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Michele A. Wong

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CHINA'S DIRECT MARKETING BAN: A CASE STUDY OF CHINA'S RESPONSE TO CAPITAL-BASED SOCIAL NETWORKS

Michele A. Wong

Abstract: China's State Administration for Industry and Commerce issued a circular on April 18, 1998 banning all forms of multi-level direct marketing, citing concerns with social stability and economic order. While the direct marketing ban was ultimately implemented in such a way as to allow those who engaged in network marketing to transition to retail sales, alleviating some of the violence of the protest to the ban, opposition to the ban has continued both domestically and abroad. Direct marketing organizations create tight-knit, extensive networks of individuals with similar economic interests. By assembling around a common economic interest, the group may also emerge as a self-motivated political force, particularly when personal economic interests are tested. This latent risk of political activism poses a threat to the authoritarian regime in China. The state's response in issuing a blanket ban of all direct marketing activity illustrates its apprehension of private social and economic networks, and its inability and reluctance to seek regulatory alternatives. As China's economic system continues to evolve under the post-1978 market reform policy, the administration will need to adapt its political approach in order to better understand and respond to the demands of a population with expanding private interests, as well as a growing desire to pursue and protect those interests.

I. INTRODUCTION

The complex mechanics of leveraging dense personal networks to achieve social, political and financial goals permeates the history of Chinese culture. With the advent of economic reform, such network mechanisms have taken on a new function in the exploding consumerism of modern China. Direct marketing, a popular business development tool in the United States for decades, was introduced to the Chinese market in the late-1980s. Soon, tens of thousands of Chinese were engaged in multi-level marketing, through legitimate and illegitimate organizations, generating hundreds of millions of dollars in revenue. However, in late April 1998, China's State Council issued a blanket ban of all direct marketing activities¹ announcing

¹ Circular of the State Council Concerning the Ban of Operational Activities of Pyramid Sales (1998) [hereinafter Pyramid Sales Ban]. The Pyramid Sales Ban is translated in the Appendix to this Comment.

that “the nation’s weak regulatory system is not sufficient to protect consumers from swindlers cloaked as direct salespeople.”²

Part II of this Comment profiles direct marketing and briefly describes post-1978 economic reform in China. This background section also examines the implementation and effects of the direct marketing ban, including the ambiguous legal status of this type of State Council regulation. Part III discusses the emerging antagonism between the new social and economic demands of the post-Mao reform era and the continuing authoritarian role of the state, as illustrated by the direct marketing ban. Finally, Part IV concludes that as China’s economic system continues to evolve under the post-1978 market reform policy, the administration will need to adapt its political approach in order to better understand and respond to the demands of a population with expanding private interests, as well as a growing desire to pursue and protect those interests.

II. BACKGROUND

A. *Multi-Level Direct Marketing*³

Understanding the difference between a legitimate direct network marketing business model and an illegitimate pyramid scheme is a prerequisite to the critical examination of China’s blanket ban on direct marketing. The fundamental distinction between the two models lies in the definition of the revenue-generating mechanism, i.e., whether it is product-based or recruitment-based. In a direct multi-level marketing business—like Amway, Avon, Mary Kay, or Tupperware—revenue comes primarily from product sales.⁴ Direct marketers generate income through commissions from product sales. The role of the network mechanism comes in when a direct marketer recruits a new marketer, often referred to as her “downline.”⁵ The recruiting marketer then receives a commission from all sales made by

² ABC-CLIO, *Government Bans Direct Marketing*, in KALEIDOSCOPE CHINA, LEXIS (Apr. 22, 1998).

³ This type of business model is also known as direct marketing, network marketing, and direct sales, terms that are used interchangeably throughout this Comment. The terminology used in the April 1998 ban is *zhi xiao*, which literally means, “direct sales” or “direct selling.” However, the official English translation by Xinhua of the term as applied in the April 18, 1998 ban is “pyramid sales.” See Pyramid Sales Ban, *supra* note 1.

⁴ Direct Selling Education Foundation, *Pyramid Schemes: Not What They Seem*, in THE DIRECT SELLING INDUSTRY (1997), at <http://www.dsa.org/pyramid.stm>.

⁵ *Id.*

her downline, in addition to the commissions from her own sales.⁶ Thus, an incentive to recruit is created by the net product sales commissions.

In the typical pyramid scheme, revenue is generated primarily from recruitment alone.⁷ Recruits are required to invest amounts of capital, sometimes substantial, to take part in the business.⁸ Those who bring in the new recruits receive a commission from the initiation fees of their recruits and any new members introduced by their recruits, and so on.⁹ Thus, the pyramid is established, with earlier or founding members receiving substantial commissions based on extensive multi-layer recruitment. Jon M. Taylor¹⁰ describes three distinguishing characteristics that can be used as tools to determine whether a business model is in fact an illegitimate pyramid scheme:

1. A chaining hierarchy of levels of distributors—more than is functionally justified—is recruited without area limits, which leads to extreme leverage and perceived saturation in the marketplace.
2. Relative vertical equality in compensation systems leads to extreme horizontal inequality in payout over the network of distributors—huge payouts to a tiny percentage of participants, while the vast majority wind up losing the money and effort they invested over a period of time.
3. Significant purchase or recruiting quotas are required (or incentives offered) to qualify for increasing bonus levels or purchasing discounts in an ascending hierarchy of payout levels (the “pay to play” feature).¹¹

⁶ *Id.*

⁷ The Federal Trade Commission (“FTC”) defines “pyramid schemes” as plans which: (1) “concentrate on the commissions you could earn just for recruiting new distributors;” (2) “generally ignore the marketing and selling of products and services.” Jon M. Taylor, *Product-Based Pyramid Schemes: When Should an MLM or Network Marketing Program Be Considered an Illegal Pyramid Scheme?*, in PYRAMID SCHEME ALERT (2000), at <http://www.pyramidschemealert.org/resources/ppabstract.htm>.

⁸ Direct Selling Education Foundation, *supra* note 4.

⁹ *Id.*

¹⁰ Jon M. Taylor is a direct marketing consultant with an MBA from Brigham Young University in 1965 and a Ph.D. in Applied Psychology from the University of Utah in 1986.

¹¹ Taylor, *supra* note 7.

The fundamental weakness of this type of business is the absence of any meaningful, long-term revenue generating potential. Such businesses often have low quality product or no product at all to offer.¹² Capital acquisition is based purely on new memberships, and new members join hoping that they have come in early enough to profit.¹³ Recruiters often play on people's dreams of quick money to draw new members into such pyramid schemes. When such businesses ultimately collapse, there is little, if any, recourse for the vast majority of members who did not come in early enough to profit.

China's April 1998 blanket ban on direct marketing targeted not only illegitimate pyramid schemes, but also prohibited any other form of network marketing activity.¹⁴ Rather than drawing a distinction between the two business models, and instituting a regulatory framework that would allow Chinese to engage in a genuine business opportunity, while at the same time prohibiting pyramid scams, a radical blanket ban was imposed by the state. China's approach to direct marketing illustrates the tension that has persisted since economic reform began in 1978 between an increasingly capitalist market and an enduring authoritarian government.

