these issues are centralization and consolidation. These are major initiatives undertaken by the centre. However, each suffers from unintended consequences, and, taken together, create their own problems. For the short and medium term, this should raise concerns when analysing the prospects of nation-wide WTO compliance in China.

The notion of China's current experimentation with centralization is discussed at length elsewhere,[31] but the principal dynamic is to reverse the trend of horizontal, decentralized leadership relations that blossomed under the first two decades of reform and to transform them into vertical authority relations. Put another way, decentralized leadership relationships, whereby binding orders are with the local government at the same administrative level, are transformed into a centralized (*tiao*) leadership relationship, in which binding orders are with the administrative superior within the same functional system. Such a vertical management system (*chuizhi guanli*) means, for example, that a municipal-level Quality Technical Supervision Bureau receives its marching orders from the provincial-level quality technical supervision bureau and not from the municipal government.

Why have these particular sectors been chosen for centralized management? Although the actual policy decisions remain shrouded in secrecy, interviews with local officials confirm that their bureaucracies were chosen specifically because of their role in China's economic development.[32] Administrative regulatory bureaucracies are key actors in moni-

30. This memo was only officially available to the following agencies: the State Economics and Trade Commission, the State Planning Commission, the State Commission for Restructuring the Economic System, the Ministry of Posts and Telecommunications, the Ministry of Electronics Industry, the Ministry of Electric Power, the Ministry of Railways, and China Unicom.

31. Andrew C. Mertha, "China's 'soft' centralization: shifting *tiao/kuai* authority relations since 1998" (forthcoming in *The China Quarterly*).

32. Earlier attempts at centralization in 1994–95 of the taxation bureau provided a blueprint for changing these other bureaucracies, which began around 1999–2000.

https://doi.org/10.1017/S0305741005000214 Published online by Cambridge University Press

Table 2: **Partial List of Newly-Centralized/Centralizing Bureaucracies in China**

Administrative regulation	*Financial services*	*Commodities management*
The Administration for Industry and Commerce	China Securities Regulatory Commission	Electric power
The Quality Technical Supervision Bureau	China Construction Bank Auditing Department	Grain management
The Pharmaceutical Supervision Bureau	Agricultural Bank of China Auditing Department	Coal safety
The China Taxation Bureau	Life insurance	
Land Resources Bureau		

toring the economy and standardizing commercial practices throughout China. They were chosen to increase their regulatory scope and power in order to combat local protectionism (indeed, "combating local protectionism" has become a mantra among these officials). The centralization of financial services is an attempt to rationalize China's banking sector in order to help it withstand the competition to which it will be exposed under the WTO, as discussed earlier in this article. Finally, the centralization of commodities targets their unregulated production and sale, as well as rationalizing China's distribution networks and related infrastructure. This will be especially important as China opens its markets to competition for agricultural products, as dictated by its WTO accession protocol. In sum, the regulatory bureaucracies are directly involved with the commercial regulation essential for China to fulfil its WTO commitments; the centralization of financial and commodities-related bureaucracies is part of the attempt to decrease their vulnerability once China lifts its trade restrictions on services and agriculture.

Centralization appears to be akin to a "trial balloon," a limited experiment that nevertheless seems to be popular among bureaucratic actors. Indeed, an increasing number of units are clambering to centralize their own bureaucracies. One scholar/official recently mused about the possibility of centralization in the environmental protection administration, it "would be wonderful for environmental protection, [the environmental protection administration] would be more independent and there would be less local government interference."[33] Indeed, there is also a push by

33. Interview 04KM02, 20 August 2004.

https://doi.org/10.1017/S0305741005000214 Published online by Cambridge University Press

an increasing number of people within the legal *xitong* to centralize China's prosecutorial system.[34]

Nevertheless, problems remain. There is, first of all, the uneasy legal and institutional relationship between local units within centralized bureaucracies and the local governments and people's congresses within the same administrative level. This weakens the latter and allows the former to function without sufficient local oversight. Secondly, and related, the new fiscal relationships that govern these new authority relations remain underspecified, and, as is often the case, pockets of ambiguity are quickly filled by corrupt and illegal practices. Thirdly, the proximity of the officials within these functional bureaucracies to their former local government superiors makes it easy for the latter to withhold extra budgetary funding or other resources, mitigating the new direction of power relations and further undermining the prospects for serious reform.[35]

