Administrative Monopoly in China

Causes, Behaviors, and Termination

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Causes, Behaviors, and Termination

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Abstract

In recent years, the development and the strengthening of the market economy in China has encountered severe obstacles, with one of the major reasons being administrative monopolies. Some enterprises, especially large-scale state-owned enterprises (SOEs), have obtained preferential market conditions and artificial advantages in competition. Through the strong support and active cooperation of administrative departments, they have gained different levels of dominance over certain markets. This phenomenon not only compromises sufficient competition, but also undermines the fairness of competition.

By utilizing the administrative monopolies granted through government action, monopoly enterprises have not only damaged economic efficiency and social justice, but also raked in substantial profits on paper. This model of profiting without exhaustive innovation and operation has encouraged blind pursuit for “image,” indulgence in position-related consumption, and company welfare and bonuses in monopoly enterprises, which resulted in tremendous waste of resources and social injustice. It also leads to more effective melon-cutting coalitions within interest groups, and stronger intention and motivation to maintain, enhance, and expand administrative monopolies.

The two-fold damage to both economic efficiency and social justice has aroused harsh public criticism of administrative monopolies. Therefore, the investigation and analysis of administrative monopolies is of both strong theoretical value and immediate practical use.

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Introduction

- An “administrative monopoly” is a business monopoly granted by the administrative departments of the government to business agents — enterprises or profit-making administrative entities. These monopolies are often granted through the issuance of administrative documents such as regulations, statutes, or guidelines. Administrative monopolies are often characterized by barriers to market entry and price regulations that are issued by administrative departments, establishing stronger or weaker economic monopolies.
- Granting monopoly powers to an enterprise is an important economic decision that represents a shift in the basic economic system (the “socialist market economy”). Under the *Law of Legislation*, monopolies shall be established by the legislature. According to the principle of law reservation, monopolies established without the approval of the legislature pose great constraints to potential competitors’ economic freedom and consumers’ freedom of choice. In practice, most administrative monopolies in China are established by formal regulations issued by administrative departments, regulations that the departments themselves authorize. The monopoly powers established by the administrative bodies are unconstitutional and, therefore, illegal.
- Broadly speaking, administrative departments abuse their authority over drafting legislative acts to establish monopoly powers in favor of certain enterprises. This is made possible by a weak legislature, granting these departments their own kind of “administrative monopoly” in the regulatory process. Since the beginning of reform and opening up, China’s constitution has been amended several times. There have been great changes made to its fundamental principles, such as

the introduction of the “socialist market economy,” and the guiding principle that “the state encourages, supports and guides the development of the non-public economy.” Laws that allow for the creation of administrative monopolies are incompatible with China’s constitution.

- Almost all of the main industries subject to administrative monopoly that are discussed in this study evolved out of the completely planned economy. After years of reform to the fiscal system, the central government’s main sources of revenue come from taxable income. The central government has incentives to push forward reforms for state-owned enterprises (SOEs), but no incentives to break the monopolies held by these enterprises. On the contrary, granting administrative monopolies as preferential policies to SOEs could be a way to reduce the financial burden on SOEs.
- With the success of China’s economic reforms, huge domestic markets have emerged, which in turn highlighted the value of monopolies over these markets. Because the enterprises with monopoly powers *do not need to hand over their profits*, and there are no ceilings on the level of wages and bonuses, the enterprises keep all the profit derived from the existence of administrative monopolies. As interest groups, they have a strong incentive to attempt an expansion of their administrative monopolies.
- “In-house lobbying” refers to the lobbying of administrative officials done by high-level management at SOEs in order to secure administrative monopolies. One reason for this is the revolving door linking administrators and SOE managers, with SOE managers frequently serving stints in administrative positions and vice versa. This is an indirect yet important indicator of administrative monopolization, and this phenomenon appeared in several industries dealt with in this book.
- “In-house lobbying” works because of the existence of “departmental legislation,” the manipulation or creation of legislation by government administrators. “Departmental legislation” exists because of the lack of sufficient supervision over administrative departments in the current political structure, leading to an abuse of power that both directly and indirectly affects legislation. Broadly speaking, “departmental legislation” also refers to the fact that in carrying out administrative duties, departments are in effect creating or amending legislation.

