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REGULATORY MANAGEMENT AND REFORM IN CHINA

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REGULATORY MANAGEMENT AND REFORM IN CHINA

1. Introduction and summary

1. This chapter reviews recent efforts in China to improve regulatory capacities and to build a regulatory environment on the basis of the rule of law.

2. China has taken a series of radical steps to construct a framework of credible rules, legal systems, procedures and institutions needed for a market economy. Reforms to introduce and consolidate the rule of law which were started in the late 1970s have been accelerated and broadened since the late 1990. Improving regulatory quality and promoting administrative and regulatory practices within the rule of law continues to be a high priority of the Chinese government.

3. China is moving with impressive speed and perseverance in implementing this objective. Recent initiatives such as the reform of China’s Administrative Approval System starting in 2001 may mark a fundamental change in China’s regulatory practices. These reforms will establish explicit criteria and principles for regulatory interventions, and will in principle reverse previous practices based on ex-ante licensing of most business activities into a system based on ex-post control. Although still at an early stage, China is also taking steps to standardize and improve regulatory consultation and transparency mechanisms, and to introduce assessments of the economic impacts of proposed regulation. To avoid dangerous market failures in the utility sectors, which are gradually beginning to operate on market conditions, China has moved toward establishing more autonomous regulators in order to prevent capture by vested interests and to avoid bias in decision-making.

4. However a number of severe regulatory problems continue to weaken or threaten China’s economic performance. China suffers high costs from many poor regulatory practices: insufficient law enforcement, over-regulation, under-regulation, inefficient and outdated regulation, and the abuse of discretionary regulatory powers. Moreover, co-ordination between levels of government in a context of significant regulatory powers delegated to provinces and regions constitute a separate and equally important challenge. Continued efforts to promote regulatory quality and reform are needed to address these challenges. The Chinese government realizes this. Commitments to improve regulatory quality and enforcement in accordance with the rule of law have been supported by a series of concrete measures. Although the nature, pace and effect of regulatory and administrative reforms will continue to be shaped mainly by China’s particular circumstances, the convergence with and application of OECD best practices in many areas is noteworthy.

5. The chapter is organized as follows: Section two summarises some of the benefits and major challenges for regulatory reform in China. Section three provides an overview of some the recent initiatives to improve regulatory quality. The following seven sections look at efforts to improve specific regulatory practices, tools and institutions. Section 11 concludes.¹

¹ Although this chapter presents and reviews many of China’s most recent regulatory management and reform efforts, it is important to note that – given the context of this publication – it does not intend to provide a
Box 1. Definitions

*Regulation* refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations fall into three categories: Economic regulations intervene directly in market decisions such as pricing, competition, market entry, or exit; Social regulations protect public interests such as health, safety, the environment, and social cohesion; and Administrative regulations are paperwork and administrative formalities through which governments collect information, among others to monitor regulatory compliance and to inform other policy decisions.

*Regulatory tools and institutions* refer to the mechanisms by which governments promote regulatory quality, consistent with their underlying regulatory policies. Examples of regulatory tools include regulatory impact analysis (RIA), consultation and communication mechanisms, simplification measures such as time-limits for decision-making, sunsetting and automatic review clauses. Regulatory institutions include central regulatory quality oversight units, external committees (established by government with the purpose to promote, propose or implement various regulatory quality measures), and independent regulators.

*Regulatory policies* are policies designed to maximize the efficiency, effectiveness, transparency and accountability of regulation based on an integrated and rational approach to the application of regulatory tools and institutions. Regulatory policies focus on creating the optimal framework for the process of producing and reviewing regulations, rather than on the material content of regulations per se.

*Regulatory quality* refers to the extent to which a regulatory system pursues its underlying objectives. These objectives involve the specific policy objectives which the regulatory tool is being employed to pursue and the efficiency with which those objectives are achieved, as well as governance based objectives including transparency and accountability. To decide whether a system of regulation is of high quality, or in need of reform, it is necessary to be clear about the benchmarks that are relevant in such an evaluation. The OECD’s Reference Checklist for Regulatory Decision-Making sets out ten general criteria and principles for regulatory quality, which have been widely applied by OECD Member Countries in designing and implementing regulatory procedures. (See Box 5)