B. *Economic Reform in China*

China set in motion its modern economic reform strategy at the meeting of the Third Plenum of the Eleventh Central Committee in December 1978.¹⁵ Starting first with agricultural reform in the rural sector, the state did not begin to institute urban reform until 1984.¹⁶ China's urban reform policy from 1984 to the present has proceeded in three primary phases.¹⁷

The initial phase of urban reform (1984-1989) brought "changes in enterprise structure, prices, finance, banking, housing, labor markets, welfare, pensions, and wages."¹⁸ Soon the economy was expanding beyond the limited formal institutional control of the state.¹⁹ An epidemic of

¹² Direct Selling Education Foundation, *supra* note 4.

¹³ *Id.*

¹⁴ See Pyramid Sales Ban, *supra* note 1.

¹⁵ Communiqué of the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China (Dec. 22, 1978).

¹⁶ WENFANG TANG & WILLIAM L. PARISH, CHINESE URBAN LIFE UNDER REFORM: THE CHANGING SOCIAL CONTRACT 22-23 (2000).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

bureaucratic profiteering, along with uncontrolled inflation, threatened the rapidly expanding economy.²⁰

In the next phase (1989-1992), through an "economic austerity program" and incidents such as the suppression of urban protest at Tiananmen Square in 1989, the state attempted to slow reform.²¹ In this phase, state control of the economy was bolstered at the expense of political freedom.²²

The current phase of reform was signaled by Deng Xiaoping's famous 1992 speech, which emphasized a neoauthoritarian approach to reform, focused on economic modernization combined with strict political control.²³ In the post-Deng era, it is this neoauthoritarian approach that guides the policy of the state in China's continued development.²⁴

China's methodology as a transitional economy is unique. Rather than abruptly switching to a market economy, as the former Soviet Union and Eastern European countries attempted, China's policy has been one of gradual reform.²⁵ For example, rather than allowing its public industry and state-owned enterprises to be supplanted by immediate privatization, China has sheltered them through bank loans and tax benefits.²⁶

Andrew Walder²⁷ describes the general macro-historical trends that have been associated with the waning of communism: "global military and economic competition, the rigidities and inefficiencies of central planning, declining consumer living standards, a decline in the legitimacy of the party and its ideology, and the gradual emergence of oppositional movements."²⁸ From this perspective the key question is whether China's transitional economy damages party cohesion, and thus leads to the emergence of political opposition, or whether political opposition first emerges and thereby undermines the party hegemony.

China's severe response in banning the social and economic networks produced by multi-level marketing suggests that the threat such networks pose to "social stability"²⁹ is at least in part perceived as

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.* For a more extensive account of the reform era under Deng Xiaoping, see generally RICHARD BAUM, *BURYING MAO* (1996).

²⁴ TANG & PARISH, *supra* note 16, at 22-23.

²⁵ Andrew G. Walder, *Interpreting its Significance, in CHINA'S TRANSITIONAL ECONOMY* 1, 10-11 (Andrew G. Walder ed., 1996).

²⁶ *See id.*

²⁷ Professor of Sociology at Harvard University.

²⁸ Andrew G. Walder, *The Quiet Revolution From Within: Economic Reform as A Source of Political Decline, in THE WANING OF THE COMMUNIST STATE* 1, 3 (Andrew G. Walder ed., 1995).

²⁹ *See Pyramid Sales Ban, supra* note 1.

a threat to the Chinese Communist Party ("CCP") and the state's authority.

C. *The Authority of a State Council Regulation*

The implementation of the policy against, and the ultimate blanket ban on, direct marketing is illustrative of the complexity and, in some cases, ambiguity of the lawmaking process in China today. In China, many national laws and regulations are promulgated by the administrative branch of the government overseen by the State Council, rather than by the National People's Congress ("NPC"), the legislative branch of government. However, China's Constitution is sometimes vague and ambiguous with respect to the assignment of lawmaking authority between the two branches. The actions of the NPC and the State Council also contribute to this ambiguity.

The State Council is in effect the executive branch of government.³⁰ The State Council oversees more than sixty government departments, including the central commissions like the State Planning Commission, as well as the numerous ministries and bureaus that constitute the base of the administrative hierarchy.³¹ CCP members hold the key positions of power in the State Council. For example the Premier and Vice-Premiers of the State Council are generally members of the Standing Committee of the Politburo, the CCP leadership.³² Article 89 of the 1982 Constitution grants the State Council the power to issue administrative directives and regulations in the form of official documents (*gongwen*).³³ In this form, the State Council defines government policy at the highest level, which is then transmitted and filtered down through the administrative bureaucracy to reach the local level.³⁴ In general, the State Council's rules of public conduct, or administrative regulations (*xingzheng fagui*), are treated and enforced as the official law, but they may be challenged or voided if they contradict the Constitution or laws passed by the NPC.³⁵

³⁰ The Legislation Law of the People's Republic of China, art. 56 (adopted by the Third Session of the Ninth National People's Congress on Mar. 15, 2000) [hereinafter The Legislation Law]; Perry Keller, *Legislation in the People's Republic of China*, 23 U.B.C.L. REV. 653, 669 (1989) (citing THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, adopted Dec. 4 1982, by the Fifth Session of the Fifth NPC, pmbl.)

³¹ The Legislation Law, *supra* note 30, art. 71.

³² Keller, *supra* note 30, at 669.

³³ XIANFA [THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA] art. 89, sec. 1 (1982).

³⁴ Keller, *supra* note 30, at 669-70.

³⁵ The Legislation Law, *supra* note 30, art. 91; XIANFA art. 67, sec. 7. See also Keller, *supra* note 30, at 669-70.

The 1982 Constitution granted the NPC more clearly delineated legislative power, declaring that the NPC had sole authority to enact and amend those "basic laws" (*jiben falu*) dealing with "criminal offences, civil affairs, the state organs and other matters."³⁶ However, it was left unclear how this altered the State Council's role, which under earlier versions of the Constitution included the power to adopt "administrative measures; administrative laws and regulations (*xingzheng fagui*); and orders in accordance with the Constitution and national laws (*falu*)."³⁷ The State Council can also refer draft laws to the NPC and its Standing Committee for adoption.³⁸

While not expressly defined in the Constitution, the State Council's role appears to be expanding. Since 1982, the NPC has additionally authorized the State Council to promulgate temporary legislation (*zhanxing tiaoli, zhanxing guiding*) on issues of economic reform and restructuring, as well as opening trade.³⁹ The intent of this grant of authority is to permit the State Council greater freedom to experiment with innovative new policies. The direct marketing ban is an example of these short-term regulations promulgated by the State Council in response to concern over the perceived dangers of rapid market reform. Yet, the legal status of this "empowered legislation" (*shouquan fa*) and the time limits on its effectiveness remain ill defined.⁴⁰ For the businesses engaged in direct marketing, this lack of predictability in the law can be costly because building such a business may require an investment of thousands of dollars, and yet can be wiped out

³⁶ MURRAY S. TANNER, *THE POLITICS OF LAWMAKING IN CHINA* 44-46 (1999).

