
AN ECONOMIC ANALYSIS OF REGULATORY OVERLAP AND REGULATORY COMPETITION: THE EXPERIENCE OF INTERAGENCY REGULATORY COMPETITION IN CHINA'S REGULATION OF INBOUND FOREIGN INVESTMENT

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Regulatory competition theorists predict that interagency regulatory competition—one form of regulatory competition—may generate benefits that outweigh costs. However, this Article presents a case study on how complexities arising from the institutional setting and strategic behavior of regulatory agencies may undermine meaningful competition. The subject of the study is the domestic regulation of inbound foreign investment in China.

The study uncovers how and why agencies' self-expansion behavior without proper external constraints, alongside the distorted incentive structures of regulatory agencies, makes the predictions of theorists not hold true in the context of China's regulation of foreign investment. It identifies one behavior pattern that has not been sufficiently addressed in previous literature: in interagency competition, Chinese agencies strategize to become additive—rather than alternative—to each other out of a rational cost-benefit calculation. This Article's economic analysis probes into the inefficiencies derived from such a behavior pattern. An emphasis on due delegation of authority, utilization of centralized coordination mechanisms, and installation of screening processes to avoid wasteful overlap up front, as well as adequate deterrent mechanisms to reshape agencies'

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incentive structures, may help mitigate the inefficiencies. Distinctions are drawn from select regulatory competition and regulatory overlap scenarios in the United States.

The theoretical implications are as follows: (1) in order to design an efficient and effective regulatory competition framework tailored to specific legal and institutional frameworks, certain presumptions about regulatory competition need to be clarified or modified; (2) jurisdictional competition has implications distinct from interagency regulatory competition; (3) theoretical modeling sufficiently needs to factor in agencies' tendencies to expand bottom-up and their strategic behavior in an overlapping jurisdiction; (4) interagency regulatory competition in a law enforcement scheme may generate effects different from a permit-granting regime; (5) to achieve an optimal number of regulatory agencies within a regulatory domain, in lieu of abstaining from intervention and endorsing free competition analogous to private firms' competition in the marketplace, the principal should police and coordinate competition among regulatory agencies and curb the free entry by agencies into a regulatory regime.

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INTRODUCTION

Regulatory competition theory, as an advance over economic theory of regulation, has been applied to analyze the effects of multiple regulatory agencies in regulating firms and market activities. Regulatory competition theory predicts that having multiple regulatory agencies oversee the same regulatory matter generates a fail-safe system, and thus regulatory failure can be averted because when one agency fails, a second agency may be able to work in its place. The core value of regulatory competition hinges on the contention that it provides independent checks on the performance of the regulatory system.

Scholarship argues that regulatory competition has several other benefits, including (1) working as a mechanism to overcome agency problems, aligning principal-agent incentives when the agents' policy preferences diverge from those of the principal; (2) decreasing the monitoring costs of the principal by creating a system of agency fire alarms, alerting each other of potential problems; (3) balancing against the prospect of regulatory capture; and ultimately (4) leading to a race to the top.

Regulatory competition may take several forms. For instance, multiple federal agencies—in the case of the United States—or multiple ministerial-level agencies—in the case of China—compete for jurisdiction over a regulatory arena. This may give rise to regulatory overlap, which is believed to be an effective way of stimulating competition among agencies.

However, this Article, drawn from the experience of China's regulation of inbound foreign investment, finds that under certain conditions, regulatory competition fails to produce the benefits as predicted. More importantly, the failure is systemic in the context of China's distinctive

regulatory framework. It propounds that in a jurisdiction like China, where heavy and overlapping regulation is the norm, regulatory competition generates enormous costs, outweighing potential payoffs.

This Article proceeds as follows. Part I sets the theoretical stage and reviews the literature to explore the potential benefits and drawbacks of regulatory overlap and regulatory competition. Part II studies interagency regulatory competition in the domestic regulation of inward foreign investment in China, a country where regulatory overlap is pervasive and stubborn yet scarcely explored by scholarly literature. It finds several characteristics of China's regulatory system that lead to inefficiency in interagency competition, generalizing the behavioral pattern of agencies in China's institutional setting. Part III inquires into a few typical phenomena of regulatory overlap in the United States and distinguishes the phenomena from the pattern of interagency regulatory competition in China. Part IV draws a more systemic analysis of the inefficiencies embedded in China's agency behavior pattern and discusses structural implications. It further endeavors to fine tune regulatory competition theory, factoring in the lessons drawn from China's experience. The Conclusion summarizes the clarifications and modifications to general theories of regulatory competition and regulatory overlap that may have a wider scope of applicability.

I. REGULATORY OVERLAP AND REGULATORY COMPETITION

Regulatory competition theory is an advance over economic theory of regulation. The economic theory of regulation was first developed to explain regulatory agencies' entry and exit in a market¹ and was later extended to study, from an economic perspective, the coalitional

1. Economic theory of regulation explains the pattern of regulatory intervention in the market and how regulated firms influence regulators of their industry to ward off competition by blocking new entry. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 876–79 (9th ed. 2014) (“Regulatory capture implies that the regulated firms have as it were made war on the regulatory agency and won the war, turning the agency into their vassal.”); Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983) (providing a seminal theory that the rationale for the entry of regulatory bodies in an otherwise free market is to correct market failure); Sam Peltzman et al., *The Economic Theory of Regulation After a Decade of Deregulation*, BROOKINGS PAPERS ON ECON. ACTIVITY, 1989: MICROECONOMICS, at 1, 38 (1989) (modifying the model of the economic theory of regulation and explaining the viability of deregulation—that regulation is a result of “a wide discrepancy between the political balance of pressures and the unregulated distribution of wealth” and the wealth distribution effect of regulation may in turn make deregulation—a restoration to the status quo—more appealing than regulation); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974) (discussing “public interest” theory and “capture” theory).

interactions between the regulated and the regulators, which were traditionally viewed through the lens of politics—i.e., regulatory capture, where competing interest groups exert their influences over regulators by making regulators their captives so as to help them ward off new entrants.² The economic theory of regulation has further marched beyond the study of the infiltration of one single regulatory agency by regulated firms and come to systemically analyze how agencies behave as utility maximizers³—and furthermore, how multiple agencies interact with each other.

Regulatory competition takes various forms. One is jurisdictional competition, where regulators in different locations—within one country or internationally—compete for residents based on the regulations they offer. For example, different states in the United States compete for corporate charters, with Delaware generally prevailing as a favorite jurisdiction.⁴

2. For an authoritative examination of regulatory capture, see POSNER, *ECONOMIC ANALYSIS*, *supra* note 1, at 876–79 (contrasting Marver Bernstein’s theory on different stages of regulatory capture, which is analogous to a human-being’s life cycle, Posner emphasizes that a correct view of regulatory capture should be that instead of weakening regulation, regulated firms that successfully capture regulatory agencies limit competition among themselves). The theory of regulatory capture was crafted by political scientist Marver Bernstein, re-conceptualized by economist George Stigler, and further developed by economists Sam Peltzman and Gary Becker. See MARVER H. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* 74–102 (1966) (proposing an “ages of man” theory of regulation, that is, regulatory agencies will experience a cycle from birth to death similar to man); Gary Becker, *Toward a More General Theory of Regulation: Comment*, 19 J.L. & ECON. 245 (1976); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) (establishing the theory that regulation is a product governed by the laws of supply and demand). This Chicago school of regulation theory was criticized for its inability to reconcile with the deregulation initiatives observed in the United States; in response, the economists made some defenses. See POSNER, *ECONOMIC ANALYSIS*, *supra* note 1, at 878–79 (describing the impact of the deregulation movement on the positive economic theory of regulation and emphasizing that deregulation initiatives in a number of industries have cast doubt on the plausibility of economic theory of regulation); See also Ernesto Dal Bó, *Regulatory Capture: A Review*, 22 OXFORD REV. ECON. POL’Y 203 (2006).

3. See Richard A. Posner, *The Behavior of Administrative Agencies*, 1 J. LEGAL STUD. 305 (1972).

4. See, e.g., John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605 (2012) (studying the empirics and trend of lawsuits filed outside Delaware against Delaware-incorporated public companies—a factor that affects Delaware’s competitiveness in the market for incorporations—and finding that Delaware courts are losing their market share to other courts as Delaware companies file cases outside of Delaware); Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV. 685, 692, 694 (2009) (generally favoring competition between states for corporate governance and arguing that suppressing competition among states “in the design and implementation of [corporate] governance devices” and that, in the meantime, shifting toward a national system of corporate governance regulation causes an undesirable “race to the bottom”); Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91 (2011) (finding closely-held limited liability

Competition in insurance regulation presents another example.⁵ Insurance as an industry in the United States is generally regulated by the states.⁶ Insurance companies then choose to charter in one of the fifty states, though no jurisdictional overlap of competing states is present. Internationally, a notable example is the global competition of securities markets enabled by the cross listing of firms.⁷ Jurisdictional competition implies mobility of the regulated firms, to which different jurisdictions try to appeal—the resident in one jurisdiction may move from that jurisdiction to another so as to seek the most favorable regulations.

Another form of regulatory competition, the subject of this Article, takes place within the same regulatory space. Different federal regulators may engage in competition for authority over the same regulatory matter. The relevant phenomenon is regulatory overlap—i.e., different agencies sharing the same regulatory authority.⁸ In the real world, regulatory competition usually takes hybrid forms, involving elements of inter-regional competition, interagency regulatory competition, and federal-versus-state competition. The regulation of the U.S. financial services sector is a salient example, where competitions among different agencies, states, or even countries are concurrently present.⁹

companies tend not to choose to form outside their home state so as to seek regulatory arbitrage over variations in state corporate law provisions, whereas larger limited liability companies—like large corporations—tend to form in Delaware).

5. See, e.g., Michael K. McShane et al., *Regulatory Competition and Forbearance: Evidence from the Life Insurance Industry*, 34 J. BANKING & FIN. 522 (2009) (empirically studying the profitability of the U.S. life-health insurance industry—an industry subject to fragmented state, and not federal, regulation—during the period between 1999 and 2003 and finding a positive relationship between the industry's profitability and regulatory competition measures for the industry).

6. See RICHARD S. CARNELL ET AL., *THE LAW OF BANKING AND FINANCIAL INSTITUTIONS* 539–43 (4th ed. 2009).

7. See, e.g., John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listing and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002) (arguing that cross-listing presents a new form of regulatory competition worth encouragement, as the higher disclosure standards enforced by cross-listed exchanges increase the protection of minority shareholders).

8. To differentiate from jurisdictional competition—in essence, inter-regional competition of regulations—this Article uses the term “interagency regulatory competition” to describe competition between agencies for the same regulatory space.

9. For an analysis of competition within the U.S. domestic regulatory system, see William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 GEO. L.J. 201 (1997); Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677 (1988); Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1 (1977). For a cross-country analysis of banking regulation, see RICHARD J. HERRING & ROBERT E. LITAN, *FINANCIAL REGULATION IN THE GLOBAL ECONOMY* (1995); James R. Barth et al., *A Cross-Country Analysis of the Bank Supervisory Framework and Bank*

A. A Fail-Safe System

In addition to its basis in economics, regulatory competition theory has a root in reliability engineering, a sub-discipline within systems engineering. Under reliability engineering theory, functionally similar components can be added to a system to improve its performance and, hence, to prevent its failure.¹⁰ A simple illustration is that having redundant parts and components in place can prevent the unexpected failure of mechanical devices such as ships, trains, and cars. Reliability engineering was later transplanted into the arena of institutional design, where regulatory overlap theorists argue that principals can choose multiple agents as functionally similar components in the regulatory system so as to enhance organizational effectiveness.¹¹ The game theory model behind this is that redundancy improves the odds of some part of an organization succeeding in its task, thus reducing the overall likelihood of organizational failure. It is, therefore, an argument for redundancy and decentralization in institutional design.¹² Put differently, it may be desirable to intentionally invoke regulatory overlap such that it serves as insurance against a single agency's failure.

In contrast, normal accident theory is a disparate school of thought opposite from reliability engineering within the discipline of organizational theory. The term "normal accident" reflects the notion that "given a system's characteristics, multiple and unexpected interactions of failures are inevitable."¹³ Unlike reliability engineering, normal accident theory places more emphasis on strategic behavior between multiple agencies concurrently in place, holding that a regulatory system's reliability is a function of complex interactions among the agencies as its components. An

Performance, 12 FIN. MARKETS, INSTITUTIONS & INSTRUMENTS 67 (2003).

10. See RICHARD E. BARLOW & FRANK PROSCHAN, MATHEMATICAL THEORY OF RELIABILITY 163–70 (1965) (establishing conditions under which system stability can be increased by concurrently having multiple functionally similar components in place).

11. For some early prominent advocacy of overlapping regulatory structure in the enhancement of government effectiveness, see C.F. LARRY HEIMANN, ACCEPTABLE RISKS (1997) (examining the implications of Type I and Type II errors and finding that redundant systems can prevent Type I errors—but raise the probability of Type II errors); Martin Landau, *Multiorganizational Systems in Public Administration*, 1 J. PUB. ADMIN. RES. & THEORY 5 (1991); Martin Landau, *Redundancy, Rationality, and the Problem of Duplication and Overlap*, 29 PUB. ADMIN. REV. 346 (1969) (endorsing public administration redundancy).

12. For arguments in support of agency competition as a guard against regulatory failure, see Dara Kay Cohen et al., *Crisis Bureaucracy: Homeland Security and the Political Design of Legal Mandates*, 59 STAN. L. REV. 673, 710–11 (2006); Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUP. CT. REV. 201, 211–14 (2006); Neal Kumar Katyal, *Internal Separation of Powers: Checking Today's Most Dangerous Branch from Within*, 115 YALE L.J. 2314, 2324 (2006).

13. CHARLES PERROW, NORMAL ACCIDENTS 5 (1984).

important implication of the theory is that these complex, unintended, or unforeseen interactions within a regulatory system—instead of enhancing its stability—may result in an unpreventable failure of the system.¹⁴

B. Reduction of the Principal's Monitoring Costs

Regulatory competition theorists claim that benefits of regulatory competition also include that it works as a mechanism to overcome agency problems: it helps to align principal-agent incentives.¹⁵ To illustrate, pressure from competition between agencies forces them to reveal more information and to opt for policy choices more consistent with that of the principal.¹⁶ In a competitive system where two agencies have jurisdiction to regulate the same activity, as Judge Posner points out, “the competitive setting will keep each [agency] on its toes.”¹⁷

Enabling regulatory competition may prompt agencies to alert each other of potential problems within the system, which works to reduce the monitoring costs of the principal. Furthermore, regulatory competition is thought to be an information-revelation mechanism to prompt competing agencies to produce policy-relevant information¹⁸ and to develop expertise.¹⁹

Scholarship also makes the argument that regulatory competition helps reduce regulatory capture.²⁰ In a situation where multiple regulators compete with each other, if the prerequisites of separation of information—

14. For an introduction to normal accident theory, see generally PERROW, *supra* note 13 (laying down the theoretical foundation for normal accident theory as a school of thought); SCOTT D. SAGAN, *THE LIMITS OF SAFETY* (1993); Jos A. Rijpma, *Complexity, Tight-Coupling and Reliability: Connecting Normal Accidents Theory and High Reliability Theory*, 5 J. CONTINGENCIES & CRISIS MGMT. 15 (1997).

15. See Gersen, *supra* note 12, at 211–12 (arguing that competing agents can be adopted as a mechanism to manage agency problems).

16. See Anne Joseph O’Connell, *The Architecture of Smart Intelligence: Structuring and Overseeing Agencies in the Post-9/11 World*, 94 CALIF. L. REV. 1655, 1702–05, 1727–29 (2006) (theoretically modeling the considerations behind delegation to multiple agencies within a regulatory space, including that concurrent delegation may bring agencies’ policy choices closer to the ideal preferences of the principal); Michael M. Ting, *A Strategic Theory of Bureaucratic Redundancy*, 47 AM. J. POL. SCI. 274, 287 (2003).

17. See Richard A. Posner, *Regulation (Agencies) versus Litigation (Courts): An Analytical Framework*, in REGULATION VERSUS LITIGATION 11, 24 (Daniel P. Kessler ed., 2012).

18. See Gersen, *supra* note 12, at 211 (“Congress might use overlapping . . . jurisdiction as a mechanism for encouraging the development and accurate revelation of information by agencies.”); Matthew C. Stephenson, *Information Acquisition and Institutional Design*, 124 HARV. L. REV. 1422, 1427, 1463 (2011).

19. See Gersen, *supra* note 12, at 212–13 (arguing that the use of regulatory overlap is an incentive to encourage agencies to develop expertise).

20. See Jean-Jacques Laffont & David Martimort, *Separation of Regulators against Collusive Behavior*, 30 RAND J. ECON. 231–34 (1999).

meaning that each regulator only possesses partial information on the regulated—and independence of action—meaning that each regulator acts independently and non-cooperatively without knowledge of its counterpart regulator(s)’s moves—are satisfied, the costs of collusion between the regulators are increased. We will note from the subsequent analysis in this Article that these prerequisites are missing in China’s scenario. With the costs of collusion increased, the likelihood of regulatory capture is therefore reduced.²¹ In contrast, however, Giovanni Dell’Ariccia and Robert Marquez’s alternative theoretical model predicts that, in banking regulation, competition between multiple regulators generates such externalities that induce regulators to lean toward the adoption of lower regulatory standards, thus a “competition in laxity.”²²

C. The Administrative Law Perspective

Administrative law, as a related strand, offers some perspective on regulatory overlap,²³ building on bureaucratic behavior theories.²⁴ At the federal agency level, regulatory overlap in the United States may be present when Congress or the President creates an overlapping delegation with multiple agencies overseeing the same regulatory matter.²⁵ Regulatory overlap may also be born as a consequence of independent political behavior.²⁶ Multiple delegations create a forum within which agencies

21. *Id.*

22. See Giovanni Dell’Ariccia & Robert Marquez, *Competition among Regulators and Credit Market Integration*, 79 J. FIN. ECON. 401, 401–03 (2006).

23. Administrative scholarship explores regulatory overlap to theorize agency interactions and to facilitate agency coordination. See, e.g., Eric Biber, *Too Many Things to Do: How to Deal with the Dysfunctions of Multiple-Goal Agencies*, 33 HARV. ENVTL. L. REV. 1 (2009); Keith Bradley, *The Design of Agency Interactions*, 111 COLUM. L. REV. 745 (2011); J.R. DeShazo & Jody Freeman, *Public Agencies as Lobbyists*, 105 COLUM. L. REV. 2217 (2005); Bijal Shah, *Uncovering Coordinated Interagency Adjudication*, 128 HARV. L. REV. 805 (2015) (discussing problems of coordination among federal agencies and advocating the vesting of some agency such as the Office of Information and Regulatory Affairs (OIRA)—or a sub-agency within OIRA—with overall coordination). Cf. Jennifer Nou, *Agency Coordinators Outside of the Executive Branch*, 128 HARV. L. REV. F. 64, 69–74 (2015).

24. See Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131, 1136 (2012) (noting that academic discussions about regulatory overlap—or redundancy—has largely been in the context of public policy and political science).

25. For studies on the origins and purposes of overlapping delegation, see generally Freeman & Rossi, *supra* note 24; Gersen, *supra* note 12. Multiple delegations can be incidental as “by-products of a legislative process that occurs on a rolling basis over time, producing inconsistencies, inefficiencies, and unintended consequences.” Freeman & Rossi, *supra* note 24 at 1143.

26. See generally DAVID E. LEWIS, *PRESIDENTS AND THE POLITICS OF AGENCY DESIGN* 30–35 (2003); Jason Marisam, *Duplicative Delegations*, 63 ADMIN. L. REV. 181, 190–95 (2011)

compete. Regulatory overlap is therefore thought to be a worthwhile arrangement as it may spur productive and efficiency-producing agency competition.²⁷ At times, fragmented delegation of power creates situations in which different agencies possess the authority necessary to tackle different aspects of a larger problem.²⁸ On the side of costs, some scholars have begun to note the rise in compliance and administering costs in an overlapping scenario.²⁹

Regarding regulatory overlap among federal regulators, the focus of administrative scholarship has been agency coordination: how coordination works “to minimize inconsistency, maximize joint gains, plug gaps, and prevent systemic failures.”³⁰ Administrative scholarship is particularly interested in the types of coordination instruments available to overcome dysfunctions of overlapping agencies.³¹ In a sense, the center of attention is not the economics of regulatory competition, regulatory overlap, or the economic justification of coordination to overcome the deficiencies in regulatory overlap. Therefore, while administrative law scholars marshal impressive real-world examples of overlapping regulations, there is nevertheless a disconnect between problems and recommendations; they are not inclined to take an interdisciplinary approach—employing economics, organization theory, sociology, etc.—in conducting their analyses.