2. Potential benefits and challenges of regulatory reform in China

6. Experience from OECD Countries show that a comprehensive approach to regulatory reform can boost consumer benefits, reduce business burdens, improve competitiveness of industries, reduce vulnerability to external shocks and at the same time maintaining and increasing high levels of regulatory protections in areas such as health and safety. (OECD, 1997; OECD 2002b)

7. An efficient and market oriented regulatory environment can help China create the incentives in which trade, investment liberalisation and good governance will support longer-term growth. Regulatory reform can help China meet its legal WTO obligations by removing barriers to trade and investment; improving transparency, neutrality, and due process; and building new institutions and practices expected by international norms, such as autonomous regulators in utility sectors. In a wider sense, regulatory reform should be seen as a pro-active strategy that complements trade and investment liberalisation in comprehensive overview of those matters. Regulatory Reform in China was also the subject of a 2002 report by the OECD. Where relevant, this report builds on analysis and findings of that report.
boosting potential growth in China. As subsidies and monopolies for state-owned enterprises are eliminated, regulatory reform is also necessary as a defence against pressures on regulators to increase protection for incumbent firms.

8. China, however is facing a number of specific regulatory problems, which could undermine sustainable economic performance:

- **Regulatory risks** are high, reducing investment and competition by increasing the cost of capital;

- **Regulatory transactions costs** are high due to an overly-complex, multi-layered, often arbitrary and interventionist regulatory environment that is vulnerable to corruption;

- **Regulatory barriers to entry and competition** in many sectors are high. In other areas, regulation distorts incentives and misallocates resources;

- **Under-regulation**. China suffers in many sectors from too little regulation, poor enforcement, and under-institutionalisation. Insufficient regulatory safeguards reduce confidence in markets by consumers and investors;

- **Checks and balances**, such as an effective judiciary to ensure application of the rule of law and efficient dispute resolution procedures between the state and market entities, are weak, reducing the capacity of outsiders to challenge market insiders;

- **Infrastructure bottlenecks** raise production costs throughout the economy, partly due to the lack of market-oriented regulatory regimes.

9. There is no universal model for the right regulatory system. Appropriate solutions must be designed to fit within the specific circumstances of a country’s values and institutions, and stage of economic development. There is probably no doubt that the nature, pace and effect of regulatory and administrative reforms have been, and will continue to be, shaped mainly by China’s particular circumstances. On the other hand, international experiences and expectations for high-quality regulatory regimes can be a valuable source of information, not least given the emerging convergence and consensus on a range of regulatory quality principles. Moreover, since China is increasingly operating in the global economy operating under WTO obligations, international experiences may serve as targets and benchmarks for reforms. Box 2 below summarises the OECD Principles of Regulatory Reform.
### Box 2. The OECD Principles on Regulatory Reform

1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.
2. Review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.
3. Ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied.
4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.
5. Reform economic regulations in all sectors to stimulate competition, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.
6. Eliminate unnecessary regulatory barriers to trade and investment by enhancing implementation of international agreements and strengthening international principles.
7. Identify important links with other policy objectives and develop policies to achieve those objectives in ways that support reform.

*Source: OECD Report on Regulatory Reform, 1997.*

3. **An overview of recent efforts to improve regulatory quality**

*China is moving from Rule by Law toward the Rule of Law*

10. The principal elements of a rule of law system include meaningful limits on the arbitrary exercise of state power, predictable and equal application of the law, transparency in the lawmaking process, and an independent judiciary. China has made progress in building a legal infrastructure and has taken limited steps to provide checks on state actors and improve transparency. The Chinese government has made the judiciary a primary focus of its legal reform effort.

11. In 1999, the Chinese Constitution was amended to emphasize the concept of rule of law. This is widely recognized as a change of significant symbolic importance. Subsequent laws such as the Administrative Litigation Law, the State Compensation Law, the Legislation Law and the Administrative Licensing Law have demonstrated the priority and importance of implementing these revisions into real-world effects. In 2004, the Constitution was amended again, with the adoption of explicit rules to protect private property rights, and in May 2004 the State Council issued a detailed guideline – the *Guideline for Advancing Administration in Accordance with the Laws* – intended to provide a framework and roadmap for the next decade’s efforts to build a rule-of-law based society.