- Administrative monopolies are created by setting barriers to entering an industry and by regulating prices. Price regulations can be further subdivided into (1) regulations over sales prices by monopolists; and (2) regulations over purchase prices for monopolists. The holders of administrative monopolies can, therefore, obtain resources and other inputs at large discounts or even for free.
- As long as there are institutional barriers to entry, even if other market conditions allow for fair competition, under a certain level of demand, administrative monopolies can also lead to high prices, low production, and welfare losses.
- When barriers to entry drive up prices, they unfairly convert consumer surplus into corporate profits, and in the process further distort income distribution. If the resources that become monopoly profits were used in exchanges dictated by the market, they would go toward the creation of other goods and services. The value of these goods and services (with consumer surplus added in) is the opportunity loss caused by administrative monopolies, along with the social welfare losses from distortions to income distribution.
- Regulation over purchase prices (with factor prices being low or zero) is a serious distortion of income distribution. It unfairly transfers huge amounts of wealth originally belonging to the state or other economic agents to SOEs. We assume that the rents for resources not paid or underpaid for by monopoly enterprises are used to occupy other production factors (such as labor, land, and capital), and that they could be put to more productive use if activities were determined by market forces. The value of such products (with consumer surplus added in) is the opportunity cost caused by the distortion of distribution. In the end, these lead to a decrease in aggregate social welfare.
- Administrative monopolies transfer wealth, in the form of money, from consumers to the companies that enjoy a monopoly, including their management and staff. These companies do not use these monetary resources to produce the corresponding amount of goods or services. From a macro social perspective, there now exists a greater supply of money chasing a relatively low amount of goods, a process that inevitably leads to inflation.
- In recent years, adjusting the deposit reserve requirements instead of interest rates has become the primary means of implementing monetary

policy. The deposit reserve requirement is frequently adjusted, changing up to ten times a year. The total range of adjustments has been 14%, with the highest rate being 21.5%. From the perspective of banks, adjusting the deposit reserve requirements and adjusting interest rates are very different. This is particularly true when implementing tightening policies where raising the deposit reserve requirements allows banks to avoid the huge costs of raising interest rates.

- Given the government's central role in the creation of administrative monopolies, the losses generated are three-fold. Not only do administrative monopolies lower economic efficiency and violate principles of social justice, but in the formation, maintenance, and strengthening of administrative monopolies, the credibility and authority of the administrators themselves is seriously weakened. This means that SOEs and the control they have over the national economy does not constitute the often-touted "basis of rule" for the government; it is instead a threat to that very rule.
- Following is a figure showing welfare loss and distribution distortions caused by administrative monopoly:

An Illustration of Welfare Losses and Distribution Distortions caused by Administrative Monopoly.

The dark grey triangle in the figure is the net loss of social welfare caused by administrative monopolies; we call it “Social Welfare Loss I.” The light grey part in the figure is distribution distortion caused by monopoly (regulated) sales prices; we call it “Social Welfare Loss II.” The grey part in the figure is the distribution distortion caused by buyers’ monopoly (regulated) purchase prices (with some costs approaching zero); we call it “Social Welfare Loss III.”