II. REGULATORY OVERLAP AND REGULATORY COMPETITION IN CHINA

A. *The Background and the Problem*

China enacted its open-door policy to introduce foreign investment on a massive scale in the late 1970s. Since then, as illustrated in Figure 1 below, the annual inflow of foreign investment into China has significantly increased over the years with only a few exceptions, such as the year 2009,

(claiming duplicative delegations are largely incidental and unintentional creations).

27. See Gersen, *supra* note 12, at 212 (arguing overlapping delegation can produce positive goods by generating positive agency competition).

28. See, e.g., Jody Freeman & Daniel A. Farber, *Modular Environmental Regulation*, 54 DUKE L.J. 795, 806–13 (2005); Freeman & Rossi, *supra* note 24, at 1138–45 (explaining how overlapping and fragmented delegations rise and why they are pervasive).

29. Literature mentions duplicative monitoring and enforcement costs. See, e.g., Andrew B. Whitford, *Adapting Agencies: Competition, Imitation, and Punishment in the Design of Bureaucratic Performance*, in *POLITICS, POLICY, AND ORGANIZATIONS* 160 (George A. Krause & Kenneth J. Meier eds., 2003).

30. Freeman & Rossi, *supra* note 24, at 1149.

31. See, e.g., *id.* at 1155–81 (discussing interagency consultation, interagency agreements, joint policymaking, and presidential management as coordination tools); Nou, *supra* note 23.

when the global economy was in recession after the onset of the financial crisis.³² The scale of foreign capital inflow to China far exceeds that of its similarly situated developing or transitioning country rivals such as India and Brazil. In 2014, China became the world's top destination for foreign direct investment, surpassing the United States, the biggest recipient of foreign capital among the developed countries, for the first time since 2003.³³

Such colossal inflow of foreign capital into China implies lucrative rent-seeking opportunities for regulatory agencies. Foreign capital is deemed a particularly valued resource because China is more reliant than other countries on foreign investment as its engine for economic development—as shown in Figure 2 below.³⁴ Foreign investment ordinarily comprises as much as three to five percent of China's gross domestic product (GDP), in contrast to one to two percent of the GDP of developed countries like the United States. This percentage is at times even higher than that of developing host countries such as India and Brazil.³⁵ Agencies have a natural inclination to expand to politically rewarding fields or fields where resources—and, hence, rents—are concentrated;³⁶ it is no exception in China. The temptation to have a grip on the regulation of foreign investment leads excess agencies to cluster on the regulatory regime for foreign investment.

The herding of regulatory agencies and, consequently, of regulation has caused great concern despite China's impressive economic success and continued attraction of foreign investment. As of 2014, the Organisation for Economic Co-operation and Development (OECD) ranks China first in its Foreign Direct Investment (FDI) Regulatory Restrictiveness Index, an index measuring statutory restrictions on FDI in fifty-eight countries;³⁷

32. ORG. FOR ECON. CO-OPERATION AND DEV. (OECD), FDI SERIES OF BOP AND IIP AGGREGATES [hereinafter FDI SERIES], *available at* stats.oecd.org/viewhtml.aspx?datasetcode=FDI_BOP_IIP&lang=en# (last visited Nov. 13, 2015) (data extracted for Figure 1 is on file with author); OECD, OECD International Direct Investment Statistics 2012 10 tbl. 1 (2012), *available at* http://www.oecd-ilibrary.org/finance-and-investment/oecd-international-direct-investment-statistics-2012_9789264185722-en (demonstrating a decrease in the inflow of foreign investment in China in 2009).

33. See Paul Hannon, *China Trumps U.S. for Foreign Investment*, WALL ST. J. (Jan. 29, 2015, 5:09 PM), <http://www.wsj.com/articles/china-trumps-u-s-for-foreign-investment-1422550982> (citing statistics from the United Nations Conference on Trade and Development).

34. See FDI SERIES, *supra* note 32 (data extracted for Figure 2 is on file with author).

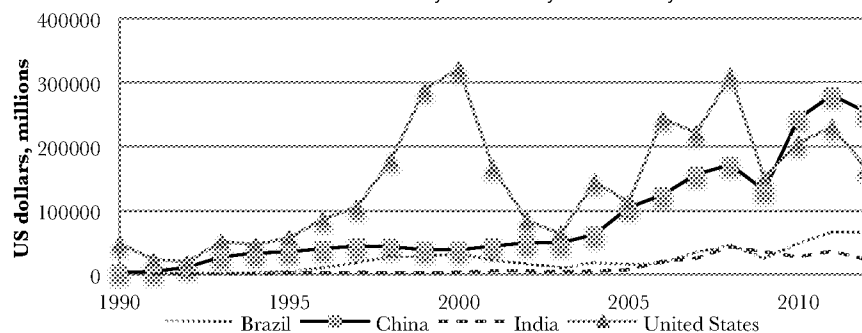
35. See *id.*

36. The economic theory of regulation's answer to the question of why regulatory bodies were established in the first place is that "politicians seek politically rewarding fields to regulate and avoid or exit from the losers." See Peltzman et al., *supra* note 1, at 14–15.

37. The Foreign Direct Investment (FDI) Regulatory Restrictiveness Index gauges the

China is the most restrictive in foreign investment regulation in terms of both primary industries—e.g., agriculture, mining, etc.—and secondary industries—e.g., manufacturing, financial services, etc.³⁸ Likewise, the same problem is exemplified in a survey conducted by the European Chamber of Commerce in China, which shows that, in the eyes of respondent foreign investors making investments in China, unpredictable legislative environments, administrative issues (including a lack of coordination of different regulators), discretionary enforcement of regulations, and licensing requirements (i.e., approval requirements) are among the top regulatory hurdles to doing business in China.³⁹ To address the problem, one important question needs to be asked: how did the distinctively pervasive systems of regulatory overlap and regulatory fragmentation originate?

Figure 1: Inflows of Foreign Direct Investment in Brazil, China, India & the United States, 1990-2012, US Dollars, Millions

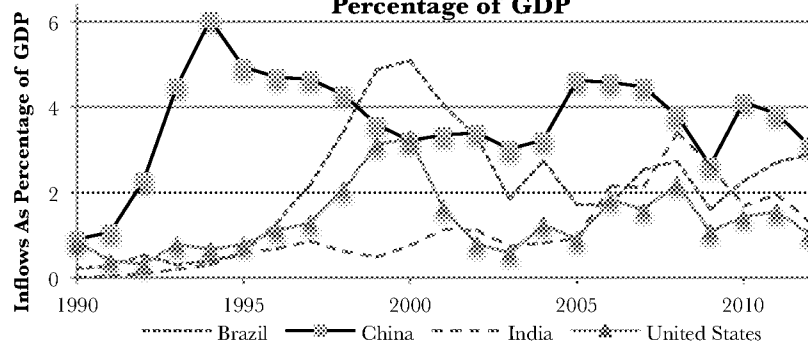


restrictiveness of a country's FDI rules by looking at the four main types of restrictions on FDI: screening or approval mechanisms; foreign equity limitations; limitations on the employment of foreigners as key personnel; and operational restrictions—"e.g., restrictions on branching and on capital repatriation or on land ownership." For the types of restrictiveness the FDI Regulatory Restrictiveness Index measures, see *FDI Regulatory Restrictiveness Index*, OECD, <http://www.oecd.org/investment/fdiindex.htm> (last visited Sept. 13, 2015).

38. For the FDI Regulatory Restrictiveness Index rankings by country, see *OECD FDI Regulatory Restrictiveness Index*, OECD, <http://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#> (last updated Nov. 6, 2015).

39. See EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA, EUROPEAN BUSINESS IN CHINA: BUSINESS CONFIDENCE SURVEY 2015 (2015) available at <http://www.europeanchamber.com.cn/en/publications-business-confidence-survey#download-table-254>; Press Release, European Union Chamber of Commerce in China, European Companies are Reconsidering Their Strategies in Response to a Protracted Chinese Economic Slowdown (June 10, 2015), <http://www.europeanchamber.com.cn/en/press-releases/2286>.

Figure 2: Inflows of Foreign Direct Investment in Brazil, China, India & the United States, 1990-2012, As Percentage of GDP



B. China's Foreign Investment Regulatory Structure and a Comparison with that of the United States

China pre-screens foreign investment projects before they are permitted to enter the Chinese market, closely monitors operations of ongoing projects, and monitors the exit of any such projects. The pre-screening is largely a pure system of administrative regulation with adjudication by a court, but the adjudication is rarely invoked. In the wake of recent foreign investment regulatory reform, China now plans to publish its Foreign Investment Law by the end of 2015,⁴⁰ the first unified code governing foreign investment in more than three decades since opening up to foreign capital. The pre-screening and permitting requirements, albeit alleviated to some extent, are expected to remain in place.⁴¹

This regulatory framework is different from the United States. The United States is generally open to foreign investment, imposing few restrictions on potential foreign investors unless certain regulatory issues are concerned, such as antitrust, export control-related filings, environmental issues, or compliance matters—e.g. securities law compliance. No full-

40. In January 2015, the Ministry of Commerce (MOFCOM), not the State Council (China's cabinet), published a draft Foreign Investment Law to solicit public comments. *See* Waiguo Touzi Fa (Cao'an Zhengqu Yijian Gao) (外国投资法(草案征求意见稿)) [Foreign Investment Law of the People's Republic of China (Draft for Comments)] (promulgated by MOFCOM, Jan. 19, 2015), available at <http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>.

41. Foreign investments that either (1) meet the specified value threshold, irrespective of industrial sectors or (2) fall into certain restrictive categories—called a “Negative List” (with the coverage of industrial sectors unknown as of the date of this Article)—irrespective of value threshold require pre-screenings before market entry. Those that are exempt from pre-approvals are, therefore, foreign investments that are both not characterized to fall into the restrictive categories and below the specified value threshold. *See id.* arts. 26–27.

blown ex ante investment screening mechanism is installed. The Committee on Foreign Investment in the United States (CFIUS), an interagency committee consisting of representatives from seven ministerial-level executive branch departments,⁴² conducts national security review on inbound foreign investment in the United States when the investment takes the form of mergers, acquisitions, and takeovers (M&As).⁴³

The CFIUS has the authority to employ enforcement mechanisms to impose mitigation conditions on, block, or retrospectively unwind a foreign investment project when it deems such investment threatens national security.⁴⁴ While “national security” is usually thought of as protection of the nation against military or terrorist threats emanating from nations or movements outside the United States, the CFIUS looks to broader economic and political factors than to purely national security concerns in making its decisions.⁴⁵ This gives rise to the concern that the CFIUS is aimed at protecting U.S. economic interests rather than national security interests because (1) the CFIUS is chaired by the Treasury Department, the steward of U.S. economic and financial systems,⁴⁶ (2) “national security” is not defined,⁴⁷ (3) the CFIUS process is highly secretive,⁴⁸ and (4) its

42. Committee on Foreign Investment in the United States (CFIUS) members include the Department of Treasury, Department of Defense, Department of Homeland Security, Department of State, Department of Justice (DOJ), Department of Commerce, and Department of Energy, as well as two White House offices: the Office of the U.S. Trade Representative and the Office of Science and Technology Policy.

43. See generally 50 U.S.C. app. § 2170 (2012).

44. Only the President has the authority to prohibit incoming mergers and acquisitions (M&As). Yet the President’s decision highly relies on the CFIUS’s opinion, acting only after reviewing the report compiled by the CFIUS and reviewing CFIUS’s recommendation on the disposition of the transaction. See 31 C.F.R. § 800.506(b)–(c) (2008).

45. For non-classified statistical information about the cases that the CFIUS reviews, see CFIUS, ANNUAL REPORT TO CONGRESS (December 2013), available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2013%20CFIUS%20Annual%20Report%20PUBLIC.pdf>.

46. See George Stephanov Georgiev, Comment, *The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security*, 25 YALE J. ON REG. 125, 129 (2008) (arguing that because the CFIUS is led by the Department of Treasury, economic concerns prevail over national security concerns).

47. See Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (2007); Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, 1257–60 (1988); Exec. Order No. 11,858, 40 Fed. Reg. 20,263 (May 9, 1975).

48. See 50 U.S.C. app. § 2170(c) (providing that any information or documentary material filed under the provision may not be made public “except as may be relevant to any administrative or judicial action or proceeding”). Therefore, each CFIUS review—even the fact that a review is being conducted—is strictly confidential unless the transacting parties need to make disclosures pursuant to, for example, the Securities Exchange Commission (SEC) filing requirements or judicial proceeding requirements.

decisions are not subject to judicial review,⁴⁹ owing to judicial passivity and self-constraint before political issues⁵⁰ and shielding its inner workings from the public as well as from judicial adjudication.

One distinctive feature of China's domestic regulation of inbound foreign investment is the multi-tiered regulatory oversight by various agencies at the national level. In its simple form, a foreign investor's proposed investment in a specific industry is subject to numerous permitting requirements involving multiple regulatory agencies. Various ministerial-level agencies concurrently exercise the jurisdiction of *ex ante* screening investment projects and accordingly grant permits for market entry.

The specific agencies—usually there are a number of them—in charge of one investment project work on a case-by-case basis, depending on the industrial sector into which the project is characterized. In order to launch one investment project, a foreign investor needs to obtain signoff from *all* relevant agencies—that is to say, it is a sequential permitting chain, and each agency has veto power.

Once the specific agencies involved in the permitting scheme are identified, the foreign investor would then need to ascertain to which branch office within each of these agencies will the application for approval need to be submitted: the central, provincial, municipal, or county office. Within an agency, approval authority is delegated by a central office to lower offices, largely depending on the size of the project—a decentralization of decisionmaking: the smaller the project, the lower the level of the office.

To further complicate the picture, at the local level, different provinces, municipalities, counties, or even preferential zones—special regions identified by the central government (or more often, local governments), as having certain autonomy in rulemaking so as to entice foreign investment—impose their own regulations or rules on foreign investment projects established in their territory. Although often contradictory to

49. See 50 U.S.C. app. § 2170(e) (2012); see also *Ralls Corp. v. CFIUS*, 758 F.3d 296, 311 (D.C. Cir. 2014) (alteration in original) (internal quotation marks omitted) (ruling that although the statutory bar of judicial review does not preclude judicial review of a due process challenge, the “final action[s] the President takes to *suspend or prohibit* any covered transaction that threatens to impair the national security of the United States” are barred from judicial review).

50. See Richard A. Posner, *Reply: The Institutional Dimension of Statutory and Constitutional Interpretation*, 101 MICH. L. REV. 952, 957 (2003) (emphasizing the judicial passivity and self-constraint before profoundly contested political issues—“Those of us who argue that courts should be extremely cautious about checking presidential initiatives in the current emergency do so in part at least on the basis of our assessment of the relative competence of courts and executive officials to deal with national security issues.”).

national-level statutes, local governments demand concurrent compliance by foreign investors with local regulations.⁵¹

Alongside the multi-tiered regulatory structure comes the expansive, ever-increasing, and constantly-changing regulations, rules, orders, and guidelines, which present a major hurdle for foreign investors hoping to establish business in China. Finding “the law” poses tremendous challenges to even sophisticated legal professionals specialized in providing services to foreign investors.⁵² It has been a longstanding practice in China that even with a comprehensive set of national statutes, the administrative agencies would always have ways of getting around restrictions imposed by statutes, implementing rules in their interests, and insulating themselves from review.⁵³

C. Turf Warfare and Regulatory Overlap

It is not unusual that screenings and approvals are required in the regulatory framework with respect to inbound foreign investment, where national security and merger control concerns may be involved. What is disturbing is the level of complexity and administrative burden that China’s regulatory structure brings. This Part finds that at the national level, China’s regulatory structure with respect to foreign investment regulation—featuring its distinctive regulatory overlap model—is largely a result of agency self-expansion. In theory, agency authority in China should solely derive from congressional authorization, not from other sources of authority. In practice, however, agencies have ways of bypassing the authorization requirements and creating regulatory overlap.

As a simplified illustration of the convoluted regulatory structure, Figure 3 below presents a flow chart⁵⁴ comparing key ex ante permitting

51. For a precise and comprehensive summary on the regulatory environment and nexus of regulation governing inbound foreign investment in China, see Peter H. Corne, *Creation and Application of Law*, in 1 *DOING BUSINESS IN CHINA* (Michael J. Moser & Fu Yu eds., 2015). For the complications of regulation brought about by preferential zones at local levels, see David Ben Kay & Beth Bunnell, *Preferential Zones*, in *id.*

52. See Wei Cui, *What is the ‘Law’ in Chinese Tax Administration?*, 19 *ASIA PAC. L. REV.* 73 (2011) (discussing the difficulty of, and the confusions about, finding the applicable rules in tax practice).

53. See, e.g., Nicholas Calcina Howson, *Enforcement without Foundation?—Insider Trading and China’s Administrative Law Crisis*, 60 *AM. J. COMP. L.* 955, 973–83 (2012) (discussing *ultra vires* rulemaking by Chinese administrative agencies in insider trading regulation). By comparison, consider the executive system of the United States, where regulatory agencies are able to insulate their decisions from presidential review by raising the costs of such review. See Jennifer Nou, *Agency Self-Insulation Under Presidential Review*, 126 *HARV. L. REV.* 1755, 1782–1803 (2013).

54. The agencies listed in Figure 3 include the following: State-owned Assets

requirements with respect to greenfield foreign investment projects⁵⁵ in (1) a general industrial sector (for simplicity, no particular entry constraint is considered here because an entry restriction may compound the complexity of the analysis), (2) the automobile industry, an industry regulated more heavily than the general industrial sector, and (3) the financial services sector.⁵⁶

Figure 3: Simple Illustrative Approval Flowchart for Foreign Investment Projects

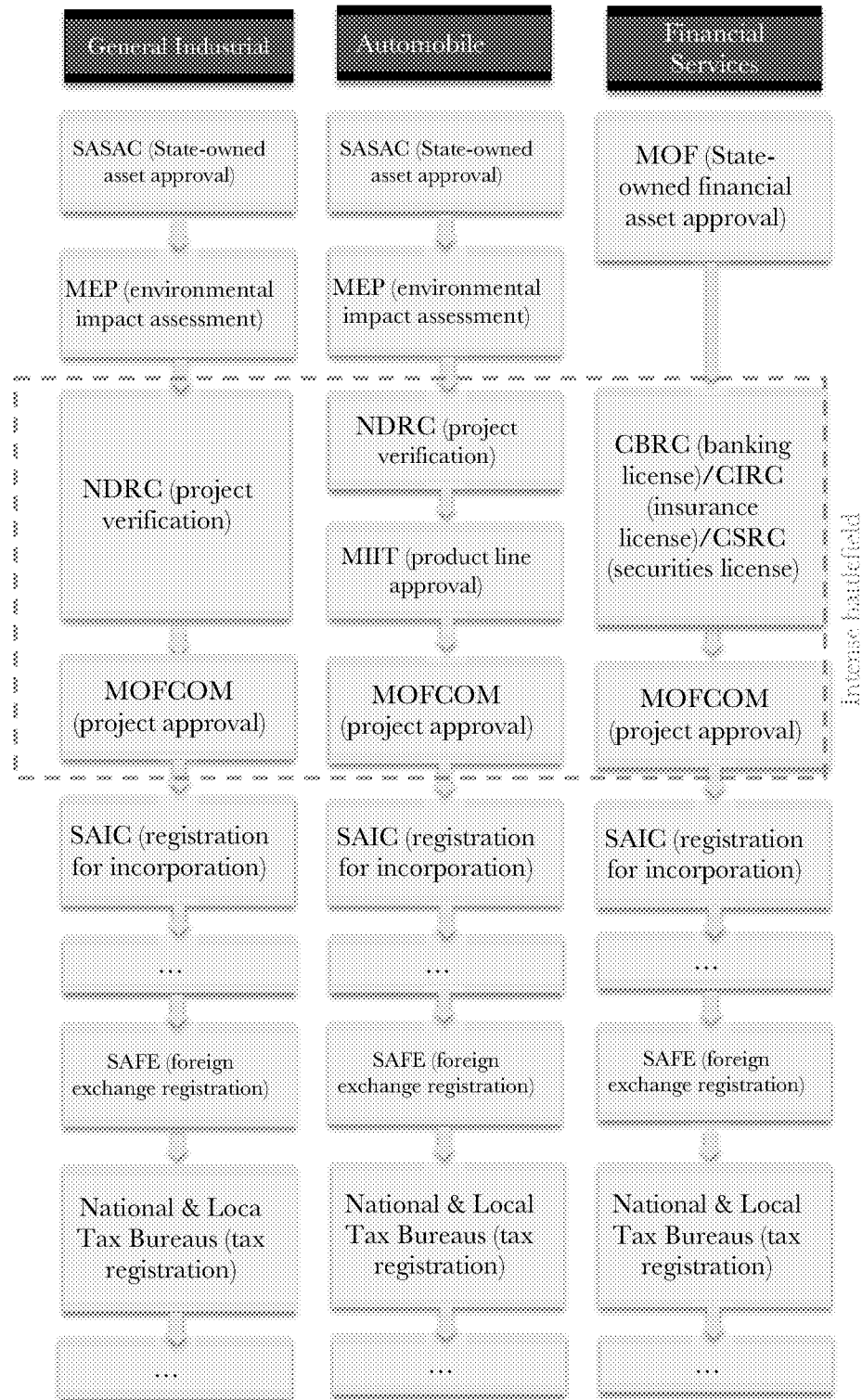
Although it can be noted from Figure 3 below that multiple regulatory agencies are concurrently involved in pre-approving foreign investment projects, they do not weigh equally in determining whether a specific investment project can go through. The Ministry of Commerce (MOFCOM)—not any other agency listed in Figure 3—was the initial administrative agency that received the delegation of principal regulatory power from the People’s Congress with respect to foreign investment regulation.⁵⁷

Supervision and Administration Commission of the State Council (SASAC); Ministry of Environmental Protection (MEP); State Administration for Industry and Commerce (SAIC), which serves as China’s corporate registry; State Administration of Foreign Exchange (SAFE); China Banking Regulatory Commission (CBRC); China Insurance Regulatory Commission (CIRC); and China Securities Regulatory Commission (CSRC).

