

# **Improving the Regulatory Quality for the Sustained Development of Service<sup>1</sup>**

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## **1. The development and current situation of China's service sectors:**

Being a planning economy country since its foundation in 1949, the People Republic of China had been giving priority to the development of the mining and manufacturing industry for a long time, and the development of the service industry was more or less restrained. After the adoption of the reform and opening up policy in 1978, the economic development strategy has been adjusted by the central government aiming to balance the investment and growth between different industries and thus more importance has been attached to the expansion of service by the central government. In 1992 the Central Committee of CPC and the State Council jointly issued The Decision on Accelerating the Development of Service Industries. In 2001 the State Council released The Notice on the Policies and Measures to Accelerate the Development of Service during the Year 2001-2005, which brings a gigantic driving force to China's service liberalization and its regulatory reform. In addition, many laws, regulations and administrative rules have been promulgated to regulate different sectors during this period, among which the Foreign Trade Law, the Commercial Bank Law, The Construction Law, the Railway Law should be highlighted. All these legislation, policies and measures have contributed much to the rapid growth of China's service industries in the past two decades.

After more than 20 years development, China's service industry has grown up to a considerable scale. According to an official report made by the State Statistic Bureau, the output value of service in 1995 was approximately 223 billion US\$ (construction service not included) , but in 2001 it grows up to about 400 billion US\$ which meant that the average growth rate of service industry between 1995 to 2001 almost reached 8%. In the year 2001, the ratio of service in GDP is 33.6% (construction service not included) and is 40.4% (construction service included). Along with the rapid growth of service industry, China's foreign trade in service increases from 10 billion US\$ in 1991 to 68 billion US\$ in 2001, among which tourism, commercial service, transportation and communication constitute the major part.

## **2. China's service liberalization and regulatory reform process:**

### **2.1 market openness: both to private sector and to foreign investment:**

Before the adoption of reform and opening up policy in 1978, most of the service business in China were owned and operated by state enterprises or collective organizations, even some major sectors including telecommunication, civil aviation, banking, insurance, railway, etc, are monopolized by one or more national corporations. In 1979, the Sino-foreign Joint Venture Law was first promulgated and accordingly some service sectors were partly opened to foreign enterprises. In 1995, the Guiding Catalogue of sectors

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<sup>1</sup> This is only the author's personal viewpoint and stands for in no sense the standpoint of any organizations or entities.

for Foreign Investment was issued, which listed all the sectors (including service sectors) that foreign enterprises or individuals are permitted to invest, either in the form of joint venture or in the form of exclusively foreign-invested enterprise. In the Accession Protocol and the Working Group Report, China made its overall commitments for trade in service covering most of the service sectors of GATS.

Meanwhile, service market was gradually opened to private sectors. Chinese citizens and private firms were encouraged to engage in service operation. In the Decision on Accelerating the Development of Service Industry and the Notice on the Policies and Measures to Accelerate the Development of Service during the Year 2001-2005, the central government took positive measures to stimulate the active participation of private enterprises in service sectors, including lowering the threshold of market access, simplifying the licensing formalities, providing more financial support and other facilitation, taxation exemption, etc. Such measures have been well functioning in practice, resulting in the rapid increase of service output by private enterprises.

## **2.2 clearance and revision of current legislation**

With the market openness and liberalization in service, China's regulatory reform has been carried out all the time and the regulatory framework has been transformed to meet the needs of practice. Such regulatory reform includes revising the current policies and laws, promulgating new laws and regulations, institutional restructuring, deregulation, breaking up the monopoly in public utilities, separation of administrative functions from business operation, etc.

In the year 2001, in order to adapt to the situation of its accession to the WTO, China launched a program to completely clear up and revise all the current laws, regulations and administrative instruments that are related to trade issues, both at the central and at local level.

