



# RESEARCH BRIEF

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## Competing for Policy Enforcement: The Marketization of Commercial Arbitration in China

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### Key Points:

- Recent development of commercial arbitration in China is characterized by the intense competition among Chinese arbitral organs for caseloads and high-stakes cases.
- Financial incentives are not the main factor for this competition.
- Rather, committing to competition can help arbitral organs avoid being perceived as redundant and bargain for administrative resources such as the increase of budget ceilings and personnel quotas.

During fieldwork in China (2017-18), one distinctive discourse that I found highly visible is the “marketization” of commercial arbitration in China. It is widely seen as the key factor that explains the increasingly market-oriented arbitral

practices under the 1994 Arbitration Law.<sup>1</sup> One such practice examined here is the competition among Chinese arbitral organs for caseloads and high-stakes cases, whose intensity appears to characterize the recent development of commercial arbitration in China. However, China’s tight fiscal control over local arbitral organs seems to raise questions about the rationale that underpins their commitment to competition. This Research Brief suggests that the rationale behind this competition seems to accord with the scenario of bureaucratic competition for policy enforcement, as identified elsewhere in China. Undertaking more caseloads and high-stakes cases would help arbitral organs avoid being perceived as redundant and provide evidence to help bargain for more administrative resources.

### The Marketization of Arbitration

Promulgated in 1994, the current Arbitration Law in China adopts two measures as the “constitutive rules” that aim to create an incentive structure modelled on market-oriented competition for financial rewards.<sup>2</sup> One is the full recognition of

<sup>1</sup> See e.g., Weixia Gu, *The Developing Nature of Arbitration in Mainland China and its Correlation with the Market: Institutional, Ad Hoc, and Foreign Institutions Seated in Mainland China*, 10 CONTEMP. ASIA ARB. J. 271 (2017).

<sup>2</sup> Zhonghua renmin gongheguo guowuyuan, chongxin zujian zhongcai jigou shouce, (中华人民共和国国务院, 重新组建仲裁机构手册) [The State Council of the

party autonomy, which gives disputants “the freedom to agree to arbitrate and to choose the arbitral organ.”<sup>3</sup> The other is the principle of institutional independence (*jigou dulixing*), providing that arbitration institutions should become financially self-supporting without relying on state subsidies to cover their expenditure.<sup>4</sup>

The implementation of this set of legal measures is exposed to the potential effects of the local bureaucracy, however.<sup>5</sup> For frontline arbitration officials, the enforcement of party autonomy is less of a problem. Instead, their challenge is the difficulty in incorporating a financially self-supporting arbitration commission, as the legislator envisioned, into the local fiscal regulatory system and practice.

The root of the challenge lies with the conventional budgetary policy of the “two lines of revenue and expenditure” (*shou zhi liang tiao xian*) (hereinafter the “two-lines” budgetary system). Local governments have long used the two-lines budgetary system to manage local “public institutions” (*shiye danwei*). Strictly speaking, arbitral organs by rule should not be categorized as public institutions; neither is the two-lines system the only budgetary scheme that local governments can adopt to govern public institutions.<sup>6</sup> Nevertheless, in practice, the two-lines budgetary system is widely used by local governments to govern arbitral organs.<sup>7</sup> Under this system, arbitral organs are prohibited from

reserving revenue collected from arbitration fees and other forms of administrative charges. This revenue has to be turned over to local treasury departments. Arbitral organs can thus only rely on annual subsidies from local governments to maintain their financial sustainability.

Of course, not every arbitral organ still depends on state subsidies to cover its expenditure. As I found during my fieldwork, some local governments have taken seriously the requirement of the Arbitration Law, relaxing the application of the two-lines budgetary system to govern their arbitral organs. One such example is the Beijing Arbitration Commission/Beijing International Arbitration Center (BAC/BIAC), which has ceased to adopt the two-lines system and has instead secured its financial independence since 1998 (less than three years after the Arbitration Law took effect).