- *Estimation of social welfare loss I:* The net social welfare losses caused by the administrative monopoly granted to China Telecom, China Mobile, and China Unicom from 2003–2010 totaled approximately RMB 84.6 billion. Total social welfare losses throughout the telecom industry during the same period were up to RMB 441.7 billion, and the corresponding losses in the oil industry total around RMB 1.309 trillion.
- *Estimation of social welfare loss II (i.e. the profits derived from monopoly pricing):* The annual rents accrued from administrative monopolies in the telecommunications industry average approximately RMB 31.3 billion per year. This amount is equal to the decrease in consumer surplus. The monopoly profits brought about by high prices in the oil industry total around RMB 437.8 billion. The monopoly profits in the salt industry are as high as RMB 17.7 billion per year. These are direct losses for consumers and also amount to social welfare losses.
- *Estimation of social welfare loss III:* From 2001 to 2010, PetroChina underpaid by RMB 166.8 billion on rental costs for industrial-use land. On land used for gas stations, PetroChina and Sinopec collectively underpaid by RMB 176.5 billion, and the two underpaid RMB 289.8 billion in royalties. Collectively, the Big Three in the oil industry underpaid on finance costs by RMB 224.5 billion, with all of these underpayments contributing to social welfare losses.
- In most market economies, the average difference between deposit rates and interest rates on loans is around 1–2%. In China, the difference between one-year loan rates and deposit rates has averaged 3.06% in recent years. This is achieved by pushing deposit rates down to 1.5%. With total national deposits averaging RMB 77.156 trillion in 2011, estimates of the losses to individuals and institutions total RMB 1.157 trillion, equal to 2.6% of GDP in that year.

- The persistent difficulty in buying train tickets in China indicates a general supply shortage for ordinary (non-high-speed) tickets. Judging from the constant traffic jams on the Beijing–Tibet Expressway (some reaching 100 km and lasting for ten days) and the Qingdao–Yinchuan Expressway caused by a glut of freight trucks, there appears to be a general shortage of railway freight capacity. At the same time, the already constructed high-speed railway lines are largely underutilized relative to optimal passenger levels. This suggests a severe misallocation of investment between high-speed and conventional railways.
- Reports estimate that in order for the utility-to-cost ratio of high-speed railway to equal that of regular railways, the high-speed line requires 129 daily departures. As we know, the busiest Beijing–Shanghai high-speed line has only 50–90 daily departures. This means that the decrease in construction of normal railways in favor of high-speed lines will lead to net social welfare losses. In accordance with relevant data, the welfare losses caused by the misallocated resources between high-speed and conventional railway is approximately RMB 53.3 billion per year.
- The net social welfare losses due to administrative monopolies in 2010 (including losses from misallocated railway spending) were equal to RMB 1.91 trillion. The combined losses due to monopoly sales pricing (social welfare loss II) and monopoly purchase prices on inputs equal RMB 1.62 trillion. Social welfare loss II is equal to the quantity of money that lacks corresponding goods and services, and thus inevitably brings about inflation pressure. Specifically, it will cause inflation to rise by 2.4%, equivalent to 78.7% of the rise in the retail goods price index for that year.
- In terms of adjusting deposit reserve requirements as an alternative to adjusting interest rates, we look at the June 20, 2011 decision by the People's Bank of China (PBOC) to raise deposit reserve requirements by 0.5%. The equivalent interest rate change would be 0.375%, but the decision to adjust deposit reserve requirements saved banks RMB 321.7 billion in interest payments.
- The PBOC raised reserve requirements six times in 2011, each time by 0.5%. That is, equivalent to reducing the interest payments of banks and their main borrowers by RMB 1.562 trillion.