Fourthly, although centralization theoretically decreases the collective action problem and leads to a sharp reduction in enforcement costs, in practice, because it stops at the provincial level, provincial-level governments (which still enjoy decentralized – and, therefore, direct – authority relations with their functional bureaucracies) receive a tremendous boost in their concentration of political power. The logic of this "soft centralization" is that centralization is important to rein in local excesses, but that the state needs to remain sensitive to local conditions. Thus, the provincial level is a suitable compromise.[36] However, by concentrating power at this level, the central government may be reining in the prefecture, municipal and county governments, but it is doing so in a way that does not necessarily re-establish control in Beijing, but, rather, concentrates it among China's provinces, autonomous regions and provincial-level municipalities. As such, they may actually become even more fierce competitors with Beijing over scarce political and economic resources.[37] At the same time, this concentration of power could be uneven: stronger, more prosperous provinces may provide better compliance, but on their own terms, while poorer provinces would be better poised to defy (or act as "spoilers" on) those commitments signed on by Beijing. Neither outcome bodes well for effective WTO compliance.

Finally, as is to be expected, there is tremendous variation in these attempts at centralization. Some bureaucracies appear to be better poised to take advantage of institutional changes. Because they began earlier, centralization efforts within the tax bureaucracy and the People's Bank of

34. Li Fujin, *Falu xitong chuizhi guanli tizhi de sikao* (*Thoughts on Vertical Management of the Judicial System*) http://www.hncd.gov.cn/zazhi/jiaotongshehui/ditqi/p36.htm, and *Zhifa difang baohu dangti daibiao huxu cifa xitong anshou chuizhi lingdao* (*The Judicial System Should Take the Lead in Combating Local Protectionism in the Judiciary*) http://www.yzdsb.com.cn/20020312/ca97913.htm.

35. Interview 03GY01, 19 July 2003.

36. Interview 02CD03,12 July 2002. Left unstated is the likely fact that Beijing would be unable to establish centralized relations with the provinces easily without a costly political battle that it could ill afford.

37. Mertha, "China's 'soft' centralization."

China (PBOC) have become more institutionalized and are more readily accepted as the status quo. For established bureaucracies like the Administration for Industry and Commerce and the Quality Technical Supervision Bureau, it also appears to be moving relatively smoothly, especially in developed areas like Shanghai. For the newly-formed, cash-strapped and the more specialized Pharmaceutical Supervision Bureau, it has been more difficult. Geographically, some provinces like Liaoning are way ahead, having centralized a number of bureaucracies that remain decentralized in other parts of the country, such as the bureau of communications (*jiaotong ju*).[38] In Yunnan, by contrast, such centralization is still reportedly being studied, even by those bureaucracies that were supposed to have completed it by now.[39] While one should be cautious about making generalizations about major trends within this variation, such variation does exist across both geographic and functional dimensions.

Consolidation appears to be the most recent clarion call for organizational reform in the service of economic development. This was not always the case. From 1976 to 1981, there was an unprecedented growth in the number of decentralized units (units under the direct control of the government at the same administrative level). In 1965 they numbered 45, 35 and 30 (up from 20 in the late 1950s and down from 40 in the early 1960s) at the provincial, prefecture and county levels, respectively. Between 1976 and 1981, the numbers ballooned at 80–90, 60–70 and 50–60 at the provincial, prefecture municipal and county levels.[40]

In order to halt this trend, there were several waves of organizational restructuring in 1982 and 1987; but it was only in 1992 after the Eighth National People's Congress (NPC), the ongoing "three fixes" (*san ding*) campaign, and continuing up through the Ninth NPC in 1998 that these reforms genuinely began to take root. The political logic is to establish fewer, leaner and meaner bureaucracies in the service of various general functional issue areas. The reality is that this restructuring has not been without considerable problems in meetings its goals, with some agencies more successful than others. The Ministry of Information Industry, discussed above, is an example of the former. The State Intellectual Property Office, discussed below, provides a good example of the latter.

From the beginning, the goal of the State Intellectual Property Office (SIPO) was to incorporate all three traditional IPR "subfields" (trademarks, copyright and patents) under one umbrella organization, loosely modelled on the US Patent and Trademark Office. The original intent was to elevate the SIPO to the rank of a ministry-level bureau (*zongju*) so that it could be an effective co-ordinating mechanism among the separate bureaucracies managing discrete IPR issues. However, from the outset, this co-ordination effort has been plagued by problems.