55. A “greenfield investment” is “a form of foreign direct investment, in which a parent company starts a new venture in a foreign country by building new facilities [in that country].” Bien Perez, *Chinese Direct Investment in U.S. to Top U.S. \$10 billion for Third Year in a Row*, S. CHINA MORNING POST (Nov. 13, 2015, 12:06 PM), www.scmp.com/business/companies/article/1878437/chinese-direct-investment-us-top-us10-billion-third-year-row.

56. As is shown in Figure 3 and the succeeding paragraphs of this subpart, MOFCOM approval is required in investments for some but not all financial services sectors. For instance, MOFCOM approval is skipped for foreign-invested banks. See *Waizi Yinhang Guanli Tiaoli* (外资银行管理条例) [Administrative Regulations on Foreign-Invested Banks] (promulgated by the St. Council, Nov. 11, 2006, effective Dec. 11, 2006), arts. 7, 15, 18–19, available at <http://www.cbrc.gov.cn/chinese/home/docView/2855.html>; see also, *Waizi Yinhang Guanli Tiaoli Shishi Xize* (外资银行管理条例实施细则) [Implementing Rules for the Administrative Regulations on Foreign-Invested Banks] (promulgated by the China Banking Regulatory Comm’n, Nov. 24, 2006, effective Dec. 11, 2006), arts. 19–22, available at http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/2878.html.

57. See MOFCOM, *Mission* (Dec. 7, 2010, 10:14), <http://english.mofcom.gov.cn/column/mission2010.shtml>.



In the Sino-Foreign Joint Venture Law, the Sino-Foreign Cooperative Joint Venture Law, and the Foreign Enterprises Law, the People's Congress delegated the power over pre-approval of greenfield establishments of foreign-invested companies to the predecessor of MOFCOM.⁵⁸ Furthermore, the regulation governing M&As by foreign investors of domestic Chinese corporations was jointly promulgated by six ministerial level agencies including MOFCOM⁵⁹ and also designated MOFCOM as the principal approval authority.⁶⁰ Although under the initial market practice MOFCOM or its predecessor enjoyed the primary approval power to decide whether a proposed foreign investment project could go through, over the years MOFCOM's exclusive regulatory power became eroded by other regulatory agencies.

Such agencies, including the National Reform and Development Commission (NDRC), were not originally delegated regulatory power over foreign investment projects. As a hawkish agency that evolved from the all-powerful State Planning Commission—an agency unique to China exercising mainly macro-economic planning functions—the NDRC stepped on the terrain of foreign investment regulation through self-expansion.

In 2004, the NDRC made an attempt to step into the regulatory regime with respect to foreign investment by unilaterally promulgating a regulation of its own entitled “Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects” (NDRC Rule 22).⁶¹

58. Zhongwai Hezi Jingying Qiye Fa (中外合资经营企业法) [Sino-Foreign Equity Joint Venture Enterprise Law] (promulgated by the Nat'l People's Cong., Mar. 15, 2001, effective Mar. 15, 2001), art. 3, *available at* http://www.gov.cn/banshi/2005-08/31/content_69775.htm; Zhongwai Hezuo Jingying Qiye Fa (中外合作经营企业法) [Sino-Foreign Cooperative Joint Venture Enterprise Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000), art. 5, *available at* http://www.gov.cn/banshi/2005-08/31/content_69772.htm; Waizi Qiye Fa (外资企业法) [Wholly Foreign-Owned Enterprise Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000), art. 6, *available at* http://www.gov.cn/banshi/2005-08/31/content_69774.htm.

59. Guanyu Waiguo Touzizhe Binggou Jingnei Qiye de Guiding (关于外国投资者并购境内企业的规定) [Provisions on Foreign Investors' Merger with and Acquisition of Domestic Enterprises] (promulgated by MOFCOM et al., June 22, 2009, effective June 22, 2009) [hereinafter China's M&A Rules], *available at* <http://www.mofcom.gov.cn/article/b/c/200907/20090706416939.shtml>.

60. Notice, however, that some agencies such as the National Reform and Development Commission (NDRC), which was in a turf war with MOFCOM, did not sign up to this regulation.

61. Waishang Touzi Xiangmu Hezhun Zhanxing Guanli Banfa (外商投资项目核准暂行管理办法) [Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects] (promulgated by the NDRC, May 17, 2014, effective June 17,

Under NDRC Rule 22, the NDRC not only endeavored to regulate all forms of foreign-invested entities, including both greenfield investments by foreign investors and M&A activities of foreign investors in China, but also obtained a grip on the pre-existing foreign-invested companies that had been approved prior to NDRC Rule 22, requiring any subsequent capital increase of pre-existing foreign invested companies since 2004 to be “verified”—a de facto approval requirement—by the NDRC in addition to MOFCOM.⁶² That is to say, a foreign invested company which was duly approved for incorporation by MOFCOM—without involvement of the NDRC—before 2004 would not only have to go through MOFCOM (the original approval authority), but also the NDRC (an additional layer of approval agency), if the company tried to expand the size of its same project after 2004 when NDRC Rule 22 was enacted. In this way, the NDRC retroactively invaded the turf that had traditionally been dominated by MOFCOM.

Interestingly, earlier in the same year, right before the NDRC took the initiative to expand unilaterally to the terrain of foreign investment regulation, the State Council—China’s Cabinet—conducted a sweeping review of all approval requirements mandated by all administrative agencies in order to eliminate unnecessary approval schemes. The State Council subsequently published a comprehensive list of approval requirements that it deemed permissible for the agencies to retain.⁶³ An all-inclusive regulatory authority over foreign investment projects was *not* on the list of approval requirements that the NDRC was permitted to enact—that is to say, the NDRC made the move to expand its turf despite the central government’s preceding extensive review of all administrative

2014) [hereinafter NDRC Rule 22], *available at* <http://www.ndrc.gov.cn/zcfb/zcfbl/201405/W020140521337699046281.pdf>; *see also* Waishang Touzi Xiangmu Hezhun he Beian Guanli Banfa (外商投资项目核准和备案管理办法) [Administrative Measures for the Verification and Approval and the Record-filing of Foreign Investment Projects] (promulgated by the NDRC, May 17, 2014, effective June 17, 2014) [hereinafter Record-filing], *available at* <http://www.ndrc.gov.cn/zcfb/zcfbl/201405/W020140521337699046281.pdf>.

62. Article 2 of the NDRC Rule 22 expressly provides that NDRC Rule 22 applies to all kinds of foreign-invested projects, including the establishment of Sino-foreign joint ventures, Sino-foreign cooperative joint ventures, wholly foreign-owned enterprises, M&A by foreign investors of domestic enterprises, and the capital increase of pre-existing foreign-invested companies. NDRC Rule 22, *supra* note 61, art. 2.

63. Guowuyuan dui Quexu Baoliu de Xingzheng Shenpi Xiangmu Sheding Xingzheng Xuke de Jueding (国务院对确需保留的行政审批项目设定行政许可的决定) [Decision of the St. Council on Setting Administrative Licensing for Administrative Examination and Approval Items that Need to be Retained] (promulgated by the St. Council, June 29, 2004, effective Jul. 1, 2004), *available at* http://www.gov.cn/zwggk/2005-06/20/content_7908.htm.

agencies' practices.

A caveat to note is that the NDRC did receive some endorsement from the State Council. In 2004, the State Council promulgated one "circular"—a quasi-administrative rule—aiming to shake off unnecessary approval requirements.⁶⁴ The circular ironically made it possible⁶⁵ for the NDRC to verify certain strategically important projects.⁶⁶ Such endorsement was probably a result of the NDRC's lobbying efforts—agencies like the NDRC possess strong bargaining power before the State Council.⁶⁷ The NDRC first unilaterally made the expansion and then sought the rubber-stamping from the State Council. For years, the call for reduction in approval requirements from the State Council proved to be unsuccessful.⁶⁸ Ironically, the limited blessing it conferred upon the NDRC enabled the NDRC to expand and further complicate the approval regime. Through NDRC Rule 22, the NDRC seized the opportunity to vigorously march into foreign investment regulation by (1) voluntarily expanding the limited endorsement to a full-blown regulatory power, requiring all foreign investment projects, irrespective of their project size, to be subject to its jurisdiction and, meanwhile, (2) essentially turning a "verification" into an additional approval requirement, contrary to the State Council's wish to streamline approval requirements.

64. See Guowuyuan guanyu Touzi Tizhi Gaige de Jueding (国务院关于投资体制改革的决定) [Decision of the St. Council on Reform of the Investment System] (promulgated by the St. Council, July 16, 2004, effective July 16, 2004), available at http://www.gov.cn/zhengce/content/2008-03/28/content_1387.htm.

65. See *id.* at app. (providing the Zhengfu Hezhun de Touzi Xiangmu Mulu (2004 Nian Ben) (政府核准的投资项目目录(2004年本)) [Catalogue of Investment Projects Authorized by the Government (2004)]).

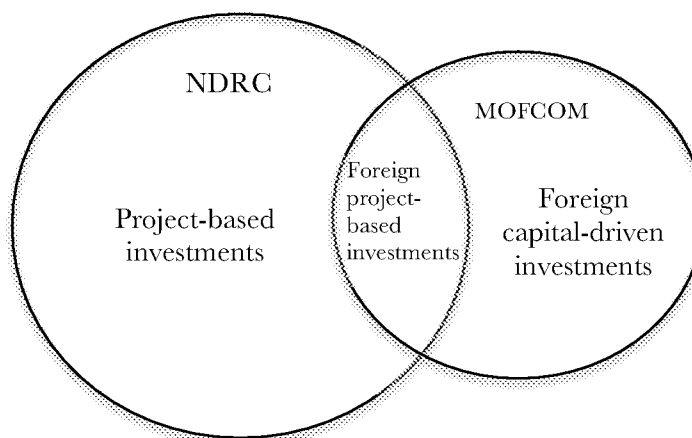
66. That is, investments above a high materiality threshold or in certain restricted industries—investments exceeding USD 100 million and falling within an encouraged or permitted category or exceeding USD 50 million and falling within a restricted category. See *id.* at art. 12.

67. For the political superpower that the NDRC possesses see, for example, Dexter Roberts, *China's Economic Policy Factory: The NDRC*, BLOOMBERG (June 20, 2013), <http://www.bloomberg.com/bw/articles/2013-06-20/chinas-economic-policy-factory-the-ndrc>.

68. See Wang Yukai (汪玉凯), *Xingzheng Shenpi Zhidu Gaige yu Difang Zhili Chuangxin Wenjuan Diaocha Fenxi* (行政审批制度改革与地方治理创新问卷调查分析) [Survey Report of Administrative Examination and Approval Reform and Local Governance Innovation], in ZHONGGUO XINGZHENG TIZHI GAIGE BAOGAO (2014–2015) No.4: XINGZHENG SHENPI ZHIDU GAIGE YU DIFANG ZHILI CHUANGXIN (中国行政体制改革报告(2014–2015) No.4: 行政审批制度改革与地方治理创新) [ANNUAL REPORT ON CHINA'S ADMINISTRATIVE SYSTEM REFORM (2014–2015) No.4] 1, 10–11, 15–16 (Wei Liqun ed., 2015) [hereinafter 2015 ANNUAL REPORT ON ADMINISTRATIVE REFORM] (surveying Chinese governmental officials on the effects of administrative reforms, noting self-interest behavior of agencies, and reflecting that regulatory overlap is an issue to be redressed).

Named “Interim Administrative Measures,” NDRC Rule 22 was unilaterally enforced by the NDRC for nearly a decade without conversion into a permanent administrative regulation until 2014 when the NDRC finally updated its NDRC Rule 22 and made it a permanent rule.⁶⁹ Not having any say on NDRC Rule 22, which imposes additional compliance obligations on the regulated firms but does not directly challenge MOFCOM’s existing authority over foreign investors, MOFCOM lost its exclusive regulatory power over the approval of foreign investment projects in the industrial sectors and had to share its regulatory space with the NDRC.⁷⁰ Figure 4 below depicts the overlap of regulatory power between MOFCOM and the NDRC as a result of the NDRC’s entry into the regulatory regime with respect to domestic regulation of foreign investment projects in China. The NDRC’s jurisdiction is reflected in Figure 4 as the larger circle, illustrating that the NDRC is a more powerful player than MOFCOM on the battlefield.

Figure 4: Overlapping Jurisdiction Between NDRC & MOFCOM



To foreign investors, the fact that the NDRC began sharing MOFCOM’s regulatory space in foreign investment did not mean that they

69. See Record-filing, *supra* note 61. The new NDRC rules backtrack and require certain projects that were previously required to be “verified” to be subject now to a seemingly less burdensome “filing” instead. Meanwhile, some verification powers shifted from the NDRC to local Chinese governments. The change is mainly driven by the Chinese government’s negotiations of bilateral investment treaties with the United States and the European Union. The effect of the new rules is yet to be seen, but it is anticipated that with no change in incentives, the NDRC would end up turning a filing requirement into an approval requirement, as has always been done.

70. Notice that as NDRC Rule 22 was unilaterally promulgated by the NDRC without having to consult MOFCOM, MOFCOM was unable to object to its promulgation.

would have an opportunity to seek regulatory arbitrage in order to decide to whose jurisdiction they would subject themselves; rather, they are subject to the jurisdiction of *both* MOFCOM and the NDRC concurrently.

Since China's institutional reform in 2008, the Ministry of Industry and Information Technology (MIIT)⁷¹ has been vested with the power to regulate industrial sectors, including the automobile industry.⁷² By such arrangement, the State Council intended to allocate the regulatory power over industrial sectors, including the automobile industry, originally possessed by the NDRC to the MIIT.⁷³ The Industrial Policy Division of the MIIT then became responsible for promulgating automobile product catalogues and overseeing the operation of the entire automobile industry. In particular, the MIIT regulates standard-setting and market entry in the automobile industry.⁷⁴

The arrangement to transfer regulatory power from the NDRC to the MIIT empowered the MIIT, but did not successfully disempower the NDRC from continuing to scrutinize foreign investors. The booming and gigantic automobile industry in China, having 22.9% of the world's annual automobile production for the year 2012—soaring from less than 3% for the year 1997⁷⁵—is not a sector of which the NDRC would easily let go. The NDRC has continued to exercise regulatory power over the automobile industry by (1) retaining the requirement that all foreign investments in the automobile industry should nevertheless go through its approval regime and (2) continuing to exercise the policymaking function that impacts the industrial sectors, including the automobile industry.

71. The Ministry of Industry and Information Technology (MIIT) was converted from its predecessor, the Ministry of Information Industry.

72. See Gongye he Xinxihua Bu Zhuyao Zhize Neishe Jigou he Renyuan Bianzhi Guiding (工业和信息化部主要职责内设机构和人员编制规定) [Regulation on the Major Functions of the Internal Divisions of MIIT and their Staffing] (promulgated by the Gen. Office of the St. Council, July 11, 2008, effective July 11, 2008), art. 1(1), *available at* <http://www.miit.gov.cn/n11293472/n11459606/n11459642/11459720.html>.

73. *Id.*

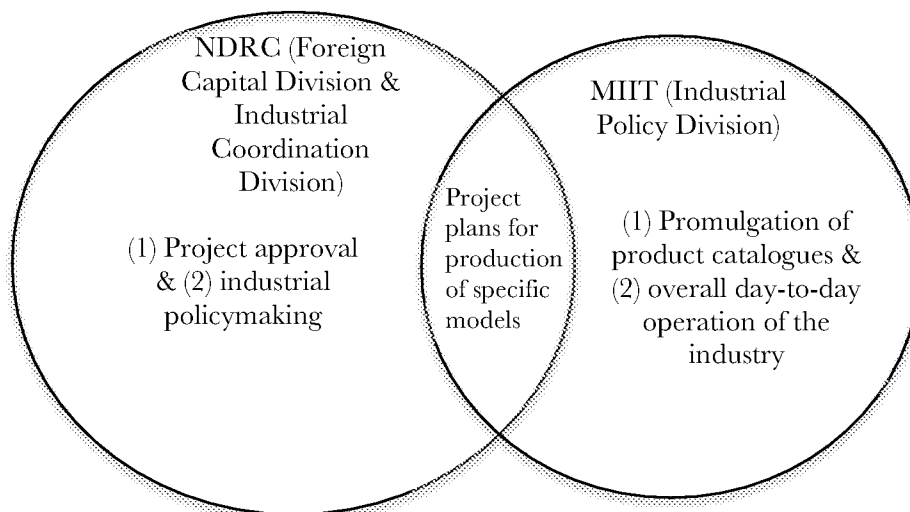
74. Chengyongche Shengchan Qiye ji Chanpin Zhunru Guanli Guize (乘用车生产企业及产品准入管理规则) [Administrative Rules for the Market Entry of Passenger Vehicle Manufacturers and their Products] (promulgated by the MIIT, Nov. 4, 2011, effective Jan. 1, 2012), *available at* <http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/14321324.html>; Shangyongche Shengchan Qiye ji Chanpin Zhunru Guanli Guize (商用车生产企业及产品准入管理规则) [Administrative Rules for the Market Entry of Commercial Vehicle Manufacturers and their Products] (promulgated by the MIIT, Dec. 15, 2010, effective Jan. 1, 2011), *available at* <http://www.miit.gov.cn/n11293472/n11505629/n11506277/n11984220/n11984250/13536981.html>.

75. See 2013 ZHONGGUO QICHE CHANYE FAZHAN BAOGAO (2013中国汽车产业发展报告) [REPORT ON THE DEVELOPMENT OF AUTOMOBILE INDUSTRY IN CHINA: 2013], *available at* http://auto.hexun.com/2013-07-16/156200195_2.html.

The final outcome: the NDRC approves foreign investment projects in the automobile industry as a whole, followed by the MIIT, which approves the market entry of the automobile companies, as well as each individual automobile product to be launched. The MIIT approval in turn is followed by the MOFCOM approval, as illustrated in Figure 3 above. In other words, the NDRC did not abdicate jurisdiction over industrial sectors despite the central government's instruction, reinforcing the notion that agencies do not abdicate easily. The NDRC's ability to exert its legacy influence resulted in the addition of another layer of regulation. Figure 5 below depicts the overlap in regulatory jurisdiction between the NDRC and the MIIT in the foreign-invested automobile industry, with the jurisdiction of the NDRC illustrated as a larger circle than that of the MIIT, once again reflecting that the NDRC is a more powerful player on the battlefield.

The regulation of foreign investments in the automobile industry is typical of the turf war among multiple agencies. There are scores of examples; what is enumerated in this Part is simply the tip of the iceberg. The result of regulatory competition in foreign investment regulation is a cumbersome system that follows neither a functional regulatory approach (i.e., regulatory powers are divided among agencies based on the similarity of business activities by foreign investors) nor a sectorial regulatory approach (i.e., regulatory powers are allocated among agencies in accordance with sectorial type). Rather, it becomes a hybrid system of both functional and sectorial regulation, where agencies are able to choose their justification in order to gain jurisdiction by swinging between the functional approach and the sectorial approach as deemed desirable.