12. However legal restraints on the arbitrary exercise of government power often remain weak in practice, due to various context-specific factors such as shortcomings in the legislative system, weak courts, poorly trained judges and lawyers, corruption, a low level of legal consciousness among government officials and the citizenry, and the fragmentation and overlapping of authority that have resulted from the transition to a more market-oriented economy. So although significant initiatives have
been launched, the sheer size of the challenge will make the change to a rule-of-law based regulatory regime incremental.\(^2\)

**The law-making process is becoming gradually more standardized**

13. As part of the Chinese government’s efforts to consolidate the rule of law, a range of laws, regulations and guidelines have been enacted to make the law-making process more standardized, transparent and coherent. The 2000 Legislation Law and procedural rules for administrative regulations effective from 2002 are among the most important initiatives.

14. The *Legislation Law* is intended to regulate China’s lawmaking process and define more clearly the boundaries of legislative power in China. The Law clarifies that only the National People’s Congress (NPC) and in some cases its Standing Committee can pass primary legislation.\(^3\) The State Council, government ministries and commissions, and the People’s Congress at local level can pass administrative regulations or local laws accordingly. The Legislation Law also provides more concrete frameworks for the State Council’s rule-making power by defining relevant authorities, procedures and interpretations on legislative affairs concerning laws, administrative ordinances, regulations and notices at various levels of governments.

15. The *Procedural Rules for the Enactment of Administrative Regulations* sets out rules for the drafting and publication of administrative regulations and departmental rules. Under the new rules, the creation of administrative regulations must be subject to a series of preparatory stages intended to allow for better scrutiny and transparency.

16. Box 3 lists some of the most important recent initiatives to make the law-making process more predictable and improve the quality of new regulations.

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\(^2\) As noted by Peerenboom (2002), rule of law does not require that discretion afforded to administrative officials is eliminated, just that it is limited by law. Peerenboom argues that administrative officials in China may actually need more discretionary authority to deviate from existing (bad) rules to meet the demands of a rapidly changing economy: “China’s legal reformers face a dilemma. They can either (i) provide administrative officers with sufficient discretion […] or (ii) pass laws that give administrative officials less discretion than is optimal.” (Peerenboom (2002): 413).

\(^3\) Beginning in the early 1990s the role of the NPC has gradually changed towards exercising more control over the legislative and policy agenda in accordance with its constitutional mandate. Source: Murray Scot Tanner, “The National People’s Congress” in Merle Goldman and Roderick MacFarquhar (eds.) The Paradox of China’s Post-Mao Reforms (Cambridge, MA: Harvard University Press 1999), 101, quoted in CESS (2003): 57
Box 3. Recent Initiatives to Improve Regulatory Quality

Administrative Litigation Law (1989)
State Compensation Law (1994)
Administrative Penalty Law (1996)
Administrative Supervision Law (1997)
Amendment of the Constitution to emphasize the concept of rule according to law (1999)
Resolution on Advancing Administration in Accordance the Law (1999)
Resolution on Rectifying and Standardizing the Market Economy Order (2001)
Procedural Rules for the Enactment of Administrative Regulations (2001)
Procedural Rules for the Enactment of Regulatory Rules (2001)
Amendment of Constitution adopting of explicit rules to protect private property rights (2004)
Outline for Advancing Administration in Accordance with the Law (2004) 

17. Box 4 provides an overview of the law-making process in China.

Box 4. The Law-making process in China at a glance (national level)

At the beginning of each year, the State Council issues a notice on legislation planning, outlining the tasks for issuing or revising laws or administrative rules. It then delegates the drafting of the administrative regulations to one of its functional departments or the State Council’s legal affairs department (the State Council’s Office for Legislation Affairs (SCOLA)).

The responsible ministries or commissions usually use the resource within the organization to carry out the preparatory work. In the course of the drafting, the responsible department can solicit the opinions and views from relevant government departments and the general public. Such solicitation will be conducted through seminars, expert meetings, hearings, and other similar forums.

After the drafts are prepared, they will be sent to the State Council Office for Legislative Affairs (SCOLA) for review and examination. The review process will in particular aim to resolve whether the proposed administrative regulations are in conformity with the Constitution and the laws of the State. SCOLA also reviews whether the draft has been consulted with relevant parties. SCOLA may circulate the draft among relevant government ministries for additional comments. Where the administrative regulations are of general importance, the State Council will publish the draft for public opinion before it finally adopts the regulations.