First, although many people understand "intellectual property" as a coherent set of issues, this is not reflected in China's IPR apparatus. The

38. Interview 04SY01, 30 August 2004.
39. Interview 04KM02, 20 August 2004.
40. Xie Qingkui, *The General Outline of Chinese Local Government Structure*, pp. 7–14.

patent bureau, the copyright bureau and the trademark office are not only discrete bureaucracies, they also belong to distinct bureaucratic clusters/*xitong* across which there is often very little contact between their member officials, severely constraining their already limited interaction. Patents fall under the science and technology *xitong*, copyright falls within the propaganda and culture *xitong*, and trademark falls under the finance and economics *xitong*. Yet this bureaucratic and functional reality is airbrushed away by the designation of SIPO as the official co-ordinating body of these three bureaucracies.[41]

SIPO has encountered sharp resistance from the outset. The bureaucracy with most to lose in such a merger, the Administration for Industry and Commerce (AIC), has consistently opposed consolidation, for several reasons. The national-level AIC covets its Trademark Office because its dual role of registering trademarks and providing trademark agents for hire contributes a tremendous amount of revenue to its budget. To the AIC, subordination under SIPO would mean losing an important source of income. Local-level AIC units have derived a considerable amount of income from enforcement, either in the form of charging fees from trademark holders or by taking a cut of the fines that counterfeiters are forced to pay. This source of considerable extrabudgetary revenue would dry up if the enforcement portfolio was given to SIPO.

The National Copyright Administration, initially more enthusiastic about such a merger, was broadsided by powerful voices in the propaganda *xitong*. Apparently, Ding Guangen, the Director of the Chinese Communist Party Propaganda Department at the time, voiced his personal objection to the merger to Zhu Rongji himself. Because copyright includes value-laden "cultural" products, Ding echoed a theme that resonates throughout the culture and propaganda *xitong*: keeping responsibilities of managing value-laden media in house. Ding's insistence that copyright responsibilities remain within the propaganda *xitong* effectively ended any idea of a merger.[42]

At present, then, SIPO lacks the authority to make demands on the IPR protection and enforcement bureaucracies – precisely those institutions which it is formally charged with managing. By focusing attention solely on the formal institutional structure – as many in the foreign IPR community do – we deny ourselves the ability to disaggregate our analysis and our understanding to the real context of IPR implementation and enforcement.

Finally, as part of a larger trend, the ongoing consolidation of China's bureaucratic apparatus, many of the line ministries have disappeared or have faced draconian staff cuts, with many of their employees being shepherded into partially or fully self sufficient "undertaking units," or *shiye danwei.* At the same time, there has been an enormous emphasis – reinforced by China's WTO commitments – for China to develop its

41. Mertha, *The Politics of Piracy: Intellectual Property in Contemporary China* (Ithaca: Cornell University Press, 2005).
42. Interviews 99BJ17B, 1 April 1999, and 02BJ01, 5 August 2002.

domestic commercial standardization regime. Because of these government-mandated compulsory standards, most products in China require certification demonstrating that they have passed a rigorous inspection based on strict criteria. However, the testing facilities are housed in precisely those "undertaking units" that employ former government officials. These former officials have found a niche as "brokers" who can influence the outcome of these standardization tests. This has had two effects. First, it has helped agencies like the Quality Technical Supervision Bureau dramatically increase their power. Secondly, and directly related to the above, it has maintained the power of these former and quasi-governmental officials in the testing and regulatory process. In the words of one retired national-level official, "power is not abolished, [it has] just shifted."[43]

Conclusion

Much of the literature on WTO compliance in China draws from a formal institutionalist focus that analyses the laws and regulations at the national level to the exclusion of other, possibly more salient factors affecting implementation. Almost as an afterthought, these analyses state that "of course, implementation may be a problem, but …" Our analysis suggests that the devil in the details of compliance and enforcement is not found in formal rules and regulations, but in the corridors of power in national bureaucracies and in the political dynamics at the local levels. By offering both a sectoral and a "levels-of-analysis" examination of China's implementation and enforcement infrastructure, we attempt to provide a roadmap to help scholars and other analysts gain some understanding of the institutional changes and political dynamics at play and thus derive a degree of predictive power and therefore overcome the indeterminacy in so many analyses of China and the World Trade Organization.