## **2.3 The reform of administrative license (administrative approval) system:**

As we know, administrative license, being a major regulatory measure, has been comprehensively applied in the administration of service. According to the statistics made by the central government, there are about 4,000 administrative licenses at central level in China, many of which are established for service industries. The existence of too many administrative licenses has been, in some sense, an obstacle for the sustainable and healthy economic growth due to its unreasonably trade restrictiveness and has been complained as a heavy burden by enterprises and traders for a long time. With a view to diminishing such negative effect, the State Council launched a reform on the current administrative license systems. According to the decision of the State Council, It is required to check and review all the established administrative licenses and, after consultation and discussion with the competent authorities, to determine whether each license should be retained or abolished according to the principles of rationale, legitimacy, efficiency and responsibility. After nearly two years work, the State Council finally decided to abolish some 1,200 administrative licenses and temporarily retained the others. For example in the field of construction service, 155 licenses have been abolished, 54 licenses abolished for financial service. The reform of administrative licenses stands for a significant step for China to deregulate and liberalize its national economy and trade including service and we will continue to make further progress in this respect.

### **3. The main regulatory issues arising in the process of service liberalization.**

The sustained development and diversification in services bring about the need for corresponding regulatory reform, aiming to improve the efficiency and effectiveness of regulation and reduce the administration cost, which becomes even more apparent with the acceleration of the liberalization process. In order to be adapted to such circumstance, we should carefully study and analyze, both in general and on a sector-by-sector basis, what are the main changes in the process of service liberalization, what kinds of issues have arisen so as to determine what kind of regulatory reform should be carried out.

Some problems are very common and exist in the regulatory regimes of most sectors, if not all, such as the inadequacy in the adoption of transparency principle, less public involvement in policy-making process and discriminatory policies and measures against certain individuals or business group. Some administrative organs are used to regulate business and trade with so-called “inside documents” which are not available to the public. Besides, even if the public involvement and participation in legislation process such as the public consultation, hearing and prior comment have been provided explicitly in the legislation law on other relevant regulations, the application of these provisions in practice is to large extent at the discretion of legislators and regulators. We can sometimes find discriminations against private businesses in market access, taxation, employment, financial support and licensing requirements.

The legal system governing service sectors is still far from being perfect. On the one hand, many laws, regulations that are essential for administration haven't been put in place. On the other hand, due to the generality of the provisions in some laws and regulations and lack of necessary procedural rules, confusion arises in many cases and it becomes hard for the regulators to implement properly in practice. Lack of uniform coordination mechanism remains a problem in some service sectors. This has led to overlap and confusion of responsibilities (both in legislation and in administration) between different bodies and ultimately resulted in the conflict and contradiction of regulations formulated respectively.

How to promote the adoption and utilization of advanced regulatory tools should be taken seriously in the course of legislation and policy making: Considering the main objective of regulatory reform is to improve the regulatory quality rather than merely reduce regulation, namely deregulation that is normally easier to do, there is an urgent need for developing countries to take full advantages of the regulatory tools in their regulatory reform. To be frank, the current situation in this respect is not satisfactory and this is partly because of their limited resources, including financial input, less experience, qualified regulators, expertise, etc. Although developed countries have initiated some technical assistance programs that have made great contributions to the capacity building in developing countries, it still seems insufficient compared with their actual needs.

In addition to those common problems, sector-specific problems also emerge. For example, in some public utilities including power supply, railway industry and civil aviation, how to break up the monopoly and introduce effective competition without impairing the public interest has been the focus of regulatory reform. In the case of telecommunication, the regulatory bodies now pay more attention on pricing, the establishment of universal service mechanism, the introduction of competition in local call, the determination of standard for the next generation of mobile communication and the elimination of non-symmetric control.

#### **4. Certain issues that are crucial for the effectiveness of regulatory reform**

##### **4.1 The balance between maintaining regulatory flexibility and ensuring market access commitment:**

Market access is the commitment made by a country in international agreement to open its domestic market, either fully or partly, to foreigners. As a basic principle of international law, once a country has made a market opening commitment, it must abide by such commitment and open domestic market according to the committed schedule. On the other hand, as a sovereignty country, it has the right to draw up relevant rules and take necessary measures to regulate all the business and trades within its territory, including those sectors it has committed to open market. This may, in some cases, give rise to the conflict and contradiction between market access commitment and regulatory power. In order to maintain necessary regulation while not violating its international obligation on market access, certain rules should be followed both in policy making and in implementing practice: First, a country should make sure that the measures taken are permitted under the exception provision or safeguard provision of the agreement; Secondly, if the measure are not the measures that can be exempted under the agreement, it should only be taken for implementing purpose and the regulatory power have not be abused in this respect. Thirdly, the measures should not be unnecessarily trade restrictive and should not substantially impair its commitments in the agreement. Finally, in the case of autonomous liberalization, a country may take any measures for regulatory purpose and this doesn't constitute a violation of the market access commitment.