³⁷ XIANFA [THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA] art. 89, sec. 2.

³⁸ The Legislation Law, *supra* note 30, art. 56(ii).

³⁹ The Legislation Law, *supra* note 30, art. 9. See also The Decision of the Third Session of the Sixth National People's Congress on Authorizing the State Council to Formulate Interim Provisions or Regulations Concerning the Reform of the Economic Structure and the Open Policy (adopted at the Third Session of the Sixth National People's Congress on Apr. 10, 1985), <http://www.embonline.net/english/e-Law/legisl-2.htm>:

With a view to ensuring the smooth progress of the reform of the economic structure and the implementation of the open policy, the Third Session of the Sixth National People's Congress has decided to authorize the State Council to formulate, promulgate and implement, whenever necessary, interim provisions or regulations concerning the reform of the economic structure and the open policy in accordance with the Constitution without contravening the relevant laws and the basic principles of the relevant decisions of the National People's Congress and its Standing Committee, and to report them to the Standing Committee of the National People's Congress for the record. These provisions and regulations shall be made into law by the National People's Congress or its Standing Committee after they are tested in practice and when conditions are ripe.

Id.

⁴⁰ TANNER, *supra* note 36, at 44-46.

without warning. However, the Chinese approach has evolved from long-standing tradition:

First, the Confucian tradition emphasizes moral values and moral instruction (not fear of legal sanctions) as a basis for guiding behavior and maintaining social order. Second, the Chinese Communist Party has long viewed the legal system as a means to implement state policy, not as a basis for articulating and guaranteeing the rights of citizens. . . . [T]hird, and finally, the Chinese legal system is underdeveloped.⁴¹

Furthermore, lawmaking in China is complicated by the CCP, which fundamentally drives national policy and is inseparable from the official bodies of government administration. The CCP has formally constituted "party core groups" in the various government ministries.⁴² The party core group includes the top few party members in each government ministry and commission.⁴³ These individuals caucus as party members to decide issues confronting the ministry and to review appropriate directions from above.⁴⁴ They then don their government hats as ministers and vice ministers to issue directives and carry them out.⁴⁵

In the late 1980s, reformers sought to phase out the party core groups, arguing both that they no longer served a distinctive purpose and that talented nonparty individuals should be allowed to hold a few top positions.⁴⁶ This idea was actually adopted as policy in 1987, but its implementation remained incomplete and reportedly was aborted in the wake of the Tiananmen Square repression in June 1989.⁴⁷ "Party life thus forms another brick . . . in the edifice of Chinese Communist party controls over the government and other bodies."⁴⁸

Perry Keller⁴⁹ explains how the transformation of CCP policy into legislation is a source of many of China's law and policy conflicts:

⁴¹ XIAOYING MA & LEONARD ORTOLANO, ENVIRONMENTAL REGULATION IN CHINA: INSTITUTIONS, ENFORCEMENT, AND COMPLIANCE 90 (2000) (Discussing the deficiencies of Chinese administration in the context of environmental regulation, Ma and Ortolano explain historical traditions underlying the Chinese system).

⁴² KENNETH LIEBERTHAL, GOVERNING CHINA: FROM REVOLUTION THROUGH REFORM 213-14 (1995).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ Professor of International and Comparative Law at King's College London, School of Law.

There does not appear to be any established procedure for this transformation process and it is often unclear when a law is no longer in effect due to a change in policy. This has been especially noticeable in the economic reform program in which legislation lagged far behind the implementation of new reform projects.⁵⁰

The lines of legal authority and procedures between China's major lawmaking institutions remain unclear. Chinese law only gives the most general guidance on the question of which legal documents should be promulgated by the State Council, which by the NPC Standing Committee, and which by the NPC plenary session.⁵¹ Jurisdictional disputes are inevitable and common between Party, State Council and NPC officials, who must separately negotiate which state organ will promulgate each law. The result "is a system which is unclear even to those officials who work within it."⁵²

Murray S. "Scot" Tanner⁵³ further explains the growing political incongruity:

On controversial reform issues, many members of the NPC Standing Committee have been openly critical of State Council-sponsored innovations when they came before the Standing Committee in the form of draft laws. Faced with such opposition, the State Council has declined, in some cases, to submit such reform policies to the NPC Standing Committee's scrutiny, choosing instead to simply continue to implement the policy under the documentary rubric of a Party Central Document or a State Council "temporary regulation."⁵⁴

This ambiguity in lawmaking can complicate the assessment made by investors when they are deciding whether to engage in business in China because they are unable to accurately appraise costs and risks. It is this lack of consistency, predictability, and transparency in the lawmaking and regulatory process that sometimes creates an insurmountable barrier to doing

⁵⁰ Keller, *supra* note 30, at 658-59.

⁵¹ TANNER, *supra* note 36, at 46-47.

⁵² *Id.*

⁵³ Associate Professor of Chinese and East Asian Politics at Western Michigan University.

⁵⁴ TANNER, *supra* note 36, at 47.

business in China. The combination of ambiguity in the lawmaking process and the permeation of party politics in legislative activity only serves to further highlight China's need for political reform in the form of structural continuity, consistency in regulation, and legislative transparency, as market reform progresses.

D. *Direct Marketing in China*

1. *Prior to the 1998 Ban*

Prior to the 1998 direct sales ban in Mainland China, there were an estimated thirty million direct marketers, and as many as 2,300 Chinese enterprises, ranging vastly in legitimacy of business practice.⁵⁵ While the ban certainly terminated the operations of a large number of scam organizations, its suitability must be evaluated in light of the legitimate business operations of domestic and transnational corporations. American direct marketing firms had a significant and growing presence prior to the ban. United States companies already doing business in China included Avon,⁵⁶ Sara Lee, Mary Kay,⁵⁷ and Amway.⁵⁸ By April 1998, Mary Kay, Avon and Amway had invested an estimated \$200 million in China.⁵⁹ With the growing population of unemployed Chinese, some individuals saw direct marketing as an unparalleled business opportunity. *Asiaweek* reported prior to the ban that "[l]ife in the central city of Wuhan was disrupted recently when some 50,000 hopefuls converged in search of work at its forty or so direct-sales firms."⁶⁰

⁵⁵ *For China, the Direct-Marketing Ban Hurts More Than It Helps*, ASIaweek, May 8, 1998, at 14 [hereinafter *For China, the Direct-Marketing Ban Hurts*].

⁵⁶ Avon, with its distribution model focused on salespeople engaged in door-to-door, presentation-oriented marketing of personal care products, was the first to enter the Chinese market in Guangzhou in the late-1980s. With the alluring potential of the Chinese market, where personal retail sales is embedded in the consumer tradition, other large direct marketing firms soon followed Avon. See Matthew Miller, *Despite Bumpy Start, Doorstep Sales Win Over Mainland*, S. CHINA MORNING POST, Mar. 12, 1998, at 2. Avon recorded revenues of seventy-five million dollars in 1997, the year prior to the ban. Amy Lo, *Selling Dreams: The Mary Kay Way*, ASIaweek, June 29, 2001.