Figure 5: Overlapping Jurisdiction Between NDRC & MIIT in Foreign-Invested Automobile Industry



D. Convergence of Agency Behavior

Notwithstanding the existence of multiple agencies concurrently overseeing the same foreign investment project, agencies such as the State Administration for Industry and Commerce (SAIC), MOFCOM, the NDRC, and the MIIT converge in their behavior to some extent. Foreign investors would need to lodge substantially similar application documentation with these overlapping agencies, contrasting the information revelation argument advocated by regulatory competition theorists,⁷⁶ and the standard and scope of review by these agencies—more about form than about substance—is largely duplicative.⁷⁷ For instance, both the Ministry of Environmental Protection (MEP) and the NDRC claim to look into the environmental impact of foreign investment projects, both the NDRC and MOFCOM oversee the shareholding structure of an investment project, and both the NDRC and the MIIT supervise the market entry of automobile producers.

When each of the multiple agencies approves an aspect of a project, its signoff is hardly an independent act—each agency’s decision is contingent on that of the preceding agency. A common practice is that one agency would require applicants to submit the same documentation as was reviewed by the preceding agencies in the approval flowchart, alongside documentation evidencing the preceding agencies’ approvals.⁷⁸ The succeeding agency then relies on the preceding agencies’ opinions as to whether the project can go through—the fundamental question to ask in a foreign investment project—to make its judgment, albeit factoring in some additional elements specific to its institution.⁷⁹ It is indeed an information cascade—each agency is not exercising its judgment about the merit of the

76. Compare NDRC Rule 22, *supra* note 61, arts. 5–6, and Record-filing, *supra* note 61, arts 8, 10, with Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli (中外合资经营企业法实施条例) [Implementing Regulations for the Sino-Foreign Equity Joint Venture Enterprise Law] (promulgated by the St. Council, July 22, 2001, effective July 22, 2001), art. 7 [hereinafter Sino-Foreign], available at http://www.gov.cn/gongbao/content/2011/content_1860719.htm.

77. Compare NDRC Rule 22, *supra* note 61, art. 12, with Sino-Foreign, *supra* note 76, art. 4.

78. Compare China’s M&A Rules, *supra* note 59, arts. 21, 23, with Record-filing, *supra* note 61, art 10–11 (providing documentation requirements).

79. This draws from the author’s experience as a practitioner representing multinational enterprise clients before various agencies. Similarly, in the CFIUS process in the United States, practitioners also reported that the pre-notice period—a period during which parties may communicate with the CFIUS regarding the particulars of the formal filing to be made—may drag on for weeks, adding a significant amount of time to the CFIUS approval process. See, e.g., Joshua C. Zive, *Unreasonable Delays: CFIUS Reviews of Energy Transactions*, 3 HARV. BUS. L. REV. ONLINE 169, 173–74 (2013).

project, but merely following the choice of its preceding counterparts.⁸⁰

In such an interlocked permitting process, once the preceding agency—especially the principal one—has signed off, the subsequent agencies usually would not turn down the application, but would only focus on unnecessary details—a clear waste of resources. The rationale for the piggybacking behavior of agencies is that, knowing the preceding agency has agreed on the launch of the project, a subsequent agency rests assured that when things go wrong, it will not be the sole agency to blame. When agencies are able to obscure the source of error, they lose the incentive to ensure that their decisions are correct.

To agencies, on the side of benefit, the payoffs of focusing on insignificant details—a misallocation of regulatory resources—and taking pains to tackle difficult, controversial issues are the same. In both scenarios, they are able to force firms to surrender to their regulation. Agencies prefer the former, as criticizing trivial technicalities is the lower hanging fruit, requiring little effort. So long as the agencies can claim jurisdiction, they have a shot at budgeting request and rent-seeking opportunities. In this process, the specific ways of regulation do not make a significant difference to them.

On the side of cost, the two approaches are drastically different. Tackling difficult or controversial issues is much more risky—they may be more politically challenging, requiring more competency which their staff is commonly found to lack. Taking a firm stand on difficult, controversial issues does not bring in lucrative benefits relative to the risks involved because agencies do not have the incentive to scrupulously tackle hard regulatory topics.

The difficulty in measuring agency performance in permit-granting schemes adds to agencies' inertia in addressing difficult, controversial issues. Unlike private, profit-maximizing enterprises where profitability is a good measurement of performance, the output of an agency in an approval chain is hard to measure. Singling out one agency's contribution to an individual project is extremely difficult.

In an ideal situation, "regulatory competition increases the likelihood that a violation will be detected and punished," as more agencies work to screen violations, and as the independence of action between agencies decreases the likelihood of collusion among regulated firms and their regulators—an optimal arrangement.⁸¹ The rigid and tedious review

80. For an example of such an information cascade, see *infra* Part II.E, discussing the Geely/Volvo entry into China's automobile market.

81. See POSNER, *Economic Analysis*, *supra* note 1, at 875; see also Laffont & Martimort, *supra* note 20.

process in China, however, does not increase the possibility of ruling out an under-qualified foreign investor or an investor posing a threat to national security. Viewing themselves as one of the many gatekeepers in the approval chain, the behavior of agencies converges—they do not take different approaches to the same project awaiting their input.

E. The Geely/Volvo Paradox and Agencies' Reluctance to Correct Type I Error

Although Chinese agencies are infamous for devoting disproportionate resources to trivial details,⁸² they shirk the responsibility of answering difficult or more pertinent questions such as whether a project is economically justified or not. Rather, the fragmented regulatory structure captures firms outside of the intended scope of regulation and in turn subjects them to onerous review and approval requirements when they should not have been—a Type I error. Geely, a domestic Chinese car manufacturer, became one of the unintended victims trapped in the obscure zone of foreign investment regulation after its acquisition of the Swedish carmaker Volvo.

In 2010, Geely's high-profile USD 1.5 billion acquisition of Volvo from Volvo's preceding shareholder Ford was deemed a much-triumphed victory for Chinese companies in their expansion into the global market.⁸³ However, after the applause, when Geely wished to have its now Swedish subsidiary Volvo make investments and establish Volvo branded car plants in China in 2012, it found itself in an awkward situation. From a technical standpoint, the regulators characterized Volvo as a foreign company despite the fact that its sole shareholder was a Chinese company. This technical characterization implied that Volvo would be subject to market access restrictions imposed on foreign carmakers and would have to partner with a domestic Chinese car manufacturer to form a 50-50 joint venture in order to enter the Chinese market.⁸⁴

82. For instance, MOFCOM can spend a tremendous amount of time back and forth with a foreign investor applicant commenting on whether the proposed company's Chinese name should appear first in the joint venture documentation ahead of its English name. SAIC can demand the whole set of transaction documentation to be re-executed simply based on its formalistic requirement that all documentation should be signed using a black, and not other colored, pen.

83. For a comprehensive account of Geely's acquisition of Volvo, see Pedro Nueno & Gary Liu, *How Geely Waited for Volvo*, FIN. TIMES (Dec. 19, 2011, 10:51 PM), <http://www.ft.com/intl/cms/s/0/3a453bbe-20ba-11e1-816d-00144feabdc0.html#axzz2dgT0XIcm>.

84. Dongmei Liang & Haili Cao, *Volvo Bian Hukou* (沃尔沃辨户口) [*The Puzzle of Volvo's 'Household Registration' Identity*], CAIXIN (Apr. 30, 2012), <http://magazine.caixin.com/2012-04-27/100384879.html?p0#page2>.

In contrast with its aggressive behavior in fighting for regulatory power with other agencies, not one single agency was willing to stretch the language of the rules to correct the overreaching rule. Nor did any agency make an effort to look through an essential aspect: Volvo's identity. Volvo should have been characterized as a "domestic Chinese company," as opposed to a "foreign company." Despite its foreign address of registration and its manufacturing presence in Europe, from a shareholding perspective Volvo is solely owned by Zhejiang Geely Holding Group, a purely domestic Chinese company.⁸⁵ Here, the Geely/Volvo paradox vividly illustrates the behavior pattern of Chinese agencies: when exerting jurisdiction would bring them benefits (e.g., a wider array of firms subject to their regulation and thereby more budgetary requests and more rent-seeking opportunities), even if it would come at the expense of third parties (e.g., the unintended capture of firms), agencies do not have incentives to reduce Type I error—wrongful condemnation of a legitimate practice that should not have been subject to excessive restriction.

Geely initiated lengthy consultations with various regulators; yet after years of effort, none of the regulators were willing to waive for Volvo the stringent access requirements applicable to foreign investors when it was more opportune, declining to exercise the broad discretionary power they possessed.⁸⁶ After spending two and a half years dealing with one agency—there were many more agencies through which to go afterward—and in order to break the deadlock, ultimately Geely compromised to accept that Volvo should be characterized as a "foreign investor," modifying its applications accordingly.⁸⁷ Putting the astoundingly complicated and lengthy approval process aside, the most direct consequence for Geely in backtracking its position was that Volvo would not be able to establish a standalone car plant in China. Instead, it would have to partner with a domestic Chinese car manufacturer.⁸⁸ Ironically, the Chinese joint venture partner would then be Geely itself.⁸⁹ Then, is there any efficiency

85. Zhejiang Geely Holding Group is the parent of Geely, the automaker. For a narrative of the shareholding structure, see John Reed & Andrew Ward, *Geely Buys Volvo for \$1.8bn*, FIN. TIMES (Mar. 29, 2010, 8:53 AM), <http://www.ft.com/intl/cms/s/0/e6874a70-3a93-11df-b6d5-00144feabdc0.html#axzz2dgT0XIcm>.

86. See *id.*; Liang and Cao, *supra* note 84; Nueno & Liu, *supra* note 83.

87. Dongmei Liang & Hong Zhang, *Volvo: Da Bianhua Jijiang Kaishi* (沃尔沃:大变化即将开始) [*Volvo: Embarking on Big Makeovers*], CAIXIN (Apr. 22, 2013), <http://magazine.caixin.com/2013-04-19/100516489.html>.

88. See Qiche Chanye Fazhan Zhengce (汽车产业发展政策) [Auto Industry Development Policy] (promulgated by the NDRC, Aug. 15, 2009, effective Sept. 1, 2009), art. 48, available at http://www.china.com.cn/policy/txt/2009-08/31/content_18430768.htm.

89. See Press Release, Volvo Car Group, Volvo Cars Acquires Control of its China

consideration behind the rigid and onerous demand from the agencies at all?

Magnification of Type I error becomes a serious and systemic problem in foreign investment regulation even when so many agencies are overseeing the regulatory regime. What is manifested in the Geely/Volvo case is that administrative agencies, eager as they may be in competing with each other in a turf war, shy away from making efforts to rectify an obviously erroneous regulatory approach. Nor does any agency step forward to ease any burden on regulated firms when such firms are under duress from other agencies.⁹⁰

A case like Geely is not rare; rather, it is representative. It was not the first time shirking occurred and was unlikely the last. With Chinese companies increasingly carrying out their “go-abroad” strategy and foraying into foreign markets by way of M&As, a new wave of “round-tripping” investment—investment in China made by “foreign” companies which have already been acquired by Chinese firms—is doomed to trigger similar unintended regulatory hurdles. When originally framing the regulatory framework for foreign investment, Chinese policymakers might not have anticipated the skyrocketing boom of Chinese enterprises’ outbound investment overseas; back then, there was more desire for inflow of foreign capital into China, rather than a policy consideration tilted toward encouraging Chinese companies to go abroad.⁹¹ Thus, agencies may come up with an excuse for such Type I error, as illustrated in the Geely/Volvo paradox. But what is surprising is the rigidity of administrative agencies in enforcement—agencies are reluctant to take a

Joint Ventures for SEK2.2bn, (Aug. 19, 2015), <https://www.media.volvocars.com/global/en-gb/media/pressreleases/166885/volvo-cars-acquires-control-of-its-china-joint-ventures-for-sek22bn> (describing that Volvo was holding fifty percent of its Chinese joint ventures, with Geely holding the other fifty percent).

90. Some agencies like MOFCOM, which is usually foreign investor friendly, and MIIT (as either way it would not lose its approval authority over Volvo) were more sympathetic to Geely, but they did not step in to redress the problem. *See supra* notes 86–90 and accompanying text.

91. *See* Y.Y. Kueh, *Foreign Investment and Economic Change in China*, 131 *CHINA Q.* 637, 637 (1992) (noting that foreign direct investment in China worked to provide much-needed capital supply to its economy). *See also* DANIEL H. ROSEN & THILO HANEMANN, PETERSON INST. FOR INT’L ECON., *CHINA’S CHANGING OUTBOUND FOREIGN DIRECT INVESTMENT PROFILE: DRIVERS AND POLICY IMPLICATIONS* 7 (June 2009), *available at* <http://www.w.iie.com/publications/pb/pb09-14.pdf> (describing that since its opening up to foreign investment, “China has been able to achieve rapid growth by quickly ramping up the scale of production in manufacturing and by restarting inward investment flows”). The rise of outbound foreign investment from China in the recent years signifies the importance of outward investments to the Chinese economy, which has changed fundamentally as China tilts its growth model toward encouraging overseas investment. *See id.* at 2, 15.

substance-over-form view and grant Chinese companies like Geely (and its subsidiaries like Volvo) the domestic company status to which they are entitled.

One prerequisite for efficient regulatory competition is that different agencies take different approaches to the same problem and thus at least one agency will hit on the right approach. However, as shown by the Geely/Volvo case, Chinese agencies unanimously shirk correcting Type I errors and do not look to the bigger overall picture when they are situated in a fragmented regulatory system. They are more enthusiastic about gaining power in turf warfare than caring for the quality of their review or scrutiny process. In their view, there are plenty of other agencies that are keeping an eye on the regulated firms, a convenient excuse for them to do a lousy job on their part.

F. Administering Costs, Significant Delay, and Compliance Costs

Administering Costs. Administering a multi-layered regulatory system turns out to be financially burdensome for China. The size of the Chinese government is notoriously large. China's government size measured by government expenditure as a percentage of GDP has shown a constant upward trend since 1994. For example, in 1998, government spending took up 12.8% of GDP, whereas by 2007, government spending reached approximately 20% of GDP. As of 2010 and 2011, government spending accounted for 27.2% and 27.3% of GDP respectively.⁹² In a jurisdiction like China where the bloated government has already taken a toll on the economy, advocating for regulatory overlap would be a highly implausible approach to regulation.

In particular, with regard to the agencies overseeing foreign investment regulation, they incur unreasonably high budgetary expenses relative to their limited headcount. One needs to consider whether a budgetary competition derived from agency competition would have merits in lowering the administering costs here. When two agencies provide duplicative services and concurrently submit budgetary requests, their principal may be in a better position to compare the quality of their services and accordingly constrain unreasonably high budgetary requests. As William Niskanen points out, regulatory competition has some efficiency justification in such a scenario, as it provides a "basis for comparison,

92. ZHONGHUA RENMIN GONGHEGUO GUOJIA TONGJI JU (中华人民共和国国家统计局) [NAT'L BUREAU OF STATISTICS OF THE PEOPLE'S REPUBLIC OF CHINA], 2013 ZHONGGUO TONGJI NIANJIAN (2013中国统计年鉴) [2013 CHINA STATISTICAL YEARBOOK] 48, 80, available at <http://www.stats.gov.cn/tjsj/ndsj/2013/html/Z0219E.HTM>.

making it easier to recognize unusually efficient or inefficient performance and to reward or penalize [agencies] on this basis.”⁹³ This, however, does not seem to be the case in China. Different agencies may perform overlapping functions, but concurrently they may assume other unique functions. Chinese agencies make their budgetary requests as a whole—they are not required to itemize the budgetary cost for each individual function—therefore making it hard for China’s central government to compare budgets from a same-function perspective.

The central level of MOFCOM, excluding its local branches, had budgetary costs of approximately RMB 2.88 billion (USD 460 million)⁹⁴ for the year 2013 when the number of its official staff was 956.⁹⁵ The cost per staff therefore is over RMB 3 million (USD 0.48 million)—a strikingly high figure, considering the economically less developed stage of China.⁹⁶ Table 1 below provides the budgetary expenditures of MOFCOM as a reference to the high budgetary costs of the foreign-investment regulatory agencies.⁹⁷

Table 1: MOFCOM Budgets, 2010–2013, Billion Chinese Yuan

Budgetary Category	2010	2011	2012	2013
General Expenditures	0.6	1.5	2.4	2.9
Expenditures on Foreign Affairs	14.6	15.3	22.4	23.3
Total Expenditures	15.2	16.8	24.8	26.2

93. See WILLIAM A. NISKANEN, *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* 159–60 (1971).

94. *Shangwu Bu 2013 Nian Bumen Yusuan* (商务部2013年部门预算) [2013 Departmental Budget for MOFCOM], MOFCOM.GOV.CN (Apr. 18, 2013, 4:15 PM), <http://www.mofcom.gov.cn/article/cwgongzuo/feiyqr/201304/20130400094676.shtml>. USD/RMB exchange rate for 2013 was approximately 6.2. This figure excludes some RMB 23.3 billion (USD 3.76 billion) of additional expenditures related to foreign affairs, which are not closely related to foreign investment regulatory functions.

95. See *Shangwu Bu Zhuyao Zhize Neishe Jigou he Renyuan Bianzhi Guiding* (商务部主要职责内设机构和人员编制规定) [Regulation on the Major Functions of the Internal Divisions of MOFCOM and Their Staffing Arrangements] (promulgated by the Gen. Office of St. Council, July 11, 2008, effective July 11, 2008), available at http://www.gov.cn/gongbao/content/2003/content_62145.htm.

96. As a crude estimation, the cost per staff is calculated by dividing the budgetary costs by the headcount.

97. For MOFCOM’S 2010–2013 budgets, see *supra* note 94.

There is also a mismatch of staff—a total of less than 1,000 official staff on file at the central office level in MOFCOM⁹⁸ is significantly disproportionate to the size of the investments they oversee. By 2014, the accumulated stock of foreign investment in China had been as large as approximately USD 2.7 trillion.⁹⁹ Considering that the MOFCOM staff is conducting comprehensive reviews of greenfield foreign investment projects, M&A activities by foreign investors, and merger-control reviews (alongside a series of other activities—e.g., foreign trade—that are not closely related to foreign investment), the capacity and competency of the officials invite serious concern, even if MOFCOM also has larger-sized local offices at the provincial, municipal, and county levels.¹⁰⁰

Significant Delay. Regulatory overlap causes significant delay. In the foreign-invested automobile industry, despite the statutory twenty-business-day timeline for approval,¹⁰¹ it is common that project approval takes two to three years—or even up to three to five years.¹⁰² A trick that agencies use at times is that, before announcing it officially “accepted” the application of a project—when the clock of twenty business days would otherwise begin to tick—it keeps demanding that the applicants furnish supplementary documentation, which drags on the review process. The opportunity cost incurred by car manufacturers due to this protracted scrutiny timeline is huge. To car manufacturers, the life cycle of a specific model of automobile is typically five years, so a three-year projected timeline to obtain an approval to launch a car model can be lethal—by the time the model obtains its approval to enter the Chinese market, it is not the most up-to-date and will soon to be replaced by newer models.

The significant delay, besides raising opportunity costs for incoming foreign investors, undermines a potential argument in favor of the

98. This excludes contract employees at MOFCOM who merely hold temporary positions.

99. See OECD, FDI IN FIGURES 10 tbl. 4 (April 2015), available at <http://www.oecd.org/investment/FDI-in-Figures-April-2015.pdf>.

100. For concerns about the competence of administrative staff and the shortage of staff relative to the workload, see Zhongguo Xingzheng Tizhi Gaige Yanjiu Hui Mishu Chu (中国行政体制改革研究会秘书处) [Secretariat Division of the Research Institute on the Reform of Administrative System of China], *Yinian Lai Xingzheng Tizhi Gaige Chengxiao Ruhe* (一年来行政体制改革成效如何) [What Were the Effects of Reform on the Administrative System in the Past Year], CAIXIN (May 27, 2014, 4:19 PM) [hereinafter *Effects of Reform*], http://opinion.caixin.com/2014-05-27/100682898_all.html#page2.

101. NDRC Rule 22, *supra* note 61, art. 10. The succeeding rule to NDRC Rule 22 has the same twenty-business-day time frame. See Record-filing, *supra* note 61, art. 15.

102. See Lu Zhang (张鹭) et al., *Xuequan Faguiwei* (削权发改委) [Weakening the NDRC], CAIJING (Aug. 11, 2013, 8:40 PM), <http://magazine.caijing.com.cn/2013-08-11/113155899.html>.

administrative regulatory system as opposed to court adjudication. In theory, a pure system of administrative regulation, relative to a pure system of litigation, may have the comparative advantage of being a cheaper, simpler, and quicker means of regulation.¹⁰³ Yet, the significant delay by agencies wipes out this potential benefit.

Compliance Costs. Regulation imposes costs on the regulated. Politicians and regulators commonly use regulations as rent-seeking vehicles¹⁰⁴ and the regulated fall victim to them. To pass regulatory muster, the regulated have to suffer from significant delay and increased compliance costs.