Following co-ordination and consultation between ministries, the draft laws are submitted by the State

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4 The guidelines are a follow up to the State Council’s 1999 resolution to promoting administration in accordance with the law.
Within the National People’s Congress, the relevant parties include the special committee of the National People’s Congress, the Legal Committee of the National People’s Congress, and an administrative body of the Standing Committee of the National Peoples’ Congress. There are usually closed door meetings with the committee members, or relevant experts from outside the drafting group may be called upon for test on matters considered relevant to the legislation. The National People’s Congress approves or rejects the law, usually through a voting procedure with the general meetings of the Standing Members of the National People’s Congress.

For administrative rules and regulations, drafts are reviewed by the Standing Committee of the State Council and approved by the State Council. The administrative regulations are published after approval and signature by the Prime Minister. They are effective 30 days after publication unless otherwise stated. Administrative regulations are required to be filed with the Standing Committee of the NPC for record.

Departmental rules and administrative notices or guidance (Xing Zheng Gui Zhang) can be issued by ministries, commissions, the People's Bank of China, the Bureau of Auditing and other regulatory agencies directly under the State Council. While these rules are not “law” per se, they provide administrative and regulatory guidance on specific areas of the administration. The departmental rules must undergo a drafting process similar to administrative rules and regulations. Departmental rules enacted in violation of these rules are invalid.

4. Regulatory transparency and accessibility

18. Transparency is essential for regulatory quality. In an operational sense, transparency is the capacity of regulated entities to express views on, identify, and understand their obligations under the rule of law. Transparency is an essential part of all phases of the regulatory process – from the initial formulation of regulatory proposals to the development of draft regulations, through to implementation, enforcement and review and reform, as well as the overall management of the regulatory system.

19. China has been making gradual progress in improving regulatory transparency and accessibility, driven by strong political commitments, World Trade Organization (WTO) requirements as well as by increasing demands from the public. However significant results seem to be hampered by a number of factors, including the absence of an overall strategy to implement the WTO transparency obligations.

WTO requirements have been an important key driver behind improvements in regulatory quality

20. In the WTO process, China has made extensive commitments to improve transparency measures as well as to establish judicial review mechanisms for administrative actions relating to trade matters. Increasing awareness of the importance of WTO compliance has served as the motivation for a number of reform efforts by national and local government bodies throughout China. China’s transparency commitments under the WTO have also been cited as justification for launching other types of reform.

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Commitments include: Only those laws, regulations and other measures that are published shall be enforced; All laws and regulations shall be publicly available before they are enforced; An official journal must be designated for the publication of the publication of these laws and regulations; There must be “reasonable periods” for comment before implementation of laws and regulations; Establishment of enquiry points where any interested party can obtain all information on all laws and regulations; Requests for information should be answered in 30 days (in exceptional cases 45 days); China must establish independent, disinterested tribunals and procedures for prompt review of all administrative actions relating to implementation.
21. Many observers have noted that the Chinese government is demonstrating a serious commitment to meeting its WTO obligations. Some observers note that there have been significant changes in regulatory frameworks and practices as China has prepared to enter into the WTO, and that more can be expected.

22. More government bodies have made their laws and regulations available to the public through publication in gazettes and on Web sites. Following the integration of a number of trade functions with the Ministry of Commerce (MOFCOM), transparency and accessibility to trade measures may be improved, as MOFCOM will publish a single gazette collecting Chinese trade measures that were once published in the gazettes of several government agencies. While publication of enacted laws and regulations has become more regular, no uniform procedure yet exists for making draft legislation available for comment before implementation.

23. Despite positive developments, there is reason to be cautious about the immediate impact of WTO obligations in the absence of further reforms. Trade partners have complained that compliance with WTO commitments have been limited in scope, uneven and incomplete, in particular due to local protectionism. US Congressional analysts have argued that China’s compliance with its WTO obligations have been “hampered by resistance to reforms by central and local government officials seeking to protect or promote industries under their jurisdiction, government corruption, and lack of resources devoted by the central government to ensure that WTO reforms are carried out in a uniform and consistent manner.”6

5. Public consultation

24. Public consultation is a vital support for analytically based decision-making, since it is a cost-effective source of data, as well as providing information on issues such as the acceptability of different policies, which can be essential in determining practicability and designing compliance and enforcement strategies.