⁵⁷ Texas-based Mary Kay entered the Chinese market in Shanghai in 1995. See Miller, *supra* note 56. The cosmetics direct marketing business soon expanded to Beijing, Tianjin, Nanjing, Wuxi, Ningbo, and Hangzhou. *Id.* By 1998, Mary Kay had employed approximately 9,000 "beauty consultants," with the average consultant earning between 800 and 900 RMB per month. *Id.* Product sales in China reached twenty-five million dollars in 1997, about eighty percent growth over the previous year, and continued to expand up to the April 1998 ban. *Id.*

⁵⁸ Amway, the largest foreign direct marketing corporation doing business in China, earned as much as \$178 million in 1997. Lo, *supra* note 56. The company had eight distribution outlets and a factory in southern Guangdong province to manufacture home and health-care products. *Id.*

⁵⁹ *Id.*

⁶⁰ See *For China, the Direct-Marketing Ban Hurts*, *supra* note 55.

Prior to the 1998 ban, the State Administration for Industry and Commerce ("SAIC") made several attempts to regulate direct marketers and eliminate illegal practices, such as pyramid scams, misrepresentation, and distribution of over-priced, shoddy products. Two re-certification campaigns were initiated between 1995 and 1997 through which hundreds of illegal operations were closed down.⁶¹ Additionally, in September 1995, the National Industrial and Commercial Bureau ("NICB") instituted a seven-month moratorium on all direct sales business. The NICB carried out an investigation into the organizations then engaged in the business, after which only forty-one of 163 firms were permitted to resume operations.⁶² Following the 1995 investigation, the NICB imposed new rules on the direct marketing business, including a ban on direct sales of medicine, jewelry, and fresh food.⁶³ Mandatory training became a requirement for all direct sales staff. Civil servants, soldiers on active duty, journalists, doctors and teachers were all barred from engaging in the business.⁶⁴ However, the restrictions were apparently ineffective in regulating the growing business. Therefore, rather than once again expending time and resources in determining and resolving the problems and issues surrounding the direct sales business, the administration simply declared a complete ban on any and all activity related to direct marketing.

2. *The Regulation of Direct Marketing in China*

On April 18, 1998 the State Council issued the blanket ban on direct, multi-level marketing.⁶⁵ Under the ban, all companies engaged in network marketing were ordered to cease operations by October 31, 1998.⁶⁶ The broad prohibition included the business activities of transnational corporations such as Amway, Avon, Mary Kay, and Tupperware.⁶⁷ The official notice claimed that direct marketing led to the "spreading [of] heretical beliefs, ganging up, superstition, and hooliganism which seriously deviate from the requirements of building of spiritual civilization and affect social stability in China."⁶⁸

⁶¹ *Id.*

⁶² Mark O'Neill, *Direct Selling Branded Social Evil as Mainland Moves Towards Ban*, S. CHINA MORNING POST, Mar. 30, 1998, at 1.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ See Pyramid Sales Ban, *supra* note 1.

⁶⁶ *Id.*

⁶⁷ *Economic Affairs: Government Bans Direct Marketing*, KALEIDOSCOPE, Apr. 22, 1998.

⁶⁸ See Pyramid Sales Ban, *supra* note 1.

In the months prior to the announcement of the direct marketing ban, the administration had foreshadowed its intended policy through television and newspaper campaigns focusing on the “evils of direct sales.”⁶⁹ Orchestrated by the CCP’s propaganda department, stories were told of innocent people driven insane after losing their life savings to scamming direct marketers.⁷⁰ Senior police officials warned that direct selling could become “uncontrollable and a danger to social stability.”⁷¹ The NICB Fair Trade Bureau Chief, Li Bida, stated that direct selling was “bringing calamity to the nation and the people.”⁷² Vice Premier, Li Lanqing announced that “under present market conditions, direct selling had caused many abuses and should be banned.”⁷³

One year following the ban, the administration still found itself expending extensive resources to enforce the prohibition. In October 1999, the State Administration of Industry and Commerce again released a circular ordering local administration across the country to concentrate on a “market clean-up.”⁷⁴ The SAIC dedicated twelve squads to assist local administrations in investigating business deals with “corrupt overtones, cronyism, and rude work manners.”⁷⁵ In one interview, the Director of the Inspection Office of the SAIC, Cheng Xin, explained that “the main target in the crackdown is the illegal pyramid scheme. . . . It has done damage to

⁶⁹ O’Neill, *supra* note 62.

⁷⁰ *Id.*

⁷¹ *Id.* The Chinese government’s concern about the pervasive danger of unregulated pyramid schemes came in part from witnessing the turmoil in Albania following the collapse of pyramid investment schemes in late 1996 and 1997, which resulted in thousands losing their life savings and triggering riots in which almost 2,000 people died. See INT’L HELSINKI FEDERATION FOR HUMAN RIGHTS, ANNUAL REPORT 1998: ALBANIA (1998), at <http://www.ihf-hr.org>. However, the turmoil in Albania was rooted deeply, beyond merely the peril of corrupt pyramid schemes. *Id.*

The chaotic events could not be attributed solely to the tragic loss of savings, for which the Democratic Party appeared at least partly responsible due to its close links to the “pyramid” scheme companies. The roots of the breakdown of the rule of law lay in long-standing political disillusionment of the population in the face of the failure of economic recovery. Moreover, the authoritarian rule of the Democratic Party and President Sali Berisha and their control over electronic media, law enforcement agencies and the judiciary; persistent disregard for human rights; undermining of democracy; corruption and mismanagement played a decisive role in the developments of early 1997.

Id.

⁷² O’Neill, *supra* note 62.

⁷³ *Id.*

⁷⁴ Li Ming, *Efforts to End Illegal Markets*, CHINA DAILY, May 8, 2000.

⁷⁵ The “clean-up” was purported to combat the prevalence of “fraudulent products, illegal companies and factories, copyright violation, and direct selling—particularly pyramid schemes.” See Pyramid Sales Ban, *supra* note 1.

many people and even caused serious social unrest in some places.”⁷⁶ Cheng cited an incident in which a crowd numbering in the thousands descended upon the headquarters of a pyramid scheme in Taihe County, Anhui Province, that had been closed by the government. To illustrate the dangerous mob mentality influence of such organizations, Cheng announced that “the revival of pyramid schemes will be stopped.”⁷⁷ The SAIC publicly reiterated the policy of the direct sales ban as recently as April 2000.⁷⁸

3. *Domestic Protest to the Ban and Pressure from Abroad*

The announcement of the April 1998 ban sparked protest both domestically and abroad. In Zhangjiajie, a city in Hunan, a protest against the ban erupted into a riot.⁷⁹ Authorities reported that hundreds of people involved in direct sales smashed cars and looted stores.⁸⁰ It was also reported that at least ten people were killed during the protests in the Hunan city of Hengyang.⁸¹ As one newspaper explained, “Resistance is fortified by a growing fear of unemployment, with state factories laying off millions, the government committed to slashing bureaucracy and China’s super-charged economy showing signs of a possibly serious slowdown ahead.”⁸²

Prior to China’s recent accession to the World Trade Organization (WTO), frustration with the 1998 direct marketing ban was also expressed from abroad. During the United States-China WTO accession negotiations between 1996 and 1998, disputes arose over numerous specific issues, including but not limited to labor practices, agriculture restrictions, telecommunication regulations, and unfair distribution rights policy towards foreigners.⁸³ Most relevant to the issue of direct sales, particularly foreign direct marketing corporations, was the tension during negotiations over distribution and retail rights:

The PRC had not agreed to grant distribution rights—such as wholesaling, retailing, maintenance and repair, and transportation—to foreign companies. In other words, foreign companies could not own and operate distribution networks

⁷⁶ Li Ming, *supra* note 74.