Let's take an example, if a country committed in a international agreement to open its telecommunication market to foreigners and allow up to 10 joint ventures to be established one year, and in order to promote the economic development of the less developed areas, the central government issued a administrative order later providing that at least 7 of the 10 joint ventures should be incorporated in the less developed areas. Since such order has constituted an additional requirement for the establishment of joint venture and has substantially impaired its commitment, it has gone beyond the reasonable regulatory flexibility. If the order says that the joint ventures established in the less developed areas will enjoy a favorable policy such as tax exemption, it doesn't undermine the market access rights granted to the foreigners and is still within the legitimate regulatory flexibility.

##### **4.2 The use of regulatory tools to support trade liberalization:**

The adoption of advanced regulatory theories, experience, principles and methodology that have been proved successful is an effective way to achieve the objective of regulatory reform and trade liberalization. Though the extensive utilization of such theories and tools, we can improve the quality and efficiency of domestic regulation while reducing the administrative cost. This is also a short-cut for developing countries to catch up with their developed partners in terms of regulatory quality. For instance, the regulatory impact analysis has been proved in many countries to be an effective way in bettering domestic legislation. Through such analysis, we can out find the rationale behind a legislation, compare its advantages with disadvantages, evaluate with due care the influence on economic and social life that a specific legislation might have (either positive or negative) and finally determine whether to revise or abolish it. By abolishing the laws, policies, regulations and administrative orders that are unnecessarily trade restrictive, the regulatory requirements and procedure (such as licensing or administrative formalities) can be simplified and thus, to some extent, the trades are liberalized. Through the registers of regulations, the public can have access to all the laws, regulations, administrative orders, etc. The

register system can serve as guidance for their business activities that can help them to forecast what rules they must comply with and make the right judgment as to what legal consequences they might have. On the other hand, through the register of regulations the legislative and regulatory bodies can have the opportunity to examine and supervise all the regulations, administrative orders and decrees registered in the competent authority to make sure that they are consistent with each other and comply with the commitment made by the central government in international agreements. All these institutions reflect, in some sense, the inherent requirements of trade liberalization and their effect has been fully testified in practice.

#### **4.3 The role of international trade rules in supporting domestic regulatory reform:**

International trade rules are closely related to domestic regulatory reform and can play an important role in this respect. International rules refer to rules, disciplines and principles in trade agreements or treaties that have been multilaterally negotiated and agreed by members, and they are binding upon all member countries. As a fundamental principle, a country to a trade agreement must abide by the commitment it has made and comply with the provisions of the agreement except for what it has made conservation to. For the purpose of fulfilling such obligations, necessary measures should be taken domestically, including the clearance and revision of laws and regulations, institutional restructuring, training of personnel in charge, etc, which are the component parts of domestic regulatory reform.

The general objective of international trade agreements is to promote the trade liberalization and market openness by the way of reducing or eliminating trade barriers. The commitments to reduce trade barriers made by members in the negotiation are, in most cases, in the form of market access, national treatment, elimination of licensing requirements and simplification of administrative formalities, etc. For the purpose of performing such obligations, the committed country should revise or abolish the relevant regulations or draw up new regulatory rules as the case may be. While lowering down the threshold for market access, the government should further perfect its legal system and take necessary measures to strengthen the day-to-day supervision and administration on business and to impose appropriate penalties on those who have broken the law.

Compared with the above-mentioned specific issues, certain common rules embodied in many trade agreements such as transparency, non-discrimination and public participation make more sense in terms of the impact on domestic regulatory reform. Through the comprehensive adoption of these rules in domestic legislation and regulatory activities, the regulatory framework will be transformed to be clearer and avails itself to the public. Through easy access to all the information they want, people can have better understanding of what legal and regulatory environments they live in, and make the right judgment and decision on what they are allowed to do in their business. The regulatory bodies are also forced by the rule of transparency to be under the strict supervision and criticism from the public and, as a result, to be more devoted and responsible for the social interest, either public or private. By stipulating and executing non-discriminative trade policies, enterprises and businessmen will be given equal and fair treatment and be inspired to compete on the same ground which will result in the improvement of economic efficiency in the whole society.