Advocates of regulatory competition—and of regulatory overlap—may underestimate the increased compliance costs for regulated firms.¹⁰⁵ In fact, regulatory overlap as a result of interagency competition greatly burdens the regulated foreign investors doing business in China. Moreover, the documentation to be filed separately with multiple agencies is substantially similar, making it futile to be lodged multiple times—there is no such mechanism as the Paperwork Reduction Act¹⁰⁶ in the United States in place, which helps reduce the paperwork burden that the federal government imposes on private businesses and citizens.¹⁰⁷ In contrast, Chinese agencies are not subject to similarly stiff procedural requirements with respect to their collection of information from foreign investors, and, thus, their information collection process is at times arbitrary and duplicative.¹⁰⁸

On top of the redundancy in paperwork, a more profound economic

103. See POSNER, *ECONOMIC ANALYSIS*, *supra* note 1, at 873–74 (comparing a pure system of administrative regulation with a pure system of litigation).

104. See Jonathan Klick, *The Law and Economics of Regulatory Competition*, in PRODUCTION OF LEGAL RULES 386, 386 (Francesco Parisi ed., 2011) (summarizing that regulations “serve as rent-seeking vehicles for politicians and other actors in the jurisdiction”).

105. See, e.g., Todd S. Aagaard, *Regulatory Overlap, Overlapping Legal Fields, and Statutory Discontinuities*, 29 VA. ENVTL. L.J. 237, 286–88 (discussing the disadvantages of regulatory overlap, the author seems not to consider compliance costs for regulated firms or whether the benefits of duplication would outweigh the costs from a cost-benefit analysis perspective).

106. 44 U.S.C. §§ 3501–21 (2012).

107. See *id.* § 3506(c)(3)(B) (requiring each federal government to guard against duplicative paperwork).

108. U.S. CHAMBER OF COMMERCE, CHINA’S APPROVAL PROCESS FOR INBOUND FOREIGN DIRECT INVESTMENT: IMPACT ON MARKET ACCESS, NATIONAL TREATMENT AND TRANSPARENCY 15 n.72 (2012), available at https://www.uschamber.com/sites/default/files/legacy/reports/020021_China_InboundInvestment_Cvr.pdf; China’s plan to promulgate its Administrative Procedure Law was in discussion for years, but has yet to be formulated. See *Guowu Yuan Fazhi Ban Huiying Xingzheng Chengxu Lifa Keneng* (国务院法制办回应行政程序法立法可能) [Legislative Affairs Office of the State Council Responding to the Possibility of Promulgating Administrative Procedure Law], PEOPLE.COM.CN (Nov. 6, 2014, 11:32 AM), <http://legal.people.com.cn/n/2014/1106/c42510-25986996.html>.

impact of similar documentation requirements is that increased layers of screening do not substantially increase the supply of information about the regulated firms,¹⁰⁹ a rationale that would otherwise justify the additional regulatory layers. A failure in promoting an information revelation attributes to the convergence of agency behavior patterns because their permitting decisions are based on information from the same source.

G. Ineffective Central Government Intervention

As interagency regulatory competition in the form of turf warfare goes on, more and more agencies flood in, creating a distinctive phenomenon of agencies stacking-up, as illustrated in Figure 3 above. In the face of fierce agency competition among multiple agencies—each eager to have a slice of the cake of foreign investment regulation—one would wonder the central government's reaction.

For a regulatory regime with approximately USD 260 billion per annum at stake,¹¹⁰ it would be hard to claim that agencies can go under the radar and sneakily impose additional approval requirements without being noticed by the central government or that the central government is completely ignorant of the fact that agencies stack up. Yet the central government has largely tolerated the turf warfare in different regulatory fields. At times the central government voices its concerns over the overcrowding of agencies, which unilaterally set up too many approval requirements.¹¹¹ It does strive to curtail the pervasiveness of agency self-expansion, mainly by abolishing overreaching approvals agencies require.¹¹² Unfortunately, these efforts are mostly an empty call—abolishing agencies' approval requirements alone is far from an adequate deterrence. Chinese agencies quickly bounce back and promulgate new regulations, rules, orders, and guidelines to impose new approval requirements. Between 2002 and 2012, the State Council abolished 1,992 approval requirements and modified 439 approval requirements agencies imposed,¹¹³ yet the ability for multiple agencies to exercise jurisdiction over

109. See *supra* note 78–80 and accompanying text.

110. See FDI IN FIGURES, *supra* note 99, at 6 tbl. 1.

111. For a summary of the Chinese central government's top-down statements and initiatives on the subject, see Wang, *supra* note 68 and accompanying text.

112. See, e.g., Guowu Yuan guanyu Quxiao Diyi Pi Xingzheng Shenpi Xiangmu de Jueding (国务院关于取消第一批行政审批项目的决定) [Decision of the St. Council to Abolish Certain Administrative Approval Requirements (First Batch)] (promulgated by the St. Council, Nov. 1, 2002, effective Nov. 1, 2002), available at http://www.gov.cn/gongbao/content/2002/content_61829.htm.

113. The author aggregated the approval requirements that were abolished and modified in the succeeding State Council Decisions. See *id.*; Guowu Yuan guanyu Quxiao

foreign investment has remained largely intact despite these efforts.¹¹⁴

Under-deterrence of the central government's measures to curb agency overreaching is accountable for the boom in regulatory overlap. Another possible explanation for the failure of the central government to effectively rectify the regulatory overlap is that as one agency expands, its vested

he Tiaozheng Yipi Xingzheng Shenpi deng Shixiang de Jueding (国务院关于取消和调整一批行政审批项目等事项的决定) [Decision of the St. Council on Matters Concerning the Abolishment and Adjustment of Certain Administrative Approval Requirements] (promulgated by the St. Council, Feb. 24, 2015, effective Feb. 24, 2015), *available at* http://www.gov.cn/zhengce/content/2015-03/13/content_9524.htm; Guowu Yuan guanyu Diliu Pi Quxiao he Tiaozheng Xingzheng Shenpi Xiangmu de Jueding (国务院关于第六批取消和调整行政审批项目的决定) [Decision of the St. Council to Abolish and Adjust Certain Administrative Approval Requirements (Sixth Batch)] (promulgated by the St. Council, Sept. 23, 2012, effective Sept. 23, 2012), *available at* http://www.gov.cn/zwgk/2012-10/10/content_2240096.htm; Guowu Yuan guanyu Diwu Pi Quxiao he Xiafang Guanli Jiecheng Xingzheng Shenpi Xiangmu de Jueding (国务院关于第五批取消和下放管理层级行政审批项目的决定) [Decision of the St. Council on the Administrative Examination and Approval Items to be Canceled and Delegated to Lower Administrative Levels (Fifth Batch)] (promulgated by the St. Council, July 4, 2010, effective July 4, 2010), *available at* http://www.gov.cn/zwgk/2010-07/09/content_1650088.htm; Guowu Yuan guanyu Disi Pi Quxiao he Tiaozheng Xingzheng Shenpi Xiangmu de Jueding (国务院关于第四批取消和调整行政审批项目的决定) [Decision of the St. Council to Abolish and Adjust Certain Administrative Approval Requirements (Fourth Batch)] (promulgated by the St. Council, Oct. 9, 2007, effective Oct. 9, 2007), *available at* http://www.gov.cn/zwgk/2007-10/12/content_775186.htm; Guowu Yuan guanyu Disan Pi Quxiao he Tiaozheng Xingzheng Shenpi Xiangmu de Jueding (国务院关于第三批取消和调整行政审批项目的决定) [Decision of the St. Council to Abolish and Adjust Certain Administrative Approval Requirements (Third Batch)] (promulgated by the St. Council, May 17, 2004, effective May 17, 2004), *available at* http://www.gov.cn/zwgk/2005-08/06/content_29614.htm; Guowu Yuan Guanyu Quxiao Dier Pi Xingzheng Shenpi Xiangmu he Gaibian Yipi Xingzheng Shenpi Xiangmu Guanli Fangshi de Jueding (国务院关于取消第二批行政审批项目和改变一批行政审批项目管理方式的决定) [Decision of the St. Council to Abolish Certain Administrative Approval Requirements (Second Batch) and Modify the Management of Certain Administrative Reviews] (promulgated by the St. Council, Feb. 27, 2003, effective Feb. 27, 2003), *available at* http://www.gov.cn/zwgk/2005-09/06/content_29621.htm.

114. Chinese agencies have various ways of retaining their approval powers in the event of the central government's deregulation initiatives. See AI LIN (艾琳) & WANG GANG (王刚), XINGZHENG SHENPI ZHIDU GAIGE TANJIU (行政审批制度改革探究) [A STUDY ON THE REFORM OF ADMINISTRATIVE APPROVAL SCHEMES] 287–96 (2015) (on file with author). These include consolidating various small sub-categories of approvals into one larger category of approvals while keeping the substance of approvals intact. Statistically, the absolute number of approvals seems to shrink, but it does not make a difference as to the actual obstacles an applicant has to overcome. Another way is to set up different phases in one approval requirement and turn each phase into another sub-approval requirement. Also, Chinese agencies may impose “hidden” approval requirements on applicants—the approval requirements are not publicly announced, but are only raised when an applicant has a face-to-face interaction with the specific agency.

interests and clientele interest groups grow considerably, as does its bargaining power, leading to a disparity between the power of the central government and that of the agency. The vested interests—as well as the large sums of money involved—make it extremely difficult for the central government to intervene *ex post* without causing significant disturbance to the economy. The central government tended to turn a blind eye on regulatory overlap when it first emerged, only to find subsequently that the magnitude of the problem went beyond its control. This slippery slope has put the central government in an embarrassing situation: if it intervenes after the vested interests have developed, the resistance it arouses may dampen the goal of moving the economy forward; however, if it does not intervene, the administrative overreach becomes widespread. The central government has paid a high price for its indulgence of agency self-expansion, yet it is far from learning its lesson. For a bloated bureaucratic administrative system, the pervasiveness of agency overreach and expansion has become a recurrent symptom. Therefore, without a proper institutional setting, the central government's effort is mismatched to the magnitude of the systemic problem.

III. HOW DOES CHINA'S REGULATORY COMPETITION APPARATUS DIFFER FROM THAT IN THE UNITED STATES?

A. Pervasiveness of Regulatory Overlap in the United States and its Causes

In the United States, there is likewise a great deal of duplicative regulation, owing in part to the fact that states, counties, and cities impose regulation on top of federal regulations. There is also much duplication among federal regulators—the U.S. counterpart of interagency regulatory competition that we see in China.¹¹⁵ The stacking-up of multiple agencies as observed in China can similarly be found in the United States, albeit on fewer occasions.¹¹⁶ When drawing comparisons, one should keep in mind

115. Some notable examples of regulatory overlap among federal regulators include the American food safety system and border patrolling. Freeman & Rossi, *supra* note 24, at 1147–49.

116. Another example of concurrent regulations by multiple federal regulators in the United States is the placement of an electric power transmission line. *See* Memorandum of Understanding Among the U.S. Department of Agriculture, Department of Commerce, Department of Defense, Department of Energy, Environmental Protection Agency (EPA), the Council on Environmental Quality, the Federal Energy Regulatory Commission, the Advisory Council on Historic Preservation, and Department of the Interior, Regarding Coordination in Federal Agency Review of Electric Transmission Facilities on Federal Land (Oct. 23, 2009), *available at* <https://www.whitehouse.gov/files/documents/ceq/Transmission%20Siting%20on%20Federal%20Lands%20MOU.pdf>.

that regulatory overlap in the United States is grounded in its inter-branch and separation-of-powers framework in a federal system¹¹⁷ where states share sovereignty with the federal government, a political setting different from China. By contrast, China is a unitary state where the central government is ultimately supreme, and any administrative divisions—i.e., provinces, cities, counties, and towns—exercise only those powers the central government chooses to delegate.

The causes of regulatory overlap among federal regulators in the United States are several. It may be due to the limitation on legislators' prescience. Lawmakers, when making a new delegation, have limited capacity in spotting its unintended duplication with earlier delegations.¹¹⁸ In such event, a related issue is the blurred boundary of jurisdiction—statutes inevitably create ambiguous jurisdictional borders among federal agencies. An agency may want to take advantage of the blurred boundary to determine the scope of its own jurisdiction, a way of entering areas of ambiguous jurisdiction.¹¹⁹

It may also be attributable to the fragmented U.S. congressional committee structure, in which various congressional committees have considerable latitudes in adopting and implementing legislation.¹²⁰ Each committee is prone to make a delegation to its own agencies even when another committee has already made a similar delegation—thus deriving regulatory overlap.¹²¹ In this way, the committee ensures its constituencies can benefit from an enlarged jurisdiction.¹²² Here, the committees compete in a political market of regulation, analogous to a market in other things.¹²³

It may be a product of tactical political design. Overlapping regulation may function to shield certain agencies or policies from presidential

117. American political institutions, by design, fragment power to prevent concentrated power from developing anywhere. There is an enormous literature on separations of power. To list only a few, see generally BERYL A. RADIN, *THE ACCOUNTABLE JUGGLER* (2002); DONALD F. KETTL, *SYSTEM UNDER STRESS* (2d ed. 2007).

118. See Marisam, *supra* note 26, at 191–93 (“It would require a Herculean effort for lawmakers to harmonize each new delegation so that it did not duplicate earlier delegations.”).

119. The U.S. legal question in such a context is whether *Chevron* deference should be given to such a determination. See Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2097 (1990).

120. See J.R. DeShazo & Jody Freeman, *The Congressional Competition to Control Delegated Power*, 81 TEX. L. REV. 1443, 1489 (2003) (describing Congressional committees as “the real engines of the legislative process”).

121. *Id.* at 1488–90, 1497–99 (discussing the oversight of agencies by committees).

122. See Freeman & Rossi, *supra* note 24, at 1139.

123. See Frank H. Easterbrook, *Keynote Address: When Does Competition Improve Regulation?*, 52 EMORY L.J. 1297, 1308 (2003) (“There is a political market in regulation as there is a market in other things.”).

control.¹²⁴ Multiagency processes are also intentionally used to expand the representation of underrepresented groups in the administrative process.¹²⁵ Moreover, regulation may stem from compromise among lawmakers with different preferences.¹²⁶

Certain adverse consequences may come with these duplicative regulations. For instance, as Jody Freeman and Jim Rossi observe, systemic risk may be present in a fragmented setting, as no single agency is answerable to the general picture.¹²⁷ Inconsistency and inadequacy arise when multiple regulators exercise oversight functions.¹²⁸ In the case of concurrent regulations by multiple federal regulators, the U.S. experience has similarly been a prolonged and burdensome process for the regulated firms.¹²⁹ Ignoring these deficiencies paints the U.S. regulatory system in too roseate a hue.

Turf warfare is observed in both countries. In China, turf warfare is typically among agencies, but in the United States it is generally more intense at the congressional committees level.¹³⁰ Agencies can also impulsively expand from the bottom up. To trace the origin of agency institutional setting, agencies in the United States are at times created to address specific regulatory problems then at issue, as a response to regulatory crisis. At their time of creation, the agendas of the agencies do not necessarily overlap with one another. But once they are created, they exhibit some patterns of competition and expansion and ultimately become duplicative over time¹³¹—duplicative in the sense that two or more agencies

124. See Marisam, *supra* note 26, at 195–96 (discussing the creation of the Consumer Product Safety Commission (CPSC) as an independent agency in addition to the existing Food and Drug Administration (FDA) to insulate the regulation of consumer products from presidential influence); LEWIS, *supra* note 26, at 30–35 (discussing the CPSC and arguing that once regulatory overlap is created, coordination among these agencies can consume considerable executive resources).

125. See Louis J. Sirico, Jr., *Agencies in Conflict: Overlapping Agencies and the Legitimacy of the Administrative Process*, 33 VAND. L. REV. 101, 103–04 (1980).

126. See Matthew D. McCubbins, Roger G. Noll & Barry R. Weingast, *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431, 432–33 (1989).

127. See Freeman & Rossi, *supra* note 24, at 1147 (generalizing from the federal food safety regulatory system).

128. *Id.* at 1147–48 (generalizing from the federal financial regulatory system).

129. *Id.* at 1164 n.153 (examining the experience of seeking to build new transmission facilities on federal land).

130. For the literature on turf wars see, for example, DAVID C. KING, *TURF WARS: HOW CONGRESSIONAL COMMITTEES CLAIM JURISDICTION* (1997); GABRIELLA GAHLIA MODAN, *TURF WARS: DISCOURSE, DIVERSITY, AND THE POLITICS OF PLACE* (2007); O'Connell, *supra* note 16, at 1659.

131. See Marisam, *supra* note 26, at 193–95 (attributing the duplication over time to the change of regulatory conditions).

assert authority to regulate the same activity.¹³²

Upon closer scrutiny, the U.S. interagency regulatory overlap is dauntingly complex. The following subpart examines several scenarios of duplicative federal regulation in the United States. The CFIUS review process is directly related to the regulation of foreign investment—in the form of M&As—in the United States. It involves multiple agencies, yet is distinct from typical duplicative regulation, as an interagency committee setting mitigates the potential collapse among agencies. The merger review process, which primarily involves the Department of Justice (DOJ) and the Federal Trade Commission (FTC), exemplifies effective interagency coordination in the event of regulatory overlap. The example of banking regulation, in contrast, exemplifies some recognized problems arising out of duplicative federal regulations.¹³³

1. CFIUS National Security Review

When screening foreign investment in the form of M&A transactions, the CFIUS, as a U.S. interagency committee, adopts a reasonable process to determine lead agencies among multiple member agencies for a specific filing, thereby avoiding the sequential approval phenomenon.

While the Treasury Department acts as the standing chair, a co-lead agency is designated for each individual transaction filed with the CFIUS. Once a CFIUS notice is filed, the Treasury Department makes the decision as to which agency will join it as co-lead agency.¹³⁴ The co-lead agency usually has equity in the transaction.¹³⁵ In practice, lead agencies are most often the Department of Defense or the Department of Homeland Security. The lead agencies generally assume the obligation of monitoring the

132. *Id.* at 193–94 (discussing the example of how both the Nuclear Regulatory Commission and the EPA asserted authority to regulate emissions from nuclear facilities).

133. One should distinguish the overlap between federal regulators from stacked power in the U.S. federal-versus-state context. At the federal-versus-state level, California, for example, has to comply with both federal and state laws over clean air—a stacking of federal and state jurisdictions. This Article focuses on federal regulators and does not address federal-versus-state stacking.

134. For an explanation on the process to designate a co-lead agency and the coordination process between agencies within the CFIUS, see S. REP. NO. 110-80 (2007), available at <http://www.gpo.gov/fdsys/pkg/CRPT-110srpt80/html/CRPT-110srpt80.htm> (providing the Committee on Banking, Housing, and Urban Affairs' report on S. 1610, the Foreign Investment and National Security Act of 2007).

135. Simpson Thacher & Bartlett LLP, *Reform of the CFIUS Process in the Wake of Dubai Ports World* (Aug. 10, 2007), <http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub624.pdf?sfvrsn=2,%20at%202> (discussing the designation of a lead agency from a practitioner's perspective).

mitigation measures imposed on the transaction later on.¹³⁶ While there are a limited number of voting members, the CFIUS in reality operates on consensus.¹³⁷ If one participant strongly objects to a transaction or seeks conditions, those demands are usually respected—the CFIUS will wish to speak with the same voice.¹³⁸ In this way, the CFIUS harnesses the expertise of agencies other than the Treasury Department.¹³⁹ One downside of having multiple member agencies within one interagency committee is, however, the unnecessary delay in the internal process.¹⁴⁰

2. Merger Review

Also consider the merger review process. Antitrust regulation in the United States approaches a pure litigation system where regulatory rules or orders do not play much of a role in regulation other than the merger guidelines published by the DOJ and FTC.¹⁴¹ At the outset, antitrust enforcement in the United States presents a similar example of overlapping functioning. The DOJ, within the Executive Branch, and the FTC, an independent agency,¹⁴² both exercise the authority of federal antitrust functions. In enforcement, the DOJ, FTC, state and territorial governments, or private citizens may file a suit.¹⁴³ In addition, the states' Attorneys General enforce state antitrust laws modeled on the federal laws and applicable to many of the same enterprises.¹⁴⁴

136. 50 U.S.C. app. § 2170(k)(5) (2012) (discussing the actions the co-lead agency should take).

137. 31 C.F.R. § 800.501–506 (2008); Jeffrey Richardson, *A Modern Approach to Tackling CFIUS Concerns*, Miller Canfield PLC (Mar. 23, 2015), www.millercanfield.com/resources-432.html (“If CFIUS cannot reach a consensus as to the transaction, or recommends a Presidential rejection, the transaction is sent to the President of the United States for a final decision during a 15-day review period, which is followed by a report to the Congress.”).