25. Traditionally, concepts of open access to government legal drafts have not been widely accepted in the Chinese administration. Access has been limited to special interests with good contacts inside the administration. Consultation – if carried out at all – has occurred too late in the policy process to assess market impacts, alternative approaches, and the need for regulation. This increases market uncertainties and the costs of mistakes.

26. China’s legal framework for new forms of public consultation is slowly developing, most notably with the Law on Legislation from 2000. An implementing by-law enacted in 2002 - “Ordinance on Rule-Making Procedure” clarifies that during the process of designing regulations, relevant government organisations and the relevant public should be consulted through workshops, meetings, or other fora. The Legislation Law also permits the NPC and its Standing Committees to seek outside opinions on its legislation. The NPC increasingly rely on scholars, private sector lawyers and other outside experts during the legislative process.

27. Despite these formal changes, public participation in the regulatory process remains limited. The current framework and practices for regulatory consultations are often not providing business and citizens with a de facto possibility to effect change. This is in part due to the design of the consultation procedure. It does not set standards for the public consultation process or the involvement of major affected interests, or for the time period of consultation and treatment of comments from the public. It does not set sanctions or remedies for failure to consult, nor does it establish any oversight of compliance. Another reason for the limited participation in consultation mechanisms may be the need for stakeholders to familiarize

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themselves with the consultation procedures. Moreover, capacities to making consultation documents physically available and accessible to businesses may also play a role.

28. In 2002, the OECD recommended that China should move toward more standardised consultation procedures that are more open and systematic. Realising the need for a flexible approach and taking into account that regulatory issues differ in impact and importance, a consultation system with (legally defined) minimum standards has several advantages. First, minimum standards provide clear benchmarks to all parties as to whether consultation has been properly undertaken, and so protects all interests. Second, consistent procedures enhance participation by a wider variety of stakeholders. Because the procedures are more widely understood, opportunities for input are less likely to be missed. Third, adopting a consistent process permits better co-ordination for regulatory initiatives across policy areas. Where potentially important stakeholders are known to be harder to reach or less able to participate, specific efforts may be required to actively seek and ensure their input.

6. Assessing market impacts of regulations

RIA has been the most valuable tool to improve regulatory quality in OECD Countries, and may be equally useful in transition and developing countries

29. Regulatory Impact Analysis (RIA) is perhaps the most important regulatory tool available to governments, as its aim is to ensure the most efficient and effective regulatory options are chosen. RIA is a decision tool, a method of i) systematically and consistently examining selected potential impacts arising from government action and of ii) communicating the information to decision-makers. Most of the 1995 OECD checklist relates to RIA good practice (see Box 5 below), and the 1997 OECD Report on Regulatory Reform recommended that governments “integrate regulatory impact analysis into the development, review, and reform of regulations”.

\[\text{OECD (2002a): 373}\]
Box 5: The OECD Reference Checklist for Regulatory Decision Making

The checklist reflects principles of good decision-making that are used in OECD countries to improve the effectiveness and efficiency of government regulation. In many OECD Countries, RIA guidelines require regulators to address all or most of the Checklist’s ten questions:

1. **Is the problem correctly defined?**
   The problem to be solved should be precisely stated, giving evidence of its nature and magnitude, and explaining why it has arisen (identifying the incentives of affected entities).

2. **Is government action justified?**
   Government intervention should be based on explicit evidence that government action is justified, given the nature of the problem, the likely benefits and costs of action (based on a realistic assessment of government effectiveness), and alternative mechanisms for addressing the problem.

3. **Is regulation the best form of government action?**
   Regulators should carry out, early in the regulatory process, an informed comparison of a variety of regulatory and non-regulatory policy instruments, considering relevant issues such as costs, benefits, distributional effects and administrative requirements.

4. **Is there a legal basis for regulation?**
   Regulatory processes should be structured so that all regulatory decisions rigorously respect the “rule of law; that is, responsibility should be explicit for ensuring that all regulations are authorised by higher level regulations and consistent with treaty obligations, and comply with relevant legal principles such as certainty, proportionality and applicable procedural requirements.

5. **What is the appropriate level (or levels) of government for this action?**
   Regulators should choose the most appropriate level of government to take action, or if multiple levels are involved, should design effective systems of co-ordination between levels of government.