But the long tradition of the two-lines budgetary system still remains deeply entrenched. Despite being financially self-supporting, arbitration institutions like the BAC/BIAC do not always have full discretion in determining how to use their revenue.<sup>8</sup> Their revenue can often only be used for the following purposes: as fees for arbitrators, salaries and year-end bonuses for staff members, and overheads (i.e., expenditures generated by day-to-day operations such as electricity and water bills and rents). If their supervisory agents in local governments do not instruct otherwise,

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People's Republic of China, Handbook for Re-establishing Arbitration Institutions] 15 (1995).

<sup>3</sup> STANLEY LUBMAN, BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO 247 (1999).

<sup>4</sup> Zhonghua renmin gongheguo guowuyuan, chongxin zujian zhongcai jigou fang'an (中华人民共和国国务院, 重新组建仲裁机构方案) [The Plan for Reorganization of Arbitration Institution], 1995 (China).

<sup>5</sup> LUBMAN, *supra* note 3, at 244; See also Andrew Mertha, “Fragmented Authoritarianism 2.0”: Political Pluralization in the Chinese Policy Process, 200 CHINA Q. 995-1012 (2009).

<sup>6</sup> See also CHEN FUYONG (陈福勇), Weijing de zhuanxing: Zhongguo zhongcai jigou xianzhuang yu fazhan qushi

shizheng yanjiu (未竟的转型: 中国仲裁机构现状与发展趋势实证研究) [THE UNFINISHED TRANSFORMATION: AN EMPIRICAL STUDY OF THE CURRENT STATUS AND FUTURE TRENDS OF CHINA'S ARBITRATION INSTITUTIONS] 35 (2010); WANG HONGSONG (王红松), Zhuzao gongxinli: Wanghongsong wenji (铸造公信力: 王红松文集) [BUILDING CREDIBILITY: A COLLECTION OF ESSAYS] 9-20 (2011).

<sup>7</sup> CHEN *id.* at 44-45 (suggesting that more than half Chinese arbitral organs operate under the two-lines budgetary system).

<sup>8</sup> See also Weixia Gu, *Piercing the Veil of Arbitration Reform in China: Promises, Pitfalls, Patterns, Prognoses, and Prospects*, 65 AM. J. COMP. L. 812 (2017).

the remaining revenue often has to be held in reserve in bank accounts.

In both cases, the utility of taking caseloads is likely to be negated by workloads that exceed either the financial or the administrative capacity of these institutions. In this regard, the 1994 Arbitration Law does not seem to have succeeded in creating an effective market system of competition driven by strong economic incentives. Nevertheless, the metaphors of “marketization” (*shichanghua*) and “competition” (*jingzheng*) are constantly addressed by many frontline arbitration officers and case managers I interviewed and worked with in China. For them, the “arbitration market” (*zhongcai shichang*) and its force do not seem to be mere delusions. The immediate questions that needs to be answered, then, are: “What precisely is the kind of market or competition that they refer to?” and “Why would frontline arbitration officials pursue their responsibilities so vigorously?”

### Bureaucratic Competition

This inter-institutional competition for caseloads and high-stakes cases is similar to the practice of bureaucratic competition identified elsewhere in China.<sup>9</sup> Bureaucratic competition here refers to a distinctive type of competition in which state organs direct resources to compete with each other over policy enforcement portfolios, insofar as their commitment to institutional performance can realize political interests.

Despite their lack of strong financial incentives, many arbitral organs are serious about their “institutional performance” (*jixiao*), devoting considerable resources to expanding their share of the arbitration market in China. The logic behind the competition is that undertaking more cases

can help frontline officials avoid being made redundant and bargain for resources from local governments.

For arbitral organs in less developed regions, pursuing caseloads helps them avoid being perceived as redundant. Many arbitration practitioners in urban areas often describe these organs as the sort of “arbitration institutions that are not supposed to exist,” due to the shortage of commercial cases in the regions where they are located. Their failure to acquire caseloads often makes them appear redundant.

Most of these underperforming institutions still remain inactive. But some have cooperated with local governments to initiate a series of policy measures to attract more users. Branded as a “pilot program” (*shidian*), one such popular measure is the “policy of diversification” (*duoyuanhua zhengce*).<sup>10</sup> It aims to increase caseloads by using two approaches. One is the “diversification of case sources,” widening the category of arbitrable cases to include non-commercial disputes over “civil” (*minshi*) matters such as medical services, traffic accidents, and landlord-tenant problems. The other is the “diversification of dispute resolution methods,” which reduces the use of adjudication but provides users with more informal dispute resolution options (such as mediation, conciliation, and settlement) to handle arbitral cases.