138. See *id.*; MARK E. PLOTKIN & DAVID N. FAGAN, VALE COLUMBIA CTR. ON SUSTAINABLE INT’L INV., FOREIGN DIRECT INVESTMENT AND U.S. NATIONAL SECURITY: CFIUS UNDER THE OBAMA ADMINISTRATION 3 (June 7, 2010), available at http://ccsi.columbia.edu/files/2014/01/FDI_24.pdf (praising the effectiveness of the CFIUS working toward consensus).

139. See *supra* note 137–138 and accompanying text.

140. Practitioners have complained about the unnecessary delays in CFIUS’ processes. See Zive, *supra* note 79, at 171–75.

141. The merger guidelines, albeit nonbinding documents, provide a basis for advance determinations by the agencies on whether to approve proposed mergers.

142. For the distinction between an agency within the executive branch and an independent agency, see POSNER, *Economic Analysis*, *supra* note 1, at 879. As an independent agency, the Federal Trade Commission (FTC) has a combination of legislative, adjudicative, and enforcement functions, does not serve at the pleasure of the President, and its commissioners can be removed only for cause.

143. *Id.* at 873–75.

144. See Lawrence M. Frankel, *The Flawed Institutional Design of U.S. Merger Review: Stacking*

Let us have a closer look at the merger review process, where there is regulatory overlap between federal agencies. Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976,¹⁴⁵ the FTC and DOJ review most of the proposed transactions that may trigger merger review concerns, and either agency can take action to block transactions that it believes would substantially lessen competition.¹⁴⁶ Companies report to both the FTC and DOJ about a proposed transaction, and upon the Hart-Scott-Rodino filing the FTC and DOJ will launch a clearance process to decide between themselves, usually depending on their relative expertise gained through prior experience of substantial investigations of the same product, which of them will do a preliminary review—i.e., the filing and initial waiting period.¹⁴⁷ In practice, the division of labor between the DOJ and FTC may be predictable to some extent—if it concerns mergers in the steel industry, the transaction will go to the DOJ, and if it concerns mergers in the pharmaceutical industry, the transaction may end up going through the FTC. For certain other industries, such as the computer industry, over which both agencies would like to have a say, they will fight with each other over which one can carry out the preliminary review.¹⁴⁸

The purpose of a preliminary review is to determine whether the proposed transaction raises any antitrust concerns that warrant closer examination.¹⁴⁹ Although the FTC and DOJ share jurisdiction over

the Deck Against Enforcement, 2008 UTAH L. REV. 159, 199–204 (2008). For the complex enforcement arrangements in the scenario of antitrust, see POSNER, *ECONOMIC ANALYSIS*, *supra* note 1, at 873–75.

145. Pub. L. No. 94-435, 90 Stat. 1383 (1976).

146. *See generally* Timothy J. Muris & Charles A. James, Memorandum of Agreement between the FTC and the Antitrust Division of the U.S. DOJ Concerning Clearance Procedures for Investigations (Mar. 5, 2002), *available at* <http://www.justice.gov/sites/default/files/atr/legacy/2007/07/17/10170.pdf>. Most significant M&As must be reported to the DOJ Antitrust Division and FTC before they occur. See 15 U.S.C. §§ 18a(a)–(b) (2012) (requiring parties to notify both the DOJ and FTC of a proposed transaction exceeding certain thresholds and requiring parties to refrain from closing the transaction until a specific waiting period has expired); *see also* DOJ ANTITRUST DIV., ANTITRUST DIV. MANUAL III-10–11 (5th ed. 2015).

147. *Id.*

148. *Id.* at app. *See, e.g.*, FTC & DOJ, HART-SCOTT-RODINO ANNUAL REPORT: FISCAL YEAR 2013 tbl. X (2013), *available at* <https://www.ftc.gov/system/files/documents/reports/36th-report-fy2013/140521hsrreport.pdf> (providing the preliminary merger review clearance granted to the DOJ or FTC in different industry groups).

149. *See Premerger Notification and the Merger Review Process*, FTC, <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/premerger-notification-and-merger> (last visited Sept. 13, 2015) (describing that during the preliminary review, parties must wait thirty days (fifteen days in the case of a bankruptcy transaction or cash tender offer) before executing their transaction).

merger review,¹⁵⁰ after the preliminary screening process, transactions requiring further review are assigned to *one* of the two agencies on a case-by-case basis, depending on which agency has more expertise with the industry involved.¹⁵¹ The vast majority of transactions reviewed by the FTC and DOJ at the preliminary review stage are allowed to proceed without having to go through the second phase.¹⁵² If the merger review enters its second phase—referred to as a “second request,” which generally sustains additional millions of dollars of expenses to the parties—only the agency with more expertise will review the information that the parties turn over.¹⁵³ The concern about duplicative exercise of jurisdiction and, therefore, waste goes away.

Although uncertainty remains over which agency would review a particular merger—primarily attributable to the tension between the FTC and DOJ, as well as the “blurred lines of jurisdiction”¹⁵⁴—there is some level of efficiency inherent in such an arrangement. The clearance process and the initial review ensure that the FTC and DOJ have a timely preliminary assessment of the proposed transaction.

3. Banking Regulation

U.S. federal regulation of the financial services sector is a regulatory apparatus saturated with regulatory overlap, having the closest approach to a pure system of administrative regulation. In a pure regulatory system, multiple federal regulators may regulate a single financial institution or

150. The FTC and DOJ published such guidelines as the Joint DOJ and FTC Horizontal Merger Guidelines. DOJ & FTC, HORIZONTAL MERGER GUIDELINES (Aug. 19, 2010), *available at* <http://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf>; *Business Resources*, DOJ, <http://www.justice.gov/atr/business-resources> (last visited Sept. 13, 2015) (providing that the guidelines are updated from time to time).

151. The allocation of responsibilities between the DOJ and FTC in the clearance process concerning M&As are “based primarily on past experience and expertise.” *See* ANTITRUST DIV. MANUAL, *supra* note 146, at III-36–37 (experience such as handling similar matters within the past five years is deemed important evidence of agency expertise).

152. *See* HART-SCOTT-RODINO ANNUAL REPORT, *supra* note 148, at 6 fig. 2 (showing that during Fiscal Years 2004–2013, the percentage of transactions resulting in second phase request were consistently at or below 4.5 percent).

153. *See supra* note 149 and accompanying text (defining a “Request for Additional Information” as a “Second Request”).

154. In 2002, the Bush Administration initiated a proposal to allocate industries between the DOJ and FTC, assigning the DOJ oversight over all mergers involving computer software companies, entertainment, and communications and assigning the FTC oversight over mergers in industries like computer hardware, health care, and biotechnology. But the proposal was withdrawn from Congress as it faced opposition from Capital Hill. *See* Philip Shenon, *Plan to Split Up Antitrust Oversight Stalls*, N.Y. TIMES (Jan. 18, 2002), <http://www.nytimes.com/2002/01/18/business/18MERG.html>.

financial product.¹⁵⁵ The 2007–2008 financial meltdown surfaced a series of pressing regulatory matters, one of which concerned the overlapping financial regulators.

Before the Dodd-Frank Act merged the Office of Thrift Supervision (OTS) (widely seen as the weakest and least effective of the then existing federal regulators) into the Office of the Comptroller of the Currency (OCC) in 2010,¹⁵⁶ the OTS regulated “thrifts.” By contrast, “banks” were regulated by three different federal regulators: the OCC regulated national banks; the Federal Reserve Board (the Fed) supervised state-chartered banks that were members of the Federal Reserve System; and the Federal Deposit Insurance Corporation (FDIC) oversaw state-chartered banks that were not members of the Federal Reserve System but were federally insured. There was also the National Credit Union Administration (NCUA), which regulated credited unions.¹⁵⁷ Credit unions are de facto banks that take deposits and make loans, which typically provide services for local employers or members of a union.¹⁵⁸

The division of authority between thrift and bank regulators was more formal than functional—it was based only on nominal differences in the description of the financial product or the legal classification of the financial institution. Put more generally, the pluralistic regulation of banks—the OCC, the Fed, the FDIC, the OTS, and the NCUA—reflected more political compromise in history than thoughtful institutional designs with economic justification.¹⁵⁹

The blurred and unjustified boundary between the statutory mandate of

155. The regulation of the Office of Thrift Supervision derivatives, including credit default swaps by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), is an infamous example. The blurred line between options and other derivatives gave rise to tension between the SEC and the CFTC over their jurisdiction. See ROBERT G. KAISER, ACT OF CONGRESS 87–88 (2013).

156. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 312, 124 Stat. 1376, 1521–23 (2010).

157. For a more detailed summary of the regulators charged with bank regulation authorities, see, for example, Alejandro Komai & Gary Richardson, *A History of Financial Regulation in the USA from the Beginning Until Today: 1789 to 2011*, in 1 HANDBOOK OF FINANCIAL DATA AND RISK INFORMATION 385, 406–09 (Margarita S. Brose et al. eds., 2014).

158. The overlap of functions in the financial services sector has long been criticized by academic scholarship. See, e.g., John C. Coffee, Jr., *Competition versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 Bus. L. 447 (1995).

159. See, e.g., Frances Rosenbluth & Ross Schaap, *The Domestic Politics of Banking Regulation*, 57 INT’L ORG. 307, 328–29 (2003) (suggesting that the extreme fragmentation of regulatory oversight in U.S. banking regulation was not a scientific design but saturated with political compromises).

each regulatory agency left ample room for regulatory arbitrage.¹⁶⁰ Regulatory arbitrage is a double-edged sword. On the one hand, it allows financial institutions to shop for accommodating regulators as a way of getting away with burdensome overlapping regulation. On the other hand, regulators, in their fierce competition for clientele, have incentives to offer lax regulation to appeal to financial institutions. Financial institutions in turn took advantage of the arbitrage opportunity and strategically placed themselves within the jurisdiction of the most lenient regulators. Through such minor changes in chartering to become a member of the Fed or dropping Fed membership, a bank was able to opt for its favorite regulator to expand its business and increase its profitability. Also, while different regulators could exercise overlapping authority over hybrid financial products—e.g., derivatives such as over-the-counter swaps—certain hybrid products managed to escape regulation altogether. At times, investment bankers innovated new financial products solely to circumvent regulatory oversight in a fragmented regulatory apparatus.¹⁶¹ Such regulatory arbitrage for lax regulation dampened safety and soundness in banking regulation, failed to substantiate meaningful competition, and instead mounted up systemic risks that contributed to the U.S. financial crisis.¹⁶² With the enactment of the Dodd-Frank Act, many of the OTS functions have been transferred to the OCC, leading to a convergence of regulatory approaches to some extent, but the division of authority among the different federal banking regulators remains.

160. For a study of regulatory arbitrage, see generally Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010) (laying out a theoretical framework to identify the conditions under which arbitrage takes place and the various constraints on arbitrage).

161. For an analysis of regulatory arbitrage in the financial services sector, see John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 726 (2009).

162. *Modernizing Bank Supervision and Regulation: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 111th Cong. (2009) (statement of Sen. Christopher J. Dodd, Chairman, S. Comm. on Banking, Hous., & Urban Affairs), available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=a5455409-f62c-4e34-9279-eb035a92a353 (“The regulatory arbitrage, duplication and inefficiency that comes with having multiple federal banking regulators was . . . a problem in creating this crisis. . . .”); see also Donato Masciandaro, *Divide et Impera: Financial Supervision Unification and Central Bank Fragmentation Effect*, 23 EURO. J. POL. ECON. 285 (2007) (offering a European Union point of view that the fragmentation of U.S. regulation has serious consequences for global financial governance). This Article does not explore in detail jurisdictional competition on an international scale, which enables investors to “evade regulation even if one part of the economy (or one nation) imposes it.” Easterbrook, *supra* note 123, at 1299–1300 (providing an analysis of international jurisdictional competition).

B. Institutional Toolkit to Restrain Wasteful Overlap

In the United States, a few institutional tools may be employed to avoid interagency duplication. Congress may reduce unnecessary redundancy by demanding that federal agencies coordinate with each other when they operate in the same regulatory area.¹⁶³ It is difficult to conclude how effective the regulatory machinery has been, but agencies do engage in joint rulemaking as a way of coordination.¹⁶⁴ Congress also passes statutes aimed at reducing overlap.¹⁶⁵

The Executive Branch plays a primary role in coordinating agencies. The White House and the President have some tools in curbing agency self-expansion.¹⁶⁶ The Office of Management and Budget (OMB) is empowered to resolve interagency jurisdictional disputes.¹⁶⁷ It exerts a centralized authority over agencies' budgets to Congress. The Office of Information and Regulatory Affairs (OIRA), as part of the OMB, is charged with the authority to review agency regulatory actions.¹⁶⁸ OIRA screens an agency's regulations to detect duplication with those of other agencies.¹⁶⁹ OIRA is not without criticism, but it is nevertheless a helpful agency in serving the function of promoting the coordination of agency regulatory actions¹⁷⁰—also notice that independent agencies are not subject

163. See Marisam, *supra* note 26, at 199.

164. To name a few examples, principal financial regulators engage in joint rulemakings concerning executive compensation. See Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21,170 (Apr. 14, 2011). The SEC and the CFTC engaged in joint rulemakings to carve out commercial end users from speculative financial investors in security-based swaps. See End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. 79,992 (Dec. 21, 2010).

165. These statutes include the Administrative Procedure Act, 5 U.S.C. §§ 551–59, 701–06 (2012), the Paperwork Reduction Act, 44 U.S.C. §§ 3501–20, and the Regulatory Flexibility Act, 5 U.S.C. §§ 601–12, which are mostly procedural requirements for federal agencies to fine-tune their behavior.

166. For an emphasis on executive branch oversight in interagency adjudication as a way of improving agency coordination, see Shah, *supra* note 23.

167. Exec. Order No. 12,866 § 2(b), 58 Fed. Reg. 51,735, 51,737 (Oct. 4, 1993) (“Coordinated review of agency rulemaking is necessary to ensure . . . decisions made by one agency do not conflict with the policies or actions taken or planned by another agency.”).

168. Pursuant to Executive Order No. 12,866, OIRA has the opportunity to identify regulations that might implicate the jurisdiction or interests of other agencies and to intervene to help ensure that such actions are consistent and coordinated. See *id.* § 4, 58 Fed. Reg. at 51,738–739.

169. See *id.* § 1(b)(10), 58 Fed. Reg. at 51,736.

170. For a description of the actual roles played by OIRA, see Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 HARV. L. REV. 1838, 1838 (2013) (stating from an insider perspective that OIRA’s day-to-day work in reality is assisting agencies to resolve interagency concerns, and that its roles to aggregate and incorporate information and to conduct costs and benefits analysis are not as dominant as an outsider

to OIRA review.¹⁷¹

Moreover, between different branches, the OMB Office of Legislative Affairs and the White House Office of Legislative Affairs may coordinate meetings between the legislature and the administration.¹⁷² Also, vertically, the White House Office of Intergovernmental Affairs oversees relations with state and local governments.¹⁷³ Occasionally, U.S. courts weigh whether their judicial decisions would have an impact on interagency duplication. But it is not an often-invoked tool compared to the legislative and executive institutions.¹⁷⁴

IV. IMPLICATIONS OF INTERAGENCY REGULATORY OVERLAP

A. Stack Up, Coordinate, or Self-Regulate? The Costs Versus the Benefits

After comparing some interagency regulatory overlap scenarios in the United States, let us revisit the case of China and draw a more systemic analysis. It is no surprise to see that agencies have preferences deviating from those of the principal; indeed, such divergence of incentives underscores the classic agency-cost problem. Like business firms in the market, agencies act as utility maximizers,¹⁷⁵ comparing the expected returns and costs in strategizing their behavior.¹⁷⁶ However, unlike marketplace competition, the competition of Chinese agencies to regulate foreign investment activity fails to achieve desirable social goods.

To begin, agencies aspire to move into new regulatory areas by enabling jurisdictional shifts.¹⁷⁷ One inference drawn is that regulatory overlap is

would envision).

171. Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011). *See also* VIVIAN S. CHU & DANIEL T. SHEDD, CONG. RESEARCH SERV., R42720, PRESIDENTIAL REVIEW OF INDEPENDENT REGULATORY COMMISSION RULEMAKING: LEGAL ISSUES 11–15 (2012) (providing OIRA may review nearly all rules proposed by federal agencies, with the exception of independent regulatory commissions).

172. *See* Sunstein, *supra* note 170, at 1873.

173. For a discussion about other agencies that exercise a coordination function, *see id.* at 1873–74.

174. *See, e.g.,* Board of Trade of the City of Chicago v. SEC, 677 F.2d 1137 (7th Cir. 1982) (addressing the duplication between the SEC and the CFTC in the regulation of futures trading). On federal duplication with state authority, *see, for example,* Chamber of Commerce of the United States v. SEC, 412 F.3d 133, 136–39 (D.C. Cir. 2005) (striking down the SEC's expansion of its rulemaking authority in areas traditionally dominated by state law to respect mutual fund boards).

175. *See* Posner, *supra* note 3, at 305 (resting economic analysis of agency behavior on the assumption that an agency's goal is to maximize the utility of its law-enforcement activity).

176. *See* POSNER, ECONOMIC ANALYSIS, *supra* note 1, at 866.

177. For the origin of the public choice theory on price competition of government agencies, *see* William A. Niskanen, *Competition Among Government Bureaus*, 22 AM. BEHAV.

inevitable—as a regulatory apparatus grows in size and complexity, regulatory boundaries become blurred. Accordingly, agencies always have the means to identify a reason to step on regulatory terrain if they so choose. Competition among agencies, similar to the competition among business firms for consumers, results in a competition for budgetary resources and clientele.¹⁷⁸

Yet, unlike the market competition of business firms, competing agencies do not have to squeeze their rivals out of the market for regulation. The rationale: a regulated firm—rather than a rival agency—bears the marginal cost of increased regulation.

When multiple agencies compete in the same regulatory space, one option would be for them to engage in interagency negotiation so as to divide the responsibilities among themselves. Negotiation with another agency is costly, however, considering negotiations often conclude in agencies compromising to give up their claim on jurisdiction in certain scenarios, so as to retain jurisdiction in others. This turns out to be a suboptimal strategy when a more appealing alternative is available to agencies: an agency can expand its turf by creating duplication on top of pre-existing regulations without having to force other incumbent agencies to shrink their territories.

In this way, no agency loses: both the new entrants and incumbents concurrently have veto powers—a way of extracting tolls on regulated firms—in the shared regulatory space. The increased transaction costs of additional layers of regulation are placed on regulated firms, not competing agencies, and businesses that propose to enter into the market would then need to subject themselves to the approval of multiple agencies. By avoiding direct confrontation with each other, agencies enrich themselves as a whole. Competition does not force less efficient agencies out of the turf or lead agencies to endeavor to outperform each other as theorists predict.¹⁷⁹

Agencies receive other payoffs when they tolerate the entry into a regulatory apparatus by a newcomer agency, as long as the latter does not erode its existing jurisdiction. In a permitting scheme, when an agency finds that it has an important or risky decision to make, it would rather have another agency siding with it in making such a decision. In this way, the agency muddies the water and secures that it will not be the sole institution to blame if the project becomes implausible later on. It also becomes easier for the agency to deflect blame because it can claim the

SCIENTIST 517, 518 (1979).

178. See *supra* Part II.G (discussing agency competition for budgets and clientele).

179. See JONATHAN B. BENDOR, *PARALLEL SYSTEMS* 55–57 (1985).

decision was a collective one.¹⁸⁰

As the number of agencies in a permitting scheme increases, the likelihood for the principal to penalize an erroneous decision decreases. On the one hand, the fact that the decision to permit a project was collective induces the principal to believe that the project was merited—it was endorsed by so many agencies. On the other hand, the more agencies involved, the more unrealistic it becomes for the principal to penalize these decisionmakers—punishing numerous agencies altogether is generally politically provocative.

Agency Coordination. This phenomenon contradicts the literature on agency abdication and coordination. In theory, in the midst of regulatory overlap, there is a possibility that as agencies undertake interagency negotiations, they may divide responsibilities among themselves, thereby avoiding the necessity of further oversight over their behavior.¹⁸¹ In the real world, agencies do coordinate on some occasions.

The contrast may be explained by the reality that agencies are unlikely to coordinate voluntarily; they would only do so when they are exposed to external constraints that change their utility functions. Coordination among U.S. agencies occurs as a result of demands from Congress, the Executive Branch, or through the utilization of coordination instruments.¹⁸² When a screening institution is put in place to repudiate overlapping regulations, agencies become alert to potential negative consequences associated with duplication. To agencies, the costs include the forfeiture of regulatory resources that the agencies have grabbed, the foregone administrative resources devoted to the rulemaking process, and non-pecuniary losses such as reputational losses. These costs, multiplied by the probability of overlapping rules, constitute the agencies' expected costs. Therefore, the less likely the screening institution is to intervene to repudiate overlapping rules, the more likely agencies are to engage in overlapping rulemaking.