6. **Do the benefits of regulation justify the costs?**
   Regulators should estimate the total expected costs and benefits of each regulatory proposal and of feasible alternatives, and should make the estimates available in accessible format to decision-makers. The costs of government action should be justified by its benefits before action is taken.

7. **Is the distribution of effects across society transparent?**
   To the extent that distributive and equity values are affected by government intervention, regulators should make transparent the distribution of regulatory costs and benefits across social groups.

8. **Is the regulation clear, consistent, comprehensible and accessible to users?**
   Regulators should assess whether rules will be understood by likely users, and to that end should take steps to ensure that the text and structure of rules are as clear as possible.

9. **Have all interested parties had the opportunity to present their views?**
   Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interest groups, or other levels of government.


10. How will compliance be achieved?

Regulators should assess the incentives and institutions through which the regulation will take effect, and should design responsive implementation strategies that make the best use of them.

30. Policymakers in most OECD countries and an increasing number of other countries use regulatory impact analysis to measure the benefits, costs, and risks of public laws and regulations on consumers and the economy. RIA allows them to assess economic and social trade-offs and consider alternatives to proposed regulations. Regulatory impact analysis can be incorporated in the process for developing proposed rules and can also be used by the government to assess existing legislation and regulations.

31. Emerging evidence suggests that RIA is also a valuable tool in developing and transition countries. RIA can strengthen the transparency, accountability and positive economic impact of regulatory decision-making. Introducing a RIA system takes time, and involves learning by mistakes. However although the design and processes are not first-best, once introduced, RIA may also have a “self-correcting” quality effect by making clear and public the reasoning behind public decisions. As for other regulatory tools and institutions, RIA is not a “one-size fits all tool” and must be introduced or adapted in an appropriate manner to the government’s capacities and sequenced to the current stage of a country’s regulatory reform activities.

32. The 1997 OECD Report on Regulatory Reform suggests that regulatory reform comes in three phases, with RIA arriving in the middle phase. The first is primarily deregulatory with a focus on eliminating regulations that impede competition and trade, reducing the number, burdens and costs of regulations. The second phase – here labeled regulatory quality improvement – focuses on improving the regulatory processes, including with the use of RIA. The third phase takes a long-term systemic focus, concerned with institutions and performance, cf. Figure 3 below.

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The State Council has endorsed basic principles supporting evidence-based assessments of draft regulation

33. The capacity to assess market impacts is particularly important in China. In the current transition phase, when market needs are changing quickly, the risk of making bad regulatory decisions is high.

34. Several mechanisms already exist through which potential regulatory impacts are assessed on an ad hoc basis. The National Peoples’ Congress evaluates the quality of proposed laws, mostly through the debates of its relevant committees. Independent economists and analysts often write papers and reports for the State Council on new proposals for regulations. The State Council may organise, for example, investigating teams to assess reforms, as was done for the banking system. The practice of allowing local governments to draft and test regulations at local levels, and to report their results to the central government, is a form of market testing that can reduce the risks of failure later. For example, the reform of China’s company law began with pilot projects at local levels. Based on their successes, local regulations were published and revised at the ministry level, and extended to national law.

35. The Chinese government seems to acknowledge the potential benefits for a more systematic approach to regulatory impact analysis and to incorporate those assessments into public consultation procedures, while at the same time recognizing the need to take a gradual approach in accordance as regulatory capacities develop.

36. In the State Council’s Outline for Advancing Administration in Accordance with Laws published in May 2004 government agencies are encouraged “to actively explore the using of cost-benefit analysis in administrative legislation, especially in making laws and regulations for economic affairs. Government’s
legislation have to take account not only the cost of the rule-making process, but also the enforcement costs and social cost of the rules to be implemented.9

37. These commitments should be followed up by training, guidance, and an appropriate targeting of RIA efforts. If not properly organized, sequenced and scoped, RIA requirements may only be complied with as a bureaucratic formality at the very end of the regulatory process, instead of framing and supporting the regulatory process as early as possible.