⁷⁷ *Id.*

⁷⁸ *Direct Marketing a No No in China*, CHINAONLINE, Apr. 5, 2000.

⁷⁹ Renee Schoof, *Hundreds Riot Over Ban on Direct Marketing*, AAP NEWSFEED, Apr. 27, 1998.

⁸⁰ *Id.*

⁸¹ Andrew Higgins, *Avon Calling? Not in China*, THE GUARDIAN (LONDON), May 1, 1998, at 18.

⁸² *Id.*

⁸³ Raj Bhala, *Enter the Dragon: An Essay on China’s WTO Accession Saga*, 15 AM. U. INT’L L. REV. 1469, 1487-89 (2000).

within the PRC. These networks were controlled by state-run Chinese companies. A foreign firm could not conduct marketing, after-sales service, maintenance and repair, and customer support unless its business license from the government allowed it to do so. Yet, distribution was a service and, pursuant to the General Agreement on Trade in Services (“GATS”), was a legitimate subject for negotiation. While the PRC had guaranteed foreign companies would have equal access, along with domestic firms, to distribution and transportation networks, the PRC needed to grant foreign companies the opportunity to set up and control these networks so they could get their wares to market. American companies like Amway, Avon, and Mary Kay Cosmetics, which relied on direct selling, were examples of foreign firms whose access was limited by the PRC’s strictures.⁸⁴

U.S. trade representatives met with Chinese officials to discuss the issue of the Pyramid Sales Ban and its impact on U.S. direct marketing companies soon after the ban was imposed in 1998.⁸⁵ Whether China will remove or modify the Pyramid Sales Ban following its accession to the WTO is still to be seen.

4. *Direct Marketing after the 1998 Ban*

Companies engaging in direct sales did not simply disappear following the April 1998 ban. In fiscal year 1999, Amway China experienced sales revenue of approximately \$225.6 million.⁸⁶ Although not yet enough to bring the China division out of the red, the 1999 sales volume was double that of 1998.⁸⁷ Subsequent to the initial blanket ban, Chinese authorities compromised and allowed Amway to continue its business in China, provided it transitioned to more traditional retail sales methods.⁸⁸ Eva Cheng, president and chief executive officer of Amway, expressed confidence that the business would continue to grow regardless of the 1998 ban, explaining that “due to the increase of sales, 2000 might be the first year the company will be able to make money since the ban of pyramid sales

⁸⁴ *Id.* at 1488.

⁸⁵ William J. McDonald, *The Ban in China: How Direct Marketing is Affected*, in DIRECT MARKETING (June 1998), at <http://www.newthinking.com/>.

⁸⁶ Tao Yun Gang, *Amway Doubles Its Sales, Looks Ahead*, CHINA DAILY, Nov. 7, 2000.

⁸⁷ *Id.*

⁸⁸ *Id.*

in China in 1998.”⁸⁹ While Amway is still permitted to recruit sales representatives, “post-ban representatives are more like typical service people, helping customers make orders and bringing the goods to them for a commission.”⁹⁰ This new methodology has compelled Amway to engage in more costly commercial marketing activity, such as promotion and advertising, to increase consumer recognition.⁹¹ However, with increasing sales, the company has no reason to withdraw from the Chinese market, despite a sometimes hostile administration.⁹²

III. DISCUSSION

The 1998 ban on direct sales is illustrative of China's reluctance to match its market reform policy with parallel political reforms. As a consequence of the State's resistance to reform, “China has already suffered serious bouts of macroeconomic instability and political unrest, and the prospect of serious reform of state industry creates the likelihood of rising urban unemployment.”⁹³ Economist Barry Naughton explains that China's macroeconomic difficulties do not derive from “a weak central government with inadequate control instruments,” but rather from the consequences of “an activist, interventionist central government with substantial power but immature financial institutions and inadequate capabilities for monitoring the economy.”⁹⁴ China's continued pace of market reform suggests a heightened need for political adaptation and development to encourage both domestic stability and the confidence of foreign investors. State action, such as the direct marketing ban, is a move in the opposite direction.

The major trends to consider in evaluating China's approach are: first, the individual rights that emerge with private enterprise may clash with China's tradition of paternalistic, administrative rule, threatening the traditional authoritarian state; second, various internal and external influences weigh on China as it seeks to expand its role in the global economy; and finally, there is pressure on China to develop new business and employment alternatives, as the State continues to gradually withdraw

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ Walder, *supra* note 25, at 11. The most notable incidents of political unrest were the 1989 protests at Tiananmen Square in which “[r]apid inflation, popular disgust over official corruption and fear of looming unemployment spilled over into dissatisfaction about the slow pace of political liberalization.” *Id.* at 11-12.

⁹⁴ Barry Naughton, *China's Macroeconomy in Transition, in CHINA'S TRANSITIONAL ECONOMY*, *supra* note 25, at 121, 137.

its support of public industry and state enterprise. These various pressures suggest that while market reform may necessitate political reform, China's administration may perceive itself directly threatened by such a change, prompting regulations such as the direct marketing ban, which clamp down on threatening social economic networks.

A. *The Waning of the Traditional Authoritarian State*

The success of direct marketing in China prior to the 1998 ban is a case study in how traditional corporatist forms of social and political interaction are gradually shifting toward more individualist forms, and market-oriented social groups are best positioned to leverage this transition. As individuals become less inclined to seek their financial and social welfare through bureaucratic institutions, they inevitably turn to private producers and interpersonal networks for resources.

The social and political trends that accompany increasingly diverse markets and growing consumerism threaten the political monopoly of the CCP. In the early 1990s, the emerging private sector had begun to compete with the traditionally influential groups, like administrators and party members, in affecting state policy.⁹⁵ Tang and Parish concluded that "with economic reform, and the growth of a significant sector outside traditional bureaucratic channels, there is more freedom of expression."⁹⁶

Combined with increasing opportunity was the continuing decline of the role of work units in providing for social welfare in the 1990s.⁹⁷ With more and more public sector workers being laid off, local governments and neighborhood committees are taking over the traditional welfare responsibilities.⁹⁸ The diminishing role of state-governed work units signals growing independence for the working populace:

The socialist social contract once promised in-kind benefits and life-time employment in exchange for worker's docility and dependence. Under the new social contract, security of employment and in-kind benefits are disappearing. Instead, workers now have more freedom to protest, to increase their

⁹⁵ TANG & PARISH, *supra* note 16, at 206.