Notice that while the downside is truncated—agencies have little to lose, since they are seldom adequately penalized even if they engage in overlapping rulemaking—the benefits of overlapping rulemaking can be enormous. Having a broader jurisdiction, which helps justify its budget and staff increases, is one of them. A wider jurisdiction also implies greater chances of soliciting interest groups as its clientele—a better rent-seeking

180. See *supra* note 78–81 and accompanying text (providing an example of Chinese agencies' capacity to shield themselves from blame through duplicative documentation that evidences a preceding agency's approval of a foreign investment project).

181. See Marisam, *supra* note 27, at 185.

182. See Freeman & Rossi, *supra* note 24, at 1173–81 (discussing the instruments the President may use to request agencies to coordinate).

prospect. The “revolving door” problem also has an impact—the broader jurisdiction one agency has, the more power it has, and hence more chances for employment by the regulated firms when the agency’s officials seek employment opportunities in the private sector.

To elaborate on the truncated downside, while the Chinese State Council periodically repeals *ultra vires* approval requirements, it usually does so every few years. Thus, there is a time lapse in reaction: the State Council occasionally intervenes only after an overreaching agency has reaped lucrative profits. By then, the agency has already greatly benefited from its expansion, and the expected costs to agencies become negligible because the odds of repealing any overlapping jurisdiction are actually low. Since it is pervasive practice for agencies to seek expansion, the reputational concern becomes attenuated. After all, there are plenty of other agencies engaging in similar rulemaking behavior; the difference is whether these actions get noticed and penalized—often selectively—by the State Council. What is worse, on top of abolishing overreaching rules, the State Council rarely invokes other mechanisms to penalize an agency for engaging in competition to expand its turf, contributing to the under-deterrence effects and in turn encouraging agency expansion. Therefore, in contrast to the United States, voluntary coordination among agencies in China is rare in that there is hardly any systemic mechanism to incentivize them to do so. Pinning the hope on voluntary agency abdication or coordination risks understating the necessity of external constraints on agencies.

Agency Self-Regulation. Likewise, counting on agency self-regulation may be an illusory hope. In the United States, scholarship identifies the phenomenon of agency self-regulation—i.e., agencies voluntarily imposing constraints on themselves.¹⁸³ The examples given seem to equate to a certain extent agencies’ rulemaking behavior—a common practice of agencies—with self-regulation. Such characterization may be misleading, exaggerating the occasions in which agencies self-constrain their behavior. In the context of China, self-constraint is not common. Agency publication of massive regulations, rules, and orders is aimed at, apart from grabbing regulatory power, *directing* the regulated firms to follow the substantive and procedural requirements as set forth by the agency rather than *self-disciplining* the agencies; it is largely a tool for communicating the agencies’ instructions to the regulated entity.

183. See Elizabeth Magill, *Agency Self-Regulation*, 77 GEO. WASH. L. REV. 859, 866–67 (2009) (listing examples of self-regulation, such as the FTC’s and DOJ’s publications on merger guidelines). The question remains: if an agency has an obligation to follow its own rules, why would it constrain itself?

Notice the reasons provided for agencies' self-regulation are, among others, to maximize their budgets¹⁸⁴ and to maintain a good reputation.¹⁸⁵ Then self-regulation is indeed not voluntary; it is a choice made by agencies factoring into the payoffs and potential costs. In the absence of external constraints, self-regulation or coordination is not as promising as it appears.

B. What Is at Risk?

What would be at risk when interagency regulatory competition predominantly leads to agency stacking-up? Furthermore, what should be the policy or institutional implications? To answer these questions, one should go beyond the usual scholarly focus of interpreting of regulations made by agencies. Instead, one should trace back to how these agencies were able to publish regulations, rules, and other guidance documentation in favor of them in the first place.

1. Systemic Risk

China's experience in foreign investment regulation suggests that the existence of multiple regulators in the same regulatory space, each additive to another, does not necessarily enhance the effectiveness of control by the principal. A dispersed regulatory system makes it difficult for multiple agencies to effectively monitor foreign investment activities from a broader policy goal perspective. Therefore, the seed for systemic failure is planted.

The stacking-up effect makes the regulatory apparatus more opaque and thus can obscure the true source of error. Who is to blame when a regulated firm turns out to be problematic? In China's foreign investment regulation, the agencies mainly engage in a "permitting" scheme to grant pre-approval for a project to proceed. It is distinct from law enforcement activities, whereby the agency detecting the violation is easy to identify and accordingly receive credentials for its better performance. In the permit-granting scheme, the agency signing off on a project is not evaluated based on the approval; instead, it is judged only when such approval turns out to be erroneous. In China, a foreign investment project is unable to be carried out unless all the agencies have unanimously signed off, which means any flawed project is relevant to *all* agencies; thus, it is hard to distinguish *one* agency from another as to which should take a greater responsibility in letting the project continue.

184. See NISKANEN, *supra* note 93, at 39 (making the budget-maximizing claim, which helps explain why agencies would not abdicate their own entrenched jurisdictions).

185. See Magill, *supra* note 183, at 891.

2. *Collective Action Problem and Responsibility Shirking*

The collective action problem is severe in China's foreign investment regulatory regime, where, despite the abundance of regulators, each agency shirks responsibility and instead free rides on other agencies' efforts, thus reducing aggregate policy production or effectiveness of regulation. An optimal regulatory overlap should incentivize each agency to exert high-level efforts *in the presence of* other agencies. But here, the strategic interplay between agencies takes the form of a typical collective action problem: all agencies exert less effort than they would if acting alone.

The tendency for agencies to exert low-level efforts helps explain why agencies demand similar documentation from regulated firms—a behavior that defies the information revelation argument in favor of regulatory competition. Agencies are reluctant to deviate from other agencies' effort levels or to take a different approach, which makes them difficult to free ride on other agencies' judgment calls. It is true that different agencies have different cultures and traditions, but their behavior nevertheless converges when agencies see the best path to maximizing payoffs in a regulatory apparatus. In this sense, diversity or independence in approaching a regulatory matter—especially in a permitting scheme—is reduced.

3. *Not Less, but More, Regulatory Capture*

Regulatory agencies are inevitably subject to intense interest group pressures.¹⁸⁶ Interest groups seek to influence agencies to insulate their members from competition.¹⁸⁷ In China's regulation of foreign investment, the sequential permit granting structure would not mitigate, but instead exacerbate, the risk of regulatory capture. This results in not less, but ironically more, regulatory capture.

As each of the multiple agencies enjoys a veto power, in order to block new entry, interest groups only need to turn *one* of the many agencies into their captive and do not have to “buy” *all* of these agencies. Furthermore, a sequential veto apparatus enables interest groups to play one agency against another and to weaken any possibly effective regulation overall. Lucrative rent-seeking opportunities in turn provoke the proliferation of agencies in one regulatory regime.¹⁸⁸

This helps explain the phenomenon in China that, in lieu of

186. See generally Posner, *Theories of Economic Regulation*, *supra* note 1.

187. *Id.*

188. See Klick, *supra* note 104, at 386 (“Regulations may also serve as rent-seeking vehicles for politicians and other actors in the jurisdiction.”).

painstakingly lobbying for national-level bills, interest groups are more enthusiastic in capturing individual agencies that they deem lenient.¹⁸⁹ Buying regulations and rules made by one administrative agency is generally easier than lobbying for a national statute as the latter imposes direct costs on other agencies, which brings on more interagency frictions and arouses resistance from other agencies. As regulatory capture becomes easier, interest groups benefit from the dissemination of rulemaking powers from the national legislature to multiple administrative agencies and, therefore, understandably campaign in favor of a fragmented and overlapping regulatory structure.

Compounding the tendency of pervasive regulatory capture is the characteristic of a pure system of administrative regulation in foreign investment regulation. Judicial review of regulatory rules or orders is to a large extent disabled in China, encouraging the agencies to stray far from the policy statements of the legislature.¹⁹⁰ Also, potential foreign investors, the majority of which are multinational corporations, tend not to initiate judicial review of administrative decisions until they have exhausted all other possible means, including bribery.¹⁹¹ They clearly understand the importance of maintaining a friendly relationship with regulatory agencies when doing business in China. They are repeat players on the market and subject to extensive ongoing oversight by the regulators.¹⁹² Hence, the last thing they want to do is irritate the regulatory agencies and invite retaliation by bringing a suit for judicial review.¹⁹³ This vividly portrays Judge Posner's insight that a pure system of administrative regulation

189. See Jean-Jacques Laffont & Jean Tirole, *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 Q.J. ECON. 1089, 1109–10 (1991) (theoretically modeling and arguing that “interest groups [have] more political power when [their] interests lie in inefficient than efficient regulation”).

190. Generally, administrative regulations, rules, or agency orders or rulings with general binding force are not judicially reviewable in China. See Xingzheng Susong Fa (行政诉讼法) [Administrative Litigation Law] (promulgated by the Standing Comm. Nat'l People's Cong., Nov. 1, 2014, effective May 1, 2015), art. 13(2), available at http://www.spp.gov.cn/sscx/201502/t20150217_91466.shtml.

191. See David L. Weller, *The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action*, 98 COLUM. L. REV. 1238, 1253, 1281 (1998) (internal quotation marks omitted) (describing foreign investors' reluctance to resort to litigation, noting that “[foreign-invested enterprises'] general managers respond to improper fee requests from officials by negotiating a payment over lunch rather than challenging the request administratively or judicially, thereby avoiding bad relations with the relevant agency,” and reporting that “foreign investors' traditional reluctance to resist illegal fee requests by legal means may now be changing”).

192. Recall in Part II.B, *supra*, that Chinese regulators exert ongoing oversight over the operation of foreign investments in China.

193. See Weller, *supra* note 191, at 1281 (discussing foreign investors' reluctance to develop sour relations with regulators).

“increases the incentives for, and therefore the likelihood of, the control of regulatory agencies by interest groups.”¹⁹⁴

4. Inefficient Division of Labor and Under-Deterrence

Where there is no stacking-up effect, regulatory competition among different agencies may be an efficient way to expand the pool of agency expertise. However, once regulatory stacking-up kicks in, the hope to achieve an efficient division of labor fades. It is by no means an efficient division of labor when multiple agencies, with or without expertise or experience in a particular investment project, are able to intervene in the investment screening process.

Replacement of an inefficient agency with an efficient one may be a useful deterrent to prevent an agency's misconduct.¹⁹⁵ But the deterrence scheme is ruled out when agencies are able to stack up: inefficient agencies with less comparative advantages do not need to worry about being driven out of the regulatory market. This undermines the essence of regulatory competition, as there is no threat of reducing profitability. It in turn encourages shirking behavior because agencies do not have to outperform their rivals to retain their turf.

Under an ideal regulatory competition, agencies would compete with each other to be rewarded for their superior performance—in the form of credentials, more budgetary or resource allocations, or more authority in the regulatory apparatus—upon demonstrating their capability. To an agency enjoying exclusive jurisdiction over a regulatory apparatus, even when not faced with immediate direct competitors, it would nevertheless be deterred from performing poorly, as the possibility exists that a more efficient agency could always replace it. This potential benefit of latent entry will go away as soon as the agency realizes that incoming regulatory players will not replace it, but become additive to it. Therefore, allowing for sequential oversights enjoyed by different agencies negates the deterring effect of a latent competition mechanism.

C. Delegation Matters, and Why Downsizing Movements Are Defective

As a general principle, regulatory power should be delegated to, not unilaterally grabbed by, regulatory agencies. To ensure the implementation of the principle, principal oversight of agency behavior, as

194. See POSNER, *ECONOMIC ANALYSIS*, *supra* note 1, at 874 (explaining that in a pure system of administrative regulation, an interest group only has to capture one agency, not the courts).

195. See Posner, *Regulation*, *supra* note 17, at 24.

opposed to sole reliance on competition among agencies, is indispensable. An implication would be that one should be skeptical about agencies' interpretation of their own jurisdictions.

A major lesson for China to learn is that its lax constraint on agency self-enabled expansion needs to be averted. If any regulatory agency could de facto unilaterally avail itself on the terrain of a particular regulatory regime, ceaseless duplication would plague the system. In order to spur healthy regulatory competition, the starting point should be for the People's Congress or the State Council to be more proactive in specifying the boundary of powers delegated to regulatory agencies and in policing and curtailing the now exuberant self-expansion of agencies. In China, the authority delegated to agencies should be as specific as possible, with narrow statutory mandates and careful definition of roles and responsibilities.

This approach would align with the recommendations of legal development scholars to prefer rules over standards in developing countries with unsophisticated legal environments, such as China—that is, the principal should endeavor to make its delegation of authority to agencies as concrete and detailed as possible.¹⁹⁶ Otherwise when agencies' impulse to self-authorize is not properly suppressed, regulatory overlap turns into a systemic recurrence.¹⁹⁷ This explains why a one-off agency-downsizing movement would not resolve the problem.

Besides legislative and executive precautions to make delegations specific, what would be the appropriate external control instruments? A centralized delegation process is essential to curb turf warfare, but in day-to-day supervision, overreliance on centralized oversight would result in an overworked oversight body. Since Deng Xiaoping's 1982 declaration that "streamlining organization is a matter of great importance," the Chinese government has undergone six rounds of downsizing at almost five-year intervals to streamline its regulatory structure.¹⁹⁸ Yet, in spite of the central

196. See, e.g., Jonathan R. Hay & Andrei Shleifer, *Private Enforcement of Public Laws: A Theory of Legal Reform*, 88 AM. ECON. REV. 398 (1998).

197. See Wang Yukai (汪玉凯) et al., *Woguo Xingzheng Tizhi Gaige 30 Nian* (我国行政管理体制改革30年) [*Thirty Years of Administrative Reforms in Our Country*], in ZHONGGUO JINGJI FAZHAN HE TIZHI GAIGE BAOGAO: GAIGE KAIFANG 30 NIAN (1978–2008) (中国经济发展和体制改革报告: 中国改革开放30年(1978–2008)) [REPORT ON CHINA'S ECONOMIC DEVELOPMENT AND INSTITUTIONAL REFORM: 30 YEARS OF REFORM AND OPENING-UP (1978–2008)] 152, 164–65 (Zou Dongtao ed., 2008) (discussing the overall ineffectiveness of institutional reforms and noting the recurring agency life cycles: downsizing–expansion–downsizing–expansion).

198. For a comprehensive historical account of China's initiatives to reform its administrative agencies, see *id.* at 153–64 (summarizing and assessing the various rounds of institutional reforms in China). See also Alfred M. Wu & Mi Lin, *Determinants of Government*

government's efforts to control agency expansion, the government size and administrative expenditures continued to soar; over time the downsizing efforts proved little success.¹⁹⁹ More specifically, in the foreign investment regulatory arena, the State Council's 2004 decision to simplify the overall regulatory system overseeing investments²⁰⁰ proved to be an ineffective prescription—for the decade following the publication of the decision, approval requirements (some in disguised forms such as “verification” and “filing”) imposed by multiple agencies have continued to boom and prosper.²⁰¹

In the wake of such a movement by the central government, agencies may temporarily behave. But once the movement fades away, the agencies will inevitably bounce back with their underlying incentives intact. Also, when the central government requires removal of unnecessary approval requirements in the movement, agencies reduce the absolute number of approvals imposed by them—by removing the less profitable, less important ones on the periphery—while nevertheless keeping a tight grip on the vital ones.²⁰² The reduction of approval requirements in their absolute number is an easy appeal to the central government, as numbers are a convenient, yet at times misleading, measurement of effect.

In late 2013, China established a Free Trade Zone in Shanghai in which the State Council initiated a pilot program to be enacted locally²⁰³ to convert a series of approvals into filing requirements with respect to foreign investment regulation—except for twenty-four categories falling into a pre-formulated “negative list,” which still require *ex ante* approvals.²⁰⁴ In

Size: Evidence from China, 151 PUB. CHOICE 255, 255 (2012).

199. *See id.* at 255–57.

200. *See supra* note 64 and accompanying text.

201. *See* AI & WANG, *supra* note 114, at 290–91 (noting that packaging approval requirements in “filings” or “verifications” are convenient for, and popular among, Chinese agencies).

202. For tricks commonly employed by administrative agencies in the event of the central government's call for streamlining approval requirements imposed on regulated firms, *see Effects of Reform, supra* note 100.

203. Guowu Yuan guanyu zai Zhongguo (Shanghai) Ziyou Maoyi Shiyan Qu nei Zanshi Tiaozheng Youguan Xingzheng Fagui he Guowu Yuan Wenjian Guiding de Xingzheng Shenpi huozhe Zhunru Tebie Guanli Cuoshi de Jueding (国务院关于在中国(上海)自由贸易试验区内暂时调整有关行政法规和国务院文件规定的行政审批或者准入特别管理措施的决定) [Decision of the St. Council on Temporarily Adjusting the Administrative Examination and Approval Items or Special Access Management Measures Prescribed by Certain Administrative Regulations and St. Council Documents in the China (Shanghai) Pilot Free Trade Zone] (promulgated by the St. Council, Dec. 21, 2013, effective Dec. 21, 2013), available at <http://en.china-shftz.gov.cn/Government-affairs/Laws/General/289.shtml>.

204. *See* Zhongguo (Shanghai) Ziyou Maoyi Shiyanqu Waishang Touzi Zhunru Tebie

December 2014, the State Council further decided to establish similar free trade zones in Guangdong Province, Tianjin City, and Fujian Province, expanding the pilot program in Shanghai to cover wider geographical regions.²⁰⁵ Such recent reform initiatives China's central government developed to streamline the approval process in foreign investment regulation deserve some credit. They move in the right direction of cutting down on bureaucratic approval requirements because additional layers of approval add little marginal value and burden foreign investors.

While the pilot program was initiated by the central government, the initiatives were not self-enforcing.²⁰⁶ The more fundamental issues remain unaddressed: (a) why, in the pilot program, multiple agencies continued to stack up—no agencies are forced out of the turf; and (b) how to prevent agencies from tactfully turning “filings” into de facto “approvals,” as they are evidenced to have been doing.²⁰⁷ A vivid recent lesson from Shanghai's experience is that, in the Free Trade Zone, while MOFCOM tempered its onerous screening requirements amid the deregulation initiatives, the SAIC rose up to demand more substantive review requirements, transforming itself into a de facto MOFCOM. Burdens on foreign investors were not

Guanli Cuoshi (Fumian Qingdan) (2013 Nian) (中国(上海)自由贸易试验区外商投资准入特别管理措施(负面清单)(2013年)) [Special Administrative Measures on Foreign Investment Access to the China (Shanghai) Pilot Free Trade Zone (Negative List) (2013)] (promulgated by the Shanghai Mun. People's Gov't, Sept. 29, 2013, effective Sept. 29, 2013), available at <http://www.scofcom.gov.cn/wgtzgl/232023.htm>. For the most up-to-date version of the Negative List, see Ziyou Maoyi Shiyanqu Waishang Touzi Zhunru Tebie Guanli Cuoshi (Fumian Qingdan) (自由贸易试验区外商投资准入特别管理措施(负面清单)) [Special Administrative Measures for Foreign Investment Access to Pilot Free Trade Zones (Negative List)] (promulgated by the Gen. Off. St. Council, Apr. 8, 2015, effective May 8, 2015), available at http://www.gov.cn/zhengce/content/2015-04/20/content_9627.htm.

205. See Rainy Yao & Steven Elsinga, *China Announces Three New Free Trade Zones in Tianjin, Guangdong and Fujian*, CHINA BRIEFING (Dec. 25, 2014), <http://www.china-briefing.com/news/2014/12/25/china-announces-three-new-ftzs.html>; XINHUA, *China Launches Three More Free Trade Zones* (Apr. 22, 2015, 10:20 AM), http://english.gov.cn/news/top_news/2015/04/21/content_281475093147395.htm.

206. While it is too early to have a comprehensive assessment on the recent reform initiatives, researchers have spotted the comeback of approval requirements despite the policy statements to reduce approvals and regulatory overlap—a symptom similar to what is discussed throughout this Article. See Mao Lixiong (毛力雄) et al., *Fumian Qingdan Guanli Moshi xia de Pudong Xinqu Xingzheng Shenpi Zhidu Gaige* (负面清单管理模式下的浦东新区行政审批制度改革) [Administrative Examination and Approval Reform in the New Area of Pudong under the Management Model of Negative Listing], in 2015 ANNUAL REPORT ON ADMINISTRATIVE REFORM, *supra* note 68, at 157, 172–73 (statistics on the continuing increase in approvals or de facto approvals in Shanghai Free Trade Zone).

