

## **Law, Regulation and Enforcement: the Experience of China**

Regulatory reform is not new to China. Since opening the economy to the outside world in the late 1970s, Chinese government at the national and regional levels have taken many positive steps to establish the framework of credible rules, legal system and a sound institution environment. The high economic growth rate enjoyed by China over the last two and half decades is partly due to the success of the legal reforms, especially those in creating the legal framework for competitive markets. However, the development of the legal and regulatory framework in general still lags far behind the growth of the economy.

In order to implement its long-term development plans (2010-2020) of transforming the planned economic system into a market economic system, China needs an efficient and market-oriented regulatory environment to create the incentives in which trade and investment liberalisation will support longer-term economic growth (Jacobs, 2002). A fundamental objective of regulatory reform is to improve the efficiency of national economies and their ability to adapt to change and to remain competitive. The experience of some developing countries suggests that regulatory reform is not an easy task. As indicated by the theory of 'embeddedness' (Granovetter, 1985), any regulatory regime will be embodied in the specific institutional context of a country as reflected in its formal and informal rules of economic transacting and social behaviour. The success of any regulatory regime therefore depends not only on the processes and outcomes of various regulatory reform measures, but also on the institutional context. The experience of some transitional economies is much indicative: regulatory reform is not essentially a deregulatory task, but a mix of new regulation, deregulation and re-regulation, backed up by legal and institutional reforms.

Based on the experience of regulatory reform in developing and transitional economies in general, and that of China in particular, the following issues are identified as important to establish an effective regulatory regime.

As regulation is embedded in the institutional context of a country, it is important to locate regulatory reform within a wide and coherent policy reform which encompasses the social, administrative, political and legal domains. Co-ordination and sequencing of various policy reform is crucial and at the same time challenging.

In particular, implementation and enforcement of laws and regulation have lagged behind the pace of national policy reforms in China. The public administration, the judiciary and the police do not always co-ordinate well in enforcing laws. Improving regulatory enforcement is a multi-faceted and long-term task that embodies regulatory reforms in consolidation of the rule of law. Institutional reforms should be promoted to reduce unpredictability of regulatory enforcement caused by multiple layers of administration and local protectionism. Another problem with the public administration is excessive discretion at both national and sub-national levels. Such discretion is not controlled by the Law on Law-making and administrative actions not

necessarily subject to effective judicial review. With inadequate checks and balances on enforcement actions, accountability in regulatory enforcement has been remarkably reduced.

The experience of OECD countries and some developing economies indicated that an overall strategy of regulatory reform is important. Almost all reforms undertaken so far in China are sectoral in nature. The major reforms are driven by external pressures rather than by strategic planning to establish the foundations for long-term growth. Such *ad hoc* regulatory reforms as collections of sectoral market-opening measures designed to satisfy foreign critics will slow down and even endanger the process of market liberalisation in China.

In the management structure of the national regulatory system there should be central regulatory reform units as an effective oversight body responsible for general regulatory reform plans and continuing adaptation and improvement of regulatory systems. The design of such a central regulatory reform unit is highly contextual, and depends on the legal and power relationships between various parts of the governing structure. Currently in China the oversight functions are scattered in several government bodies like the National People's Congress, the Legislative Affairs Office, and the State Council. The issue is therefore how to co-ordinate the various bodies to serve as the basis for more concentrated oversight of regulatory reform.

Transparency is essential for all phases of the regulatory process. This is where China lags furthest behind good international standards. Demands for improving regulatory transparency in China are not only from external critics but, more importantly, from growing domestic expectations for more transparency on government actions. As indicated in Jacobs (2002), two high-priority transparency issues in China are improving public consultation in the phase of regulatory development and accessibility to regulatory policies after they are adopted. Although progress has been made, China is still slow in developing the legal framework for public consultation. There is a need for China to move toward more standardised, more open and systematic consultation procedures. Improvement has also been made in terms of accessibility to national law and regulations after adoption. However, accessibility worsens at lower levels of government.

Regulatory Impact Assessment (RIA) is not used in China. RIA involves a *systematic* appraisal of the costs and benefits associated with a proposed new regulation and evaluation of the performance of existing regulations. RIA can contribute to both the outcome and the process dimensions of social welfare. The process contribution of RIA is closely related to the principles of 'good governance', such as consistency, accountability and transparency. Therefore, RIA is not a technical tool which substitutes for decision-making; rather it should be seen as an integral part of the policy making, which aims to raise the quality of the decision-making process. However, whether RIA, the practice originated in the USA and promoted by some major OECD countries, can be transferred to China is still a question. Even if the answer is 'yes', it is a challenge how to integrate RIA into the overall regulatory reform in China

(which is culturally, socially and historically embedded) on the one hand, and on the other, to use RIA to improve the general institutional environment and policy-making process in China in the direction of transparency, consistency and accountability.

Regulatory reform in China involves broad and systematic deregulation in some sectors and re-regulation in others. In some sectors, China suffers from substantial regulatory barriers for competition and entry. Some regulations which are anti-competition in nature are used to protect SOEs. In other areas there is too little market regulation and poor enforcement. In addition, deregulation and introduction of new regulation has not been coordinated with development in other policy areas, especially that of Competition Policy.

Like many developing countries, China has established in the utility sectors and the financial sectors the so-called 'independent' or 'autonomous' regulators. However, it has now widely agreed that there is no single right model for such institutions. The models as used in the U.S. and the U.K. cannot be easily transplanted to other countries. Furthermore, autonomous regulators are not a panacea. What is needed in China is a more systematic approach to institutional re-design.

A close look at the 'autonomous' regulators in China reveals that they are no more than re-labelling of some former government department. Their major responsibilities and their relationship with other governmental departments remain largely unchanged. 'Independence' or 'autonomy' is more nominal than real. This therefore increases the risk of captures, especially that of political capture.

Capacity constraints present another challenge to regulators. The regulatory bodies which are formed on the basis of existing departments in the line ministries may lack expertise to regulate effectively and efficiently. Old practices and organisational culture may still be pervasive.

In a developing and transitional economy like China, economic efficiency is not the only concern in an effective regulatory regime. Important social objectives such as poverty reduction and the promotion of equal rights among different social groups should be taken into account. This has imposed more complexity to the design of regulatory reform in China.

The issues mentioned above are by no means an attempt of an exhaustive list. Rather they serve to promote discussion among the participants on the topic of regulation, law and enforcement.

## References

Granovetter, M. (1985), 'Economic Action and Social Structure: the Problem of Embeddedness', *American Journal of Sociology*, 91 (3), pp.481-510.

Jacobs, S. (2002), 'An OECD Perspective on Regulatory Reform in China', published as Chapter 11 in *China in the World Economy: the Domestic Policy Challenges*, OECD, Paris.