⁹⁶ *Id.* at 206.

⁹⁷ *Id.* at 29.

⁹⁸ *Id.*

income, and to move between jobs. The changing social contract has transformed labor-management relations.⁹⁹

New social groups may be gaining a foothold in Chinese politics. Where once socialist institutions were biased toward the political elite, such as party members and bureaucrats, there is now a gradual trend toward the increasing political influence of producers, such as private entrepreneurs and business managers.¹⁰⁰ Consequently, economic reform has wrought changes in Chinese civil society. This move toward production and allocation through the market instead of through bureaucratic directives means that Chinese citizens continue to become progressively less dependent on state institutions and hence less receptive to traditional authoritarian methods of social control. Market reform is never a purely economic process, but one that involves interest group lobbying in a political system that must attend to increasingly diverse and complex interests. Walder describes various political scenarios, in which party hegemony has declined:

[D]ifferent processes may lead to the same outcome: the ruling party may lose its internal discipline and cohesion under the pressures of sustained and well-organized opposition (e.g., in Poland); in the face of large, but relatively unorganized, street demonstrations of limited duration (East Germany, Czech, and Romania); or in the relative absence of both kinds of opposition (Hungary & Soviet Union). To complicate matters still further, the decline of some regimes may be attributed to the failure to implement long-needed economic reforms (Soviet Union), while in others political decline may be an unexpected result of economic reform (China & Hungary).¹⁰¹

Accompanying expanding political and economic freedom is the inevitable, albeit gradual, breakdown in both traditional and totalitarian forms of social control, signified in China by the slowly diminishing ability of the state to completely monitor and control private action, accompanied by an increase in opportunity to commit illegal activity.¹⁰² For example,

⁹⁹ *Id.* at 162.

¹⁰⁰ *Id.* at 189-90.

¹⁰¹ Andrew G. Walder, *The Quiet Revolution From Within: Economic Reform as A Source of Political Decline*, in *THE WANING OF THE COMMUNIST STATE* 1, 3 (1995).

¹⁰² Jonathan Hecht, *Opening to Reform? An Analysis of China's Revised Criminal Procedure Law*, in *LAWYERS COMMITTEE FOR HUMAN RIGHTS* 6 (1996).

many Chinese perceive recent increases in crime “as a negative, if largely unavoidable, consequence of the policy of economic reform and opening to the outside world.”¹⁰³ This change in Chinese civil society, with the move toward production and allocation through the market instead of through bureaucratic directives, allows citizens to become less dependent on state institutions and their work unit, and hence less receptive to traditional methods of social governance and party authority. This trend threatens the status quo authority of China’s governing political party, the CCP, and in extreme cases, prompts a crackdown, like the direct marketing ban, on economic and civil liberties.

Also, perhaps the CCP’s antagonism to social business organizations such as direct marketing networks grows out of concern rooted in its own origin:

[T]he growth of grassroots networks very similar in some ways to the party’s own early organisation and its early fervour. They hark back to the sects and cults that have traditionally thrived in the Chinese countryside, where the Party once found its most zealous supporters. Meetings of direct marketing staff frequently involve singing, chanting, and inspirational sermons.¹⁰⁴

China’s reaction to direct marketing networks can be compared to its treatment of the religious organization Falun Gong in recent years. In 1999, China’s Ministry of Public Security issued a ban on all Falun Gong

¹⁰³ *Id.* See also PERRY LINK, THE USES OF LITERATURE: LIFE IN THE SOCIALIST CHINESE LITERARY SYSTEM 126 (2000):

An even more important factor in the overall shaping of this generation, however, was the money-making ethic of the Deng Xiaoping years, which led much of Chinese society into cynicism and naked pursuit of self-interest. A “popular ditty” (*shunkouliu*) of the mid-1990’s, sarcastically entitled “A Short History of Comradely Sentiment,” says:

In the 50’s we helped people
 In the 60’s we criticized people
 In the 70’s we fooled people
 In the 80’s everybody hired everybody else
 In the 90’s we “slaughter” whomever we see

Here “slaughter” (*zai*), which corresponds fairly well in both sense and tone to “rip off” in contemporary American slang, is ironic. The sense is to condemn “slaughter” even while pointing out that it is rampant.

¹⁰⁴ Higgins, *supra* note 81.

activities.¹⁰⁵ At the same time, the Chinese government launched a propaganda campaign against the group to gain public support for its actions against the group.¹⁰⁶ Despite government efforts, the Falun Gong organization persists, to the chagrin of the State.¹⁰⁷ Like its attempted suppression of Falun Gong, China's blanket ban of multi-level marketing networks is rooted, at least in part, in its apprehension of social networks founded on relations independent of the State.

As China continues to expand and liberalize its market system, its society and politics must evolve to meet new demands. The modern Chinese approach to lawmaking illuminates age-old tensions between paternalistic and adversarial human relations, with the latter gaining ground since 1978.¹⁰⁸ Historically, China has had a paternal justice system:

Moral teaching by the sovereign, men of nobility, and fathers should prevent disputes. Failing that, local notables might mediate. If courts had to be involved as a last resort, the complainant did not sue the other party but launched an accusation with the magistrate.¹⁰⁹

Contrast this with the United States democratic system in which the protection of individual rights takes priority over politically imposed, societal definitions of order.¹¹⁰ The key importance in the United States of private property ownership and due process of law is representative.¹¹¹ Yet, China continues to respond to the complexities and changing demands of an increasingly economically independent populace by clamping down through authoritarian regulations, such as the direct marketing blanket ban, rather than addressing its own internal infrastructural problems, such as the absence of an effective regulatory organ or standardized modes of operation as exist in the United States. This type of response underlies China's inability to effectively address problems associated with market reform.

¹⁰⁵ Kelly A. Thomas, Comment, *Falun Gong: An Analysis of China's National Security Concerns*, 10 PAC. RIM L. & POL'Y. J. 471, 477 (2001) (citing Notice of the Ministry of Public Security of the People's Republic of China, in *Two Documents Concerning the Banning of the Research Society of Falun Dafa*, PEOPLE'S DAILY, July 22, 1999).

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 481.

¹⁰⁸ JEFFREY C. KINKLEY, CHINESE JUSTICE, THE FICTION: LAW AND LITERATURE IN MODERN CHINA 109 (2000).

¹⁰⁹ *Id.*

¹¹⁰ U.S. CONST. amend. I.

¹¹¹ U.S. CONST. amend. XIV, § 1.