207. See *id.*

substantially eased as a result of the reform initiatives.²⁰⁸

This illustrates the pitfall that an initiative to streamline the regulatory structure may end up superficially modifying the names of “approvals” into “filings” only—the least costly way for agencies to conform to the deregulation initiative without substantially impairing their rent-seeking power and still keeping the overlapping agencies’ regulatory turf intact. All these prescriptions are addressing the symptoms but not the root causes; agencies will simply rebound after they are weakened.

The reform initiatives underscore the danger of relying on one-off organizational downsizing. One should not trust reorganization as a cure for agency overreach. The flaw of organizational structuring is that over time, reorganization proves inconsequential in operation, as it is unlikely to change the root causes for distorted incentive structures. Instead, it overworks the central government for reforms that hardly yield lasting effects while misallocating valuable oversight resources.²⁰⁹

D. Centralized Coordinators: Mitigation of Systemic Risk and Optimization of Agencies

Emphasis on delegation of authority is nevertheless unable to completely resolve the type of regulatory overlap that is derived from ambiguity in statutes. No matter how hard the legislature or the central government tries, over time ambiguity in the boundary of agencies is bound to emerge. It is expected that agencies will then take advantage of the blurred boundary to claim jurisdiction. Ambiguity can be intentional or unintentional.²¹⁰ Stressing delegation helps eliminate intentional ambiguity but does not relieve unintentional ambiguity. Unintentional ambiguity may derive from the impossibility of foreseeing all future consequences²¹¹—there is also an element of change over time and of the circumstances in play²¹² or from the legislature’s limited capacity in ironing out all possible sequences *ex ante*.

208. These propositions are based on the author’s communications with practicing lawyers working directly on foreign investment transactions in the Shanghai Free Trade Zone.

209. See RICHARD A. POSNER, PREVENTING SURPRISE ATTACKS 127–31 (2005) (discussing the implausibility of governmental reorganization during an intelligence crisis and noting that some insights may be generalized to apply to reorganization in general).

210. See Saul Levmore, *Ambiguous Statutes*, 77 U. CHI. L. REV. 1073, 1077, 1082 (2010) (raising one example of intentional ambiguity from public choice perspective that ambiguity allows legislators to make different claims to different supporters and constituents).

211. See *id.* at 1077 (“Ambiguity can be intentional or unintentional; it can derive from misunderstandings about language, from simple mistakes, from a failure to plan ahead, or from the impossibility of seeing very far ahead.”). This narrative draws on the American legal system, but is applicable to the Chinese context by analogy.

212. *Id.* at 1083 (“Ambiguity might also arise because of changing times.”).

When the cost-saving justification for interagency regulatory competition is not substantiated, as in the case of China, a lack of effective centralized coordinators to police regulatory competition would be disastrous. Here, in contrast to reliability theory, normal accident theory, which disputes the value of redundancy in an administrative system, is of merit. A proposal for a managed regulatory competition would be in line with normal accident theory, a theory suggesting that a multi-component system's reliability is highly questionable, given the unavoidable and detrimental complications arising out of complex interactions among its components.²¹³

Centralized coordinators may exercise two key functions: (1) monitoring systemic risk and accounting for the greater policy goals; and (2) assuming the role of an architect for the regulatory system—to organize regulatory institutions so as to achieve the optimal number of regulators in a legal apparatus and to exert top-down pressure to force agencies to comply with their functional blueprint for different institutions. Otherwise, an overpopulation of regulatory agencies in a regulatory terrain would undermine coherent regulatory goals contemplated by central policymakers. Centralized coordinators may compare the agencies' performances and therefore ensure that the most efficient agency takes on the responsibility in a regulatory apparatus and that agencies are acting in line with the central coordinator's preferences. In sum, the role of a centralized coordinator should be less an authoritarian macroeconomic planner, but more a gatekeeper and an architect.

Admittedly, centralized coordinators face several inherent constraints. First, due to limited capacity, centralized coordinators have to process large amounts of disparate information, which may be overwhelming. A way to overcome this limitation is to have the coordinators focus on big-picture issues—i.e., systems planning and jurisdictional disputes, and not be encumbered by having to supervise day-to-day operations. Also, the centralized coordinator does not have to be one single institution, nor is it practical to have only one. It can be a pluralist concept—there can be multiple coordinators. In the United States, apart from OIRA and the OMB as the most conspicuous coordinators,²¹⁴ there are institutions outside of the Executive Branch exercising regulatory oversight.²¹⁵ In China, the Standing Committee of the State Commission for Public Sector Reform

213. For the origin of the normal accident theory, see PERROW, *supra* note 13; SAGAN, *supra* note 14.

214. See Sunstein, *supra* note 170, at 1839 (naming centralized agencies).

215. See Nou, *supra* note 23, at 69–74 (2015) (stating that the institutions discussed include the Judicial Conference, Administrative Office of the Courts, and Administrative Conference of the United States).

(SCOPSR),²¹⁶ a division of the State Council, has the potential of acting as an interagency coordinator. To assume the task it would need to reverse its current image of being highly secretive and reluctant to mediate jurisdictional disputes between agencies. Beyond SCOPSR, the central government may explore the potential of some other central institutions as centralized coordinators.

When the central government designs centralized coordinators, it would be better to utilize existing institutions as opposed to creating new ones. A new layer of oversight is easy to create, but is prone to growing into a clumsy institution in the long run and tends to be hard to remove, adding to the bloated government size.

Notice, however, that coordination is not synonymous with centralized control. Centralization of operational functions requires a centralized regulatory body to assume all tasks previously dispersed among multiple agencies, an organizational arrangement that easily overworks the regulatory body. By contrast, in centralized coordination, several central institutions would be designated to play the role of arbitrator—not the role of player—to police interagency regulatory competition so as to ensure agencies do not collude to manipulate the regulatory apparatus.

An emphasis on the systems planning function of centralized coordinators has a reason: there should be an optimal number of agencies in a given regulatory apparatus. The fact that interagency regulatory overlap in China can be de facto initiated by agencies as opposed to by the People's Congress or the State Council as principals casts serious doubt on whether such an optimal number can actually be achieved. If institutional designers overlook the need to limit the number of regulators at play in a regulatory apparatus, they may erroneously favor the adoption of inefficient regulatory overlap.

If we merely depended on reliability engineering theory and assumed in accordance with the theory that the probability of each agency performing in a regulatory overlap scenario were independent from one another, we would conclude that adding another agency layer could increase the overall reliability of the regulatory system. In contrast, it would be a different outcome if the strategic behavior of multiple agencies were taken into account. Let us assume that agencies are strategic, each making its best choice possible while taking into account the decisions of other agencies. If agencies were able to receive one unit of utility for a good outcome (such as detecting violations), and zero for a bad outcome (such as failure to make a

216. For the major functions of State Commission for Public Sector Reform (SCOPSR), see *Main Responsibilities*, SCOPSR, http://www.scopsr.gov.cn/bbjg/zyzz/201203/t20120326_38100.html (last visited Sept. 14, 2015).

detection), an agency's best choice would be one that maximizes its utility, given the choices of other agencies unchanged. Let $p \in (0, 1)$ denote the probability that an agency will function to achieve a positive outcome. We further assume that agency performance requires an effort imposing a cost $c \in (0, p)$. In a two-agency scenario, a Nash equilibrium desirable to an institutional designer hoping both agencies will work has to satisfy that $p \in \left[\frac{1-\sqrt{1-4c}}{2}, \frac{1+\sqrt{1-4c}}{2} \right]$. In other words, the Nash equilibrium will not be an expected optimal result—i.e., both agencies choose to work, unless both the probability of violation detection and the cost of an agency's effort are low. This is consistent with our intuitive reaction when we consider an overlapping institutional setting.

However, if we revisit the assumptions in the theoretical modeling above, we will notice some nuances that may not perfectly reflect a real-world situation. In the case of a good outcome such as violation detection, usually both agencies are not rewarded—i.e., receiving utility; only the individual agency that made the detection is accredited with utility in the event that such agency succeeded in violation detection when others failed. Then, the Nash equilibrium that both agencies choose to work will need to satisfy a much less stringent requirement—i.e., $p(1-p) > 0$. In other words, selectively rewarding the agency that chooses to work may have the effect of encouraging both agencies to work.

When the number of agency entrants in a regulatory regime is not controlled by the central government, it would very likely be a wasteful outcome generating little efficiency. It helps explain why a central government should choose agencies to oversee a regulatory regime, not the other way around.

It is also important to point out that the above model fits in a law enforcement scenario better than in a permit-granting scheme. This is because in the former, it is easier for agencies to receive utilities for their performance and, accordingly, a positive outcome. The agency detecting violations or making prosecutorial decisions stands out in the crowd of overlapping agencies. Quite the contrary, overlapping agencies in a permit-granting scheme, especially in a sequential veto scenario, find it hard to receive utilities for a positive outcome or be punished for a bad outcome—a positive outcome is accredited to all agencies, while a source of error is hard to locate. Hence, there is a case against regulatory overlap in a permit-granting regulatory apparatus.

E. Screening of Agencies to Avoid Duplication and Deterrence Mechanisms

On top of centralized coordinators, several instruments may be employed to curtail stacking up. When a blurred boundary emerges

despite legislative efforts, to ensure that the optimal agency with the most relevant expertise is selected, a pre-screening mechanism similar to the preliminary review in merger review or a preliminary assessment followed by an internal responsibility allocation process similar to the inner workings of the CFIUS—both discussed in Part III.A above—may be established. A pre-screening regime would work to allocate the responsibility of further substantive review to the agency with the most comparative expertise. In this way, a repetitive exercise of the same function by different agencies in adjudicating one single case can be avoided and an efficient division of labor achieved.

Alternatively, in light of the tremendous inefficiency caused by regulatory overlap in China, a rudimentary cure may be to terminate the duplicative functions exercised by suboptimal agencies. To take this route, should the architect of institutions prefer an up-front—i.e., as soon as overlap becomes observable in agencies' rulemaking (and before regulatory overlap bursts abruptly in adjudication)—or an ex post approach—i.e., after regulatory overlap has generated significant real-world impacts?

The sensible choice would be for China to avoid regulatory overlap in the first instance, a less costly approach in light of its peculiarly bureaucratic agencies and stubbornly vested interest groups.²¹⁷ Screening regulatory overlap ex post is secondary to an up-front approach in that it incurs additional cost, although it may be more politically appealing: an ex post approach avoids direct confrontation between agencies in the first place and instead defers the problem to the future, about which politicians generally care less. Deferring the screening of regulatory overlap to a later stage only exacerbates the magnitude of the problem. Eliminating repetitive agencies would be more difficult when these agencies have grown in power and clientele, as compared to curtailing them in their infancy.

Ex post consolidation of multiple agencies is usually a massive undertaking that invites strong resistance from groups vested in the status quo.²¹⁸ Even if consolidation is initiated top-down by the central government, it is likely to end up simply turning *interagency* inefficiency into

217. Notice this is distinct from the United States, in which some legal scholars argue that the costs of avoiding regulatory overlap "*ex ante* are too great, and Congress and the White House should rely on comparative cheaper *ex post* institutions to screen out duplication among agencies." See Marisam, *supra* note 26, at 183 (alteration in original).

218. For instance, Paul Volcker's call to merge U.S. regulatory agencies, in particular the SEC and the CFTC, under the leadership of the Fed was met with strong political resistance. See, e.g., Emmanuel Olaoye, *Former U.S. CFTC Chair Criticizes Volcker Call to Merge Agency with SEC*, REUTERS (May 20, 2015), <http://blogs.reuters.com/financial-regulatory-forum/2015/05/20/former-u-s-cftc-chair-criticizes-volcker-call-to-merge-agency-with-sec/>; see also RAFFAELE SCALCIONE, *THE DERIVATIVES REVOLUTION* 354–55 (2011) (noting the political infeasibility of a merger of the SEC and the CFTC).

intra-agency inefficiency and is far from adequate deterrence. To further complicate the situation, each agency is usually multi-functional—it concurrently assumes other responsibilities apart from the overlapping functions in question. Hence, it would be infeasible to consolidate different gigantic agencies based on the rationale that one division of their functions overlaps with another.

One objection from advocates for an *ex post* scheme may be that, *ex ante*, it is unclear or unforeseeable whether one agency trumps the authority of another, and therefore *ex ante* prevention is impossible. But the administrative rules, orders, ordinances, or guidelines promulgated by the agencies when they intend to reach out to a particular regulatory regime would usually leave a trail. A more robust review of such rules, orders, ordinances, or guidelines as soon as they are released and before the agencies can act based upon them would be able to detect the potential repetition in and overreach of agencies, thereby avoiding waste.

F. Evaluation of Agency Performance

Recall in the modeling of agencies' strategic behavior in Part IV.D above that one of the premises for agencies to exert high-level efforts is that they will be accredited for their better performance in their efforts to maximize utilities. It is therefore critical that when the principal compares agency performance to decide on the allocation of jurisdiction among agencies, it would be able to measure agency outputs.

Permit-granting schemes are distinct from law enforcement—e.g., prosecutorial decisions—in that, in the latter, the contributing agency is easier to discern. Enforcement agencies have concrete outputs such as the number of cases prosecuted, the number of convictions, or the length of sentences. The agency making the most detections or prosecutions is therefore easily singled out. The principal faces less difficulty separating the wheat from the chaff and can accordingly reward the specific agency that made the detection.

In contrast, in a sequential permit-granting scenario, when a foreign investment project is found to be inappropriate, it is hard to tell which agency should be held responsible—the one reviewing the parties' commercial documentation or the one signing off on the business plan. These elements are not separable. The principal does not award agencies for granting permits; instead its quality control mechanism may punish agencies when they mess up. Moreover, significant time has usually lapsed when problems in a project emerge. As a result, it becomes even harder to retrace the steps and establish the causal link between an issue with the ongoing project and the agency that originally cleared the review. This is a

case against the enabling of regulatory overlap in a sequential permitting scheme. To better evaluate agency performance, regulatory overlap in a sequential or concurrent approval-grant regime should be reduced, not the other way around.

CONCLUSION

An evaluation of China's foreign investment regulatory structure should address such broader questions as: (1) the desirable level of competition among regulators; and (2) the prerequisites for regulatory competition to create efficiency and effectiveness. The case study in this Article reveals that while regulatory competition may function well under certain conditions—e.g., a law enforcement scenario—it does not present a similar efficiency-enhancing outcome in China's regulation of foreign investment.

For China, an outright application of western regulatory competition theory would erroneously ignore its distinctive bottom-up feature in interagency regulatory competition and add to its already bloated government size. The danger lies in the fact that under such a setting, in lieu of competing to outperform each other, coexistence would then become the dominant strategy for agencies. The ability of non-performing agencies to survive can both substantially weaken the pressure from competition and prevent agencies without expertise or information advantage to freely enter a regulatory terrain.

Without a genuine threat of replacement or termination as a credible check and as an effective measure to assess agency performance in an overlapping permitting scheme, agencies shirk responsibilities, divert blame, and have no incentive to tackle difficult or controversial regulatory problems. Diversity is reduced in the process as the behavior of agencies converges, and no greater information revelation is incentivized in this process. As a result of the fragmentation of the regulatory structure, no single agency has the big picture or is responsible for the negative externalities. In the sequential permitting scheme, regulatory capture becomes easier, not more difficult, for interest groups; capturing one agency out of multiple is sufficient for interest groups to block new entrants. The sequential permitting scheme also multiplies the cost of administering the regulatory system relative to a single-agency scenario, while regulatory effectiveness and efficiency is hampered, not enhanced. Where multiple agencies are able to cluster on the same regulatory regime irrespective of their relative expertise, no efficient division of labor is present.

To redress the problem, agency coexistence should be made more costly than agency outperformance, thus subsequently replacing less efficient regulator rivals. In addition, the central government should not abstain from intervention, believing that free competition alone is sufficient to make

the most efficient agency thrive. An emphasis on due delegation of authority, utilization of centralized coordination mechanisms, installation of screening processes to avoid wasteful overlap up front, as well as adequate deterrence mechanisms to reshape agencies' incentive structures, may be helpful in mitigating the inefficiencies.

Overall, regulatory competition in the real world presents diverse dynamics, often far more complex than theorists envision. It goes beyond simply choosing between good and bad redundancies.²¹⁹ In theoretical modeling, different scenarios of regulatory competition need to be studied separately. On the one hand, the notion of jurisdictional competition should imply mobility of firms. In jurisdictional competition, the regulated have the option of migrating from one locality to another, thereby subjecting themselves to more accommodating regulations. In this scenario, at issue would be the harm of regulatory arbitrage and the transaction costs of mobility.

On the other hand, among federal (in the case of the United States) or ministerial (in the case of China) agencies, interagency regulatory competition does not always entail forum-shopping opportunities. Firms may be subject to *concurrent* jurisdictions of multiple regulators, as is the case of China's regulation of foreign investment, which undermines meaningful competition. When multiple agencies oversee the same activity in the United States, on some occasions firms may end up being allocated to and screened by one of the multiple agencies, which may be an effective coordination model. In many other cases, overlapping jurisdictions among agencies pose serious challenges to a principal's effective control of agencies.

There is also vertical duplication, at the federal-versus-state level in the United States and the national-versus-local level in China. Relevant to such forms of regulatory competition would be the problems of preemption and separation of powers. Diversified incentive structures come with different forms of regulatory competition.

Specifically, in the scenario of interagency regulatory competition, some reflections on the theoretical approach may be worthwhile. Once regulatory overlap is in place, inevitably, the strategic behavior of agencies kicks in and the theory of reliability engineering has limited value to explain interagency competition. While the literature explores the causes of regulatory overlap as different from deliberate congressional delegation or

219. See JAMES Q. WILSON, *BUREAUCRACY* 274 (2d ed. 2000). James Wilson summarizes governmental redundancy as, "The problem, of course, is to choose between good and bad redundancies, a matter on which scholars have made little progress." *Id.*

committee arrangement,²²⁰ more attention should be paid to agencies' impulse to create regulatory overlap bottom-up.²²¹ When the bottom-up feature is not sufficiently emphasized, scholarship tends to vest hope in eliminating inefficient overlap through agency coordination,²²² as well as agency self-regulation.²²³ On the contrary, when factoring in the systemic tendency of agencies to expand both in terms of size and turf, less trust should be placed in the self-discipline of agencies in their competition and cooperation.

Additional lessons may be generalized, which may help alert the designer of institutions aimed at addressing agency problems. While competition may be introduced in regulatory overlap, one has to ensure the overlap is cost-justified²²⁴ such that it will not unduly burden the regulated entity—i.e., due to the costs of concurrent compliance with multiple sets of rules, confusion and inconsistency, or greater marginal costs than marginal benefits to comply with additional agency requirements. The impact on government size and the cost of the administrative system may also serve as an indicator of the cost justification for regulatory overlap.

To effectuate meaningful interagency regulatory competition, methods to evaluate the performance of multiple agencies need to be devised. Since it is more difficult to measure agency output when it exercises permit-granting—as compared to law enforcement—functions, regulatory overlap poses greater efficiency concerns in the former. To enable an effective evaluation of performance, and thereby stimulate competition, a designer of institutions in a permit-granting regime should aim to reduce, not increase, regulatory overlap.

In theory, terminating a non-performing agency is a possible way to deter shirking agencies. But in reality, this may prove impractical. As an agency grows, the interests vested in that agency grow as well, making the removal of its functions or a termination of such agency susceptible to strong resistance. In this sense, deliberately setting up regulatory overlap is likely to generate reverse effects that may backfire on the principal.

Lastly, in the presence of regulatory overlap, strategic behavior of

220. See Marisam, *supra* note 26, at 190–98 (“Duplicative delegations are largely the unintentional and incidental by-product of political and ad hoc agency designs coupled with Congress’s necessary use of blunt drafting tools to regulate a complex environment.”).

221. See Gersen, *supra* note 12, at 208–09 (modeling solely based on the assumption of Congressional delegation).

222. See Shah, *supra* note 23, at 810–14.

223. See Magill, *supra* note 183.

224. Some scholars have already criticized the administrative costs of regulatory overlap. See, e.g., Freeman & Rossi, *supra* note 24, at 1182 (“Where agencies share regulatory space, the appropriate baseline should include the cost, or at least the risk, of inconsistency, waste, confusion, and systemic failure to deliver on the putative statutory goals.”).

agencies tends to be pervasive and such interdependence of the regulatory agencies' behavior implies a suboptimal equilibrium that justifies regulation. This underscores the importance of centralized coordinators and policed regulatory competition. If one looks through the lens of private market competition, it may seem counter-intuitive to claim that the number of administrative agencies overseeing the same foreign investment matter should be restricted, rather than allowing decisions to be made via free competition between the regulators. But in fact there should be an optimal, not infinite, number of agencies permitted to exercise authority in a given regulatory domain, be it a permitting or enforcement scheme.