

An Analysis of the Regulatory Vacuum in China's Property and Intellectual Property Exchanges: Institutional origins and resolution strategies

Heping Cao

Abstract

China's Property and Intellectual Property Exchanges (CPIPEs) have been growing explosively over the past 5 years. As of today, the number of CPIPEs registered under the State-owned Assets Supervision and Administration Commission of the State Council is over 320. The total trading volume in these exchanges exceeded the amount of IPO financing from Shanghai and Shenzhen Stock Exchanges combined in 2006. This volume reached over 500 billion RMB in 2008, approximately 5 times the combined IPO financing in the two stock exchanges.

In contrast with this rapid growth in most local CPIPEs, regional and national integration have not been able to emerge, even though players in this market cry for a better integrated national market. The main reason is that the supervision of this market is nearly nonexistent. And the political economy behind this regulation vacuum is the conflict of interests between local governments and financial supervisory bodies in the central government. At the beginning of the development of this market, local governments were very supportive because these exchanges brought financing services to local medium and small size enterprises, while it was not in the interests of the supervisory bodies in the central government to take them over because of the small market size and uncertain returns; after the market explosively developed, each of the supervisory bodies realized the benefits and struggled to take over the regulation responsibilities. This competition for supervisory power created a regulation vacuum, which has been blocking the advance of market integration at regional and national levels. Instead segmented markets are inevitable. So the current state of this market does not result from market distortions but from regulation vacuum. This conflict between specific departments' own interests and China's national interest from market integration demands an innovative approach in regulatory mechanism design.

This is also closely related with separate supervision, whose shortcoming is its *ex post* supervision philosophy. "One body supervising only one industry" benefits mature sectors and markets but ignores emerging ones. CPIPEs could not find a supervisory body at its infancy. Ironically after they became mature, competition between supervisory bodies left them at their own again.

Since the financial and economic crisis in 2008, many countries have been rethinking about their regulatory framework and searching for new models. CPIPEs' development paths could contribute to our thinking about a new regulatory framework.