B. *China's Expanding Role as a Global Player.*

Since the late 1970s, China's role in the global economy has expanded significantly. Historically, nationalism has been the central ideological axis of China's approach to foreign affairs. However, with the economic reform of the 1980s, consumerism has begun to displace nationalist sentiment.¹¹² The popular response to utilitarian and materialist strategy has been tremendous, undoubtedly promoted by the success of nearby Asian neighbors such as Hong Kong, Taiwan, and Japan, which have served to illustrate what a mature consumer society can provide.¹¹³

With its expanding role in the world market, China can no longer disregard the interests of its trading partners and potential markets. The prevalence of foreign business and economic interests in China has dramatically increased over the last two decades:

By the mid-1990s China had become one of the world's largest trading nations, the recipient of more foreign direct investment than any other country in the world, the largest borrower from the World Bank, the largest recipient of official development assistance in the form of low-interest, long-term concessionary loans from industrialized countries, and, except for the Czech Republic, the only transition economy with ready access to international capital and equity markets.¹¹⁴

In addition to the psychological effect of the prosperity of neighboring Asian countries and the domestic impact of foreign capital, China is influenced by its focus on accession to the World Trade Organization. In July 1986, China formally applied to become a member of the General Agreement on Tariffs and Trade ("GATT").¹¹⁵ At the World Trade Organization ("WTO") Ministerial Conference in Doha, Qatar in November 2001, the negotiations that began in 1986 culminated with China's formal accession as a WTO member.¹¹⁶

¹¹² TANG & PARISH, *supra* note 16, at 42.

¹¹³ *Id.*

¹¹⁴ Nicholas R. Lardy, *The Role of Foreign Trade and Investment in China's Economic Transformation*, in CHINA'S TRANSITIONAL ECONOMY, *supra* note 25, at 103.

¹¹⁵ Donald C. Clarke, *China and the World Trade Organization*, in DOING BUSINESS IN CHINA 11 (Freshfields ed., 1999)

¹¹⁶ Press Release, World Trade Organization, WTO Successfully Concludes Negotiations on China's Entry (Sep. 17, 2001), at http://www.wto.org/english/news_e/pres01_e/pr243_e.htm.

China's membership in the WTO imposes adherence to several principles that define the WTO trading regime. Professor Donald Clarke enumerates three of these fundamental principles: existence of a market economy, the rule of law, and an open society.¹¹⁷ The issue of whether China has satisfied the requirement of creating a market-based economy will be continue to be addressed as China's state-owned enterprises ("SOEs") are adapted into private enterprise.¹¹⁸ The second principle underlying the WTO regime, rule of law, "assumes that a country's political structure involves government limited by law and a certain separation of powers."¹¹⁹ Clarke describes the discrepancy between this principle and China's government:

[T]he WTO agreements assume that all member states have institutions labeled judicial that are fundamentally different from institutions labeled administrative, and that operate with some meaningful independence of the executive. . . . But in any realistic view of PRC law, there is no such thing as limits on executive action.¹²⁰

It is this authoritarian approach, combined with the lack of transparency in lawmaking and enforcement, the third principle of the WTO regime,¹²¹ that is illustrated by the State Council's blanket ban on direct marketing. Accordingly, the direct marketing ban was a specific point of contention during the United States-China WTO negotiations, with the United States pressuring China to remove the ban.¹²²

The combination of domestic consumer sentiment and foreign influence, both political and economic, put pressure on the Chinese to take steps to support and promote continued market liberalization. China's interests would be better served by the institution of a stable, consistent market regulatory system, rather than the by the imposition of restrictive, case-specific policy.

C. *The Demand for New Employment and Business Options*

In post-Mao China, market reform has brought an array of socio-economic changes. While in the past the state was the employer and the

¹¹⁷ Clarke, *supra* note 115, at 7.

¹¹⁸ *Id.* at 8.

¹¹⁹ *Id.* at 10.

¹²⁰ *Id.* at 10-11.

¹²¹ *Id.* at 13.

¹²² See *supra* Part II.D.3.

provider of social welfare needs, people now find themselves independent, and with independence comes insecurity. Consumer business models like direct marketing provide employment alternatives for Chinese who generally have limited capital for investment, but a great deal of entrepreneurial incentive in the increasingly market driven economy.

One test of China's success will be of its ability to provide viable employment opportunities in its transitioning economy. Tang and Parish, in surveying public satisfaction with reform in China, concluded that the level of support for reform often depended upon a person's station in life prior to reform compared with post-reform:

[W]e expect societal and personal material conditions to be the primary determinant of a whole range of values related to reform, including general satisfaction with reform, beliefs about whether the pace of reform is too fast, and whether the consequences of reform, including economic opportunity and acquisitiveness, are good or bad.¹²³

They further found that:

Reactions to acquisitive behavior and attitudes provide one of the sharpest demarcations between people linked to the old, redistributive system and the new, rough-and-tumble market system. White-collar workers, party members, educated individuals, and people in Beijing found individual acquisitiveness repulsive. Many of these groups either benefited from orderly, internal labor markets in large firms and bureaus or were close to the orthodox, redistributive center, Beijing. Several other groups took quite an opposite view of acquisition. They found the prospects of individual acquisitiveness and the attendant public display of acquisition much more attractive. These opposing opinion groups included manual workers, sales and service workers, private entrepreneurs, youth, males, and residents of high-growth cities.¹²⁴

¹²³ TANG & PARISH, *supra* note 16, at 107.

¹²⁴ *Id.* at 121-22.

Popular support of reform relies heavily on the replacement of state employment and welfare institutions with private business opportunities. Business alternatives such as direct marketing, which leverage pre-existing personal networks and require little training, are well positioned to fill the gap left by shrinking government employment.

The PRC's treatment and plan for its SOEs has garnered a great deal of attention. In 1995, SOEs employed more than two-thirds of all urban workers (i.e., more than 150 million people), providing them with all of their health and social benefits.¹²⁵ If the state were to simply dissolve its SOEs, millions of workers could lose their jobs, possibly resulting in social disruption, even anarchy, on a scale that could make the turbulence of Tiananmen Square in 1989 seem mild by comparison.¹²⁶ China has so far avoided much of the political turmoil experienced in many of the other transitional economies through a gradualist approach. Economists such as John McMillan and Barry Naughton, who ascribe China's success to gradualism, argue that such partial reform can fundamentally transform a Soviet-style system. They enumerate the fundamental features of effective market reform: first, massive entry of non-state firms; second, a dramatic increase in competition, both among state firms and between state firms and non-state firms; and third, improvements in the performance of state-owned firms resulting from state-imposed market-like incentives.¹²⁷

However, as China continues to develop its socialist market economy, the state is going to have to allow and develop sustainable business alternatives to the urban SOE: "If the combined market transition of society and the technocratic transition of the bureaucracy are to succeed, the old incentive structure must be replaced by a new incentive structure that emphasizes remunerative in place of normative and coercive incentives."¹²⁸ Direct marketing provides unemployed workers with a rare opportunity for gainful employment.¹²⁹

It is notable that some studies have shown that political apathy has accompanied the modern Chinese focus on economic development. Tang and Parish, in their study of Chinese urban life also found that:

¹²⁵ See Bhala, *supra* note 83, at 1491.

¹²⁶ *Id.* at 1482.

¹²⁷ John McMillan & Barry Naughton, *How to Reform a Planned Economy: Lessons from China*, 8 OXFORD REV. OF ECON. POL'Y 131, 132-35 (1992).