Chinese arbitral organs in urban areas rarely have the problem of a shortage of cases. Instead, their problem is an excessive caseload. Due to the state’s tight control over the use of revenues, many arbitral organs still rely on state subsidies to maintain their daily operations. One immediate consequence of this is that the more cases they

<sup>9</sup> See, e.g., Andrew Mertha, *Policy Enforcement Markets: How Bureaucratic Redundancy Contributes to Effective Intellectual Property Implementation in China*, 38 COMP. POL. 295-316.

<sup>10</sup> See also Zhonghua renmin gongheguo guowuyuan fazhi bangongshi, quanguo zhongcai gongzuo anjian shouli duiyang hua jiufen chuli duoyuan hua shidian shisha yijian (

中华人民共和国国务院法制办公室, 全国仲裁工作案件受理多样化纠纷处理多元化试点实施意见) [Opinions on the National Pilot Program for the Diversification of Arbitral Cases and Methods], 2014 (China).

take, the more expenses they need to cover. These arbitral organs often exceed their budget before the next fiscal year starts.

Somewhat counterintuitively, one common strategy that frontline officials adopt to overcome this problem is to increase their overall caseload, so as to enhance their chance to argue for an increased budget for the coming fiscal year. For one thing, a higher quantity of caseloads provides greater financial contributions to local governments. Furthermore, caseloads are themselves an objective indicator that demonstrates the extent to which these arbitral organs are committed to enforcing the state's stability maintenance policy.

In addition, frontline arbitration officials in urban areas also pursue more caseloads to bargain for increased human resources. Crowded dockets provide evidence for the need to recruit more case managers and arbitrators to increase institutional capacity. In one arbitral organ in which I conducted fieldwork, for example, colleagues often needed to show local authorities the exact number of cases that each manager administered per year, so as to justify their expanding recruitment schemes.

### Conclusion

The 1994 Arbitration Law is now 26 years old, raising the question as to whether it is in need of

reform. One compelling issue has long revolved around the institutional nature of arbitral organs. The legislator's intention is clear. Not only should arbitral organs be independent of the state administrative system, but they should also develop into financially self-supporting institutions without the need to rely on state subsidies to operate. Explicit here is an aspiration that arbitral organs will gradually cut their close ties with the state and transform themselves into "non-governmental institutions" (*minjian zuzhi*).<sup>11</sup> But this ideal encounters problems with implementation. One such problem is that the Arbitration Law itself is unclear about the definition of arbitral organs in the Chinese legal system.<sup>12</sup> Most local governments can thus only operate arbitral organs in a manner that is similar to working with public institutions. As commercial arbitration in China is once again placed on the agenda for reform,<sup>13</sup> reformers need to provide a clear answer to questions about both the institutional nature and the definition of arbitral organs.

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<sup>11</sup> WANG, *supra* note 6, at 21-37.

<sup>12</sup> See also Song Lianbin (宋连斌) & Yang Ling (杨玲), *Woguo zhongcai jigou minjian hua de zhidu kunjing: Yi woguo minjian zuzhi lifa wei beijing de kaocha, faxue pinglun* (我国仲裁机构民间化的制度困境：以我国民间组织立法为背景的考察，法学评论) [*The Systematic Dilemma of the Privatization of Arbitration Institutions in China: An Investigation into the Legislation of Chinese Nongovernmental Organizations*], 155 L. REV. 49-57 (2009).

<sup>13</sup> CICC, Zhonggong zhongyang bangong ting, zhonghua renmin gongheguo guowuyuan guanyu jianla "yidai yilu" guoji shangshi zhengduan jie jue jizhi he jigou de yijian (中共中央办公厅、中华人民共和国国务院关于建立“一带一路”国际商事争端解决机制和机构的意见) [Opinion concerning the Establishment of the Belt and Road International Commercial Dispute Resolution Mechanisms and Institutions], June 2018, <http://cicc.court.gov.cn/html/1/219/208/210/819.html>