On the other hand, if a member country failed to carry out the relevant regulatory reform in conformity with the provisions of trade agreement; it may violate its international obligations and be confronted with retaliation from other countries or be brought to the dispute settlement mechanism under the agreement.

#### **4.4 The challenges faced by developing countries in building appropriate regulatory frameworks:**

Although the service trades in many developing countries have had a considerable increase in the past decades, there are still many challenges and problems that they have to face and resolve in the process of future service liberalization. Compared with that in developed countries, many service sectors, in particular those technology-intensive sectors such as telecommunication, banking, insurance and air transportation that normally involve large input of capital, R&D, intelligence and management, are still at a primary stage in developing countries. With the economic globalization and market openness, the service sectors in developing countries are more and more exposed to the outside world and have to compete with their developed counterparts no matter how less experienced they are. This makes it even hard for developing countries to explore and find the appropriate regulatory strategy and framework that can both promote the service growth, protect the domestic industry and comply with their international commitments, particularly taking into consideration that they must balance the different policy objectives and social interests. As we know, there is no one-size-fit-all regulatory pattern to follow and we have to study what is the best for a specific condition. Besides, the regulatory framework varies from sector to sector because of the different nature thereof. In the past few years China has been exploring a new mechanism in its regulatory patterns, namely the mechanism of separation of policy-making, implementing and supervising bodies. A significant step of this reform is the establishment of the Supervising Commission For Banking under the State Council which is mainly in charge of the administration and supervision of all the banks and other financial institutions alike, while the People's Bank of China as the central bank is responsible for the policy making and macroeconomic control such as the interest rate, the exchange rates.

Apart from the regulatory pattern discussed above, another regulatory problem that troubles many developing countries is the lack of qualified human resource and expertise. Modern services, after hundreds years of development, have grown to be highly complicated industries which implied the combination of complex operation, management, technology, IPR, business reputation and IQ system. In response to such situation, it becomes necessary for numerous qualified personnel with specialized knowledge and expertise to work in the regulatory bodies and undertake corresponding responsibilities. Unfortunately we can't be optimistic about the situation in many developing countries. Young people tend to be employed in private sectors where they are normally highly paid rather than government organs. Hence how to attract professional personnel of high quality to be devoted to regulation remains a hard work.

#### **4.5 The cooperation between regulators and trade policy makers:**

It is obvious that good regulation, i.e. regulation of high quality, primarily depends on two different but interrelated things: the correct trade policy that reflects the needs of reality and its proper implementation in practice, and both are of the same importance in terms of the quality of regulatory system. Thus it's not difficult to understand how critical the relationship between policy-makers and regulators is in realizing the regulatory objectives. Only if the policy makers get the true information from the regulator of what is going on in real life and what are the main problems the policy underway aims to resolve can they make the right decision on what the policy should be. On the other hand, before the regulators can implement the policy without any deviation and at no discretion the regulators must get the necessary knowledge about the policy, i.e. the background, the intention of the policy-makers and the implication of articles. For the purpose of improving the regulatory quality, the mutual understanding and cooperation between

policy makers and regulators should be encouraged in general and different measures should be taken at all level. First, it should be stipulated as a rule in the legislation law or other legal documents that the policy makers should strengthen their cooperation with regulators in legislation process, such as conducting necessary research, making impact analysis jointly, discussing issues arising and exchanging views with the regulators. On the other hand, the regulators are required to feedback the policy makers with relevant information for future policy making, including the description of the overall situation, problems arising in implementing the policies, suggestions and recommendations for the revision of the policy. However, certain mechanisms may be established to strengthen their ties and enhance their cooperation during routine duties, such as the regular joint meeting or summit to share valuable information, exchange views and study issues of common concern. Another effective way is the change of post mechanism, i.e. regulators (policy makers) are arranged to work as policy makers (regulators) for a certain period of time and then go back to the original post. It has been comprehensively adopted at all levels in China and proved to be effective in promoting the mutual understanding between them. Besides, as far as such cooperation at international level is concerned, regulators should be given more opportunities to be able to actively participate, either as a member of the delegation or in his own name, in international conferences, multilateral negotiation and forums to have their voice heard by policy maker.