¹²⁸ TANG & PARISH, *supra* note 16, at 183.

¹²⁹ Mary Kay's Asia-Pacific president, K. K. Chua, noted that twenty-five to twenty-eight percent of his company's work force was made up of "retrenched workers." See *For China, the Direct-Marketing Ban Hurts*, *supra* note 55.

By the early 1990's, two new trends had emerged. The first was a significant decline of interest in political participation. People seemed distracted by the increasing opportunities of making money in a blossoming market economy. This sense of futility fits the description of a bureaucratic authoritarian society which is characterized, among other things, by popular political apathy and rapid economic growth. The second new trend was the decline of the traditional corporatist channels of participation and the increase of other, informal channels. Unsurprisingly, with the retreat of the state from redistributing wealth, there was less need for people to go through official channels to acquire wealth.¹³⁰

That is not to suggest that the retraction of political freedoms would not once again spark protest, as it did in 1989 at Tiananmen. But perhaps the state should overcome its fear of new social and political networks, which, for example, emerge from direct sales systems, and focus more on satisfying the new demands of entrepreneurs and consumers.

IV. CONCLUSION

As China continues to develop its socialist market and expand its role in the global economy, political evolution is certain. The Chinese Communist Party cannot maintain absolute control over the person and politics of its citizenry, as it has attempted to do for the last five decades. Expanding social and political autonomy is intimately tied to increasing economic independence. The 1998 direct sales ban represents the failure of the Chinese to recognize the need for political and institutional development, which must be concurrent with market reform. Wenfang Tang explains the changing relationship between the Chinese state and the people, in the context of an evolving "social contract."

Over the last two decades, China has gone through a significant economic transformation, involving a fundamental redefinition of the social contract the government has with society.¹³¹ Tang and Parish note:

¹³⁰ TANG & PARISH, *supra* note 16, at 205.

¹³¹ *Id.* at 3.

The socialist social contract promised an egalitarian, redistributionist order that provided job security, basic living standards, and special opportunities for those from disadvantaged backgrounds. In return, the state demanded sacrifices in current consumption, a leveling of individual aspirations, and obedience to all-knowing party redistributors. In time, some of the demands wore thin, particularly when economic inefficiencies accumulated and the sacrifices in current consumption failed to translate into long-term growth or into improved housing and consumer goods.¹³²

Tang and Parish further explain the new challenges and emerging interests of the Chinese people in the modern economy:

The new, post-1978 market social contract makes a different set of demands and promises. In return for abandoning the ideal of communal egalitarianism and security of jobs and other benefits, the market contract promises that giving free reign to individualistic aspirations will produce better jobs and greater consumption.¹³³

It is essential that China adapt its policy and regulations to conform to this evolving role "social contract."

¹³² *Id.*

¹³³ *Id.* at 3.

APPENDIX

Circular of the State Council on the Ban of Operational Activities of Pyramid Sales (Apr. 18, 1998)

The State Council has instituted a ban on the operational activities of pyramid sales to protect the legitimate rights and interests of consumers, to promote fair competition, to maintain economic order, and to sustain social stability. The reasons for the ban are as follows:

- I. Pyramid sales operations are not appropriate for China at its present stage of development, and have resulted in serious damage. Pyramid selling as a mode of operation is inappropriate due to its traits of organizational closeness, the concealed nature of transactions, and its spread out systems of sales persons. In addition, the Chinese market is not sophisticated enough for such business operations, corporate management skills and experience are underdeveloped, and mass consumer mentality has yet to mature. Unlawful individuals have taken advantage of pyramid sales to promote heretical beliefs, gangs, superstition and racketeering, seriously undermining China's spiritual and cultural establishment and social stability. These unlawful individuals take advantage of pyramid selling to recruit government and party officials, soldiers and students, and thus have seriously disrupted state order in governance and education. These individuals use pyramid selling to engage in fraud, extortion of money and property, promotion of the sale of imitation, fake and inferior quality products and smuggled goods for the purpose of profiteering and tax evasion. This has seriously harmed the interests of consumers and interfered with the normal economic order. Therefore, pyramid sales must be immediately and completely banned.
- II. The operational activities of pyramid sales in any form shall be banned as of the date of issuance of this Circular. Registered enterprises engaged in the operation of pyramid sales shall cease immediately all operational activities related to pyramid sales, engage in the rehabilitation of pyramid sales persons, settle all debts, convert to other modes of business operation, and modify or withdraw business registration with the industry and commerce

administration before October 31, 1998. Failure to comply with these registration requirements will result in the revocation of the business license. Those currently engaging in pyramid sales without an authorized business license are also subject to this ban, and must cease such activity or face prosecution.

III. Efforts will be intensified in the enforcement of the ban and investigation of any suspected pyramid sales activity. As of the date of issuance of this Circular, people's governments at all levels, the department of industry and commerce administration, the department of public security, and other involved departments must adopt strong measures to enforce the ban and prevent:

- (1) pyramid sales from becoming an underground activity;
- (2) pyramid sales in the form of double-win or online sales system;
- (3) pyramid sales in the form of restricted exclusive sales, licensing rights, special permits, franchise membership operation, direct sales, chains and network sales;
- (4) pyramid sales in the form of distribution of membership cards, savings cards, lotteries and vocational training to gain membership fees, franchise membership fees, licensing fees and training fees by cheating; and
- (5) any other acts of pyramid sales in any form.

Any activity suspected of being related to pyramid sales shall be investigated and penalized by the industry and commerce administration in pursuance with the relevant state provisions. Pyramid sales used to engage in fraud, promote the sales of imitated, fake, inferior quality, and smuggled products, and to spread heresy, gangs, superstition, and racketeering shall be investigated and handled by the departments concerned. Where such activity constitutes criminal action, the case shall be transferred to a judicial organ for prosecution in accordance with the law.

IV. All central and local governments must strengthen leadership and cooperate closely with one another in firmly yet safely implementing the ban on pyramid sales. The ban on pyramid sales is an expansive order with broad impact and scope, and will be a

difficult order to implement. Government agencies at all levels must attach great importance to this order and coordinate under the command of an appointed government official, to be in charge until the ban is fully implemented. Organs of the industry and commerce administration must sternly investigate and prosecute any acts of pyramid sales which contravene the spirit of this Circular. Departments of public security must prohibit any activity that involves pyramid sales, in open or disguised forms, to maintain social order and stability. Commercial banks must support and cooperate with organs of the industry and commerce administration and public security in the work of investigation and prosecution of pyramid sales. Media and propaganda departments must intensify their efforts in publicity, extensively publicizing the harm of pyramid selling, exposing the fraudulent acts of pyramid selling, and exposing typical illegal cases of pyramid selling to educate the public and raise their awareness, encouraging the public to consciously boycott pyramid sales activity. The media should also make reports on the progress made by the departments involved in implementation of the pyramid sales ban.

All government organizations involved in the execution of the pyramid sales ban must be steadfast and proactive and, at the same time, must be painstakingly careful in their implementation of the ban so as to maintain economic order and social stability.