More than three years after China's entry into the WTO, practices inconsistent with its WTO commitments still exist in insurance, telecommunications and banking. What is most noticeable, however, is the variation in the extent to which China has been able to uphold its WTO commitments across these sectors. Evidence to date indicates that the insurance industry is making steady progress towards compliance. Foreign companies have already gained the ability to provide master policies and large-scale commercial risks without geographic restrictions. Moreover, foreign insurance brokers can now form joint ventures and may gradually make a transition to wholly owned foreign enterprises by December 2006. Importantly, some of China's reforms in the insurance sector have gone beyond the scope of its WTO commitments. In another encouraging development, the insurance industry regulator – China Insurance Regulatory Commission – has made attempts to uphold China's transparency commitments by offering public comment periods

43. Interview 03BJ03, 9 March 2003.

https://doi.org/10.1017/S0305741005000214 Published online by Cambridge University Press

on proposed regulations of foreign-invested insurance companies.[44] Even though foreign concerns remain with regard to China's high registered capital requirements, lack of transparency and clarity of the regulatory environment, and continued restrictions on branch operating structure,[45] it seems fair to say that, on the whole, signs from the insurance industry are encouraging.

By contrast, there is evidence that the telecommunications sector is continuing to resist the new regulations necessary to liberalize it to the extent mandated by the WTO. Post-accession increases in barriers are especially problematic, considering China's high registered capital requirement for foreign-invested basic service joint ventures.[46] Secondly, vague regulatory guidelines and a failure to license firms in value-added telecom and paging services mean that China has yet to fulfil its commitments to expand geographic access and to allow 49 per cent foreign equity in these new service areas, a trend exacerbated by centre–local tensions.[47] Moreover, there are concerns that the industry regulator, the (relatively) newly-consolidated MII, remains beholden to the interests of the major state-owned telecommunications operators. Along similar lines, China's legal and regulatory proceedings still lack transparency, often denying opportunities for advance notice and public comments.

Concerns also persist regarding China's compliance record in banking services, despite recent progress. The PBOC has remained extremely cautious in opening up the banking sector.[48] Foreign businesses complain that it has imposed "working capital requirements and other prudential rules that far exceeded international norms"[49]; that China's financial services regulations and administrative measures lack clarify and specificity; and that recent Bank of China proposals to limit the *renminbi* (RMB) interbank loan market for branches of foreign banks would both lead to an inefficient use of capital and violate national treatment principles.[50] Furthermore, the non-performing loan burden in the state banking system, the resolution of which would be key to further reforms with respect to interest rate determination and privatization of financial services, did not improve as expected despite recent moves to recapitalize state banks and to promote the competitiveness of state companies in international markets.[51] Overall, foreign interests remain concerned about the discrepancy between China's financial service capitalization levels

44. US Chamber of Commerce, "China's WTO record: a two-year assessment," testimony by Myron Brilliant before the Trade Policy Staff Committee, 18 September 2003.
45. United States Trade Representative (USTR), "2003 report to Congress on China's WTO compliance," 18 December 2003, pp. 57–58.
46. Jeffrey A. Bader, "China's implementation of its WTO commitments: mixed results after two years," The Atlantic Council Asia Programs, October 2003.
47. US–China Business Council, "China's WTO implementation: a mid-year assessment," 2003.
48. USTR, "2003 Report to Congress," p. 56.
49. *Ibid.*
50. US Chamber of Commerce, "China's WTO record."
51. Penelope B. Prime, "China and the WTO: the first two years," China Research Center Newsletter, Vol. 3, No. 1 (2004).

and refinancing conditions, on the one hand, and common global practices and regulatory standards, on the other.

These problems are compounded when we look beyond Beijing. Consolidation has not necessarily created a leaner and meaner bureaucracy, as the case of SIPO makes clear. Nor have these institutions become sufficiently transparent, as noted in the above discussion. Indeed, these institutional changes – intended to make the system more transparent – are themselves opaque and all but invisible to the public. All this suggests that we be cautious in our predictions regarding China's WTO compliance. This brief analysis suggests that, although we are already witnessing varying pace of reform to harmonize China's practices in three services sectors, clashes between macro-level economic policy making and entrenched bureaucratic and local interests dim the prospect of the smooth implementation of WTO-related policy and institutional change, at least in the short and medium term.