- Although there are some shortcomings in the current *Anti-Unfair Competition Law* (反不正当竞争法) and *Anti-Monopoly Law* (反垄断法), the laws do articulate legal constraints on the exercise of administrative monopolies. The monopoly behaviors defined in the *Anti-Monopoly Law* include achieving monopoly agreements between business agents, abusing monopoly positions, and concentrating firms for purpose of limiting or excluding competitors. There is even a particular chapter in the law to forbid “the abuse of administrative powers to exclude and to limit competition.”
- Administrative departments should avoid legislating through the preparation of drafts, especially when drafts of bills pertain to specific monopolies. At a bare minimum, these types of legislation should be drafted by neutral agents authorized by the legislature. Moreover, the legislature should organize committees of experts to review drafts for the establishment of monopolies in specific industries. Furthermore, the establishment of a specific monopoly should be treated as an isolated event. The legislature should avoid the creation of monopolies by reference to broad categories such as the often-cited “economic lifeline of the country.”
- Administrative departments do not have the power to establish specific monopolies. Any monopoly established by administrative departments through regulations or statutes is illegal. Rules should be established that exclude related administrative departments from the drafting of “implementation details” or “regulations.” Alternatively, the review of drafted “implementation rules” of specific laws could be strengthened to prevent the adding of articles related to the establishment or expansion of specific monopolies.
- The power of administrative departments to regulate prices should only come with authorization by the legislature. When an administrative department uses its price-regulating power, it should abide by the *Price Law* (价格法), and must first go through fair hearings. In particular, it should differentiate between the adjustment of interest rates by the PBOC to implement monetary policy and the interest rates of commercial banks. The PBOC should avoid the regulation of commercial bank interest rates in the name of implementing monetary policy.
- The constitutional powers to govern the state-owned sector of the public economy could be used to more effectively monitor and

constrain the management of SOEs. Because public resources and assets should be owned by all people, the supervision of these resources and assets should be strengthened. It must be assured that these assets do not flow into the hands of the managers who operate SOEs. Given the difficulties in effective public oversight of these resources and assets, this responsibility for supervision should be emphasized in the constitution, and established by corresponding institutions and rules in laws.

- The Standing Committee of the National People's Congress, as a specialized constitutional supervisory authority, can and should review and terminate unconstitutionally established administrative monopolies. At the same time, based on the provisions of existing constitutional law, the *Law of Legislation* (立法法) empowers authorities (mainly the Standing Committee of the National People's Congress and the State Council) to terminate or revoke existing administrative documents that establish administrative monopolies.
- Proposals for judicial reforms to break administrative monopolies include:

First, allow plaintiffs (not limited just to companies) to directly sue the companies suspected of holding an administrative monopoly. In addition, expand the rights of the plaintiff to include not merely suing for civil liabilities, but also requesting the court to review the legality of the monopoly itself.

Second, amend the relevant legislation so that courts have substantive power to review the cases of administrative monopoly and to dispose of the monopoly status.

Third, reinvigorate existing anti-trust administrative enforcement mechanisms. The keys are to consolidate institutions and functions, improve authority (for example, not relying on "recommendations to the superior authority"), and strengthen the legitimacy of the process by ensuring a fair, transparent, and participatory process, rather than relying on internal operations.

Fourth, establish a system for publicly prosecuting administrative monopolies.

- Below are listed recommendations for breaking administrative monopolies at the administrative level:

First, directly encourage enterprises, including private enterprises and SOEs, to enter the sectors where there is an absence of legal provisions of monopolies. For instance, in the oil industry there are only administrative documents, but no legal restrictions to entry. Any administrative departments that impede enterprises from entering these fields should be subject to administrative penalties.

Second, abolish and prohibit administrative departments from granting monopolies to themselves (or industrial associations controlled by them) by way of executive orders.

Third, require the Ministry of Finance, the Ministry of Land Resource, and other related departments to set up specialized agencies to verify the number of public natural resources (including land and mining licenses) occupied by enterprises, and charge rents at market prices to companies that utilize these resources.

Fourth, require the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council to set a reasonable wage ceiling on SOE employees based on average wages in society, and punish those who earn above these limits.

Fifth, request that the Ministry of Finance establish specialized agencies to monitor SOEs (particularly central SOEs), give recommendations to the State Council on the distribution of profits, strictly implement the remittance of profits, and supervise the use of profits reinvested in the companies.

Lastly, in the long run, promote the withdrawal of SOEs from profit-making areas.

Note:

- In this book, the word “monopoly” will be used to refer to a range of monopoly, duopoly and oligopoly dynamics, with the scope of market concentration ranging along that spectrum.
- In this book, all Chinese names will be written according to the Chinese convention of placing the surname before the given name.