7. Building regulatory institutions

38. Promoting regulatory reform requires that there are institutional drivers charged with the promotion, co-ordination and implementation of policy-objectives. This section examines China’s recent efforts to establish regulatory institutions responsible for general regulatory oversight, and institutions responsible for regulatory implementation and enforcement in economic sectors. In OECD countries, two of the most widespread institutions of modern regulatory governance are regulatory oversight bodies at the centre of government promoting regulatory quality and coherence, and so-called independent regulators or autonomous agencies responsible for implementing and enforcing regulation in economic sectors such as utilities and financial services. As this section will show, China’s progress and practices in building regulatory institutions are similar to that of many OECD Countries.

The State Council’s Legislative Affairs Office assumes roles similar to central regulatory reform offices in many OECD Countries

39. The allocation of specific responsibilities and powers to agencies at the center of government is often seen as necessary to promote regulatory reform over years, across levels of government and across multiple institutions.

40. In China, the State Council’s Office for Legislation Affairs (SCOLA) assumes a key role in planning and coordinating the law making process.10 SCOLA acts as a gatekeeper for draft regulations on their way to cabinet approval, and it has significant regulatory quality advisory and advocacy functions, among other in its role of producing guiding material to ministries and commissions on how to prepare regulations. SCOLA is charged with checking the constitutionality of all draft regulations at the central level and to examine their accordance with the Law on Legislation and subsequent ordinances. SCOLA often redrafts regulatory proposals from ministries and commissions, and carries out (additional) internal co-ordination if deemed necessary. The decision to forward draft laws to the State Council rests with SCOLA’s minister.

41. In addition to SCOLA, the State Council’s General Office has been taking a leading and co-ordination role in relation to the implementation of the Administrative Licensing Law and the Guideline for Administration in Accordance with Law.

China is establishing regulatory authorities for the network industries

42. China is in the middle of a number of large-scale reforms of its network industries, prompted by demands from rapidly growing markets and commitments made under free-trade agreements. The results of reforms in the network industries will be largely determined by the quality of the regulatory institutions set up to guide the reform process. Transforming the structure of a network-based industry, such as

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9 Outline for Advancing the Administration in Accordance with Laws: Section 17
10 Since 1998, the LAO has ministerial status. For a detailed description of LAO’s functions, see http://www.chinalaw.gov.cn/jsp/contentpub/browser/contentproe.jsp?contentid=co1059687381
electricity and telecommunications, from monopoly to competitive markets requires a sophisticated and evolving regulatory structure. China has taken several steps toward establishing more autonomous regulators. China is moving quickly to break up monopolies; separate public administration from commercial interests, and permit more market entry and competition in these sectors.

43. Until late 1990s, the restructuring of the network industries was piecemeal. Since the late 1990s the restructuring of network industries, in particular electricity industry, railways and telecommunications has accelerated. Aspects of the regulatory frameworks for network industries and the financials sectors are summarized in the following paragraphs.

44. As part of a complete restructuring of China’s power industry in 2002, the Chinese government established the State Electricity Regulatory Commission (SERC). SERC is not established by law, but by a State Council statute. SERC is charged with promoting and ensuring competition and with implementing and developing electricity reforms further. Powers to regulate market entry and pricing as well as to improve large projects still rest with the National Development and Reform Commission (NDRC). In May 2004, the State Council approved a plan for SERC to establish 6 regional offices to promote the development of regional electricity market. The sharing of regulatory powers between SERC and local pricing bureaus is not yet settled. Work is currently underway to revise the Electricity Law, among others to establish a clearer legal framework for SERC and regulation of the electricity sector in China.

45. In China, the rail industry is owned and operated by the state. The Ministry of Railway executes the state’s functions as owner, operator, and regulator. In the early 1990s entry regulation was relaxed to allow non-state capital to invest in building tracks for the rail system. The lack of separation of the state’s regulatory, policy and operational functions is believed to have discouraged new entrants. As a result, potential new entrants were organized as joint-stock companies with local governments, believed to have more bargaining power with Ministry of Railway. According to recent statistics around 30 railway branches have been built with funding provided by other entities than the Ministry of Railway. The Chinese government is currently drawing up a reform plan, which is expected to separate the regulatory and policy functions from enterprise functions.

46. China’s gas sector was restructured in 1998, whereby regulatory and policy functions were separated from the two largest state-owned companies, CNPC and SINOPEC, and transferred to the State Economic and Trade Commission (SETC) in October 2000. With the abolishment of SETC in 2003, NDRC assumed the role of making policy for the development of China’s gas market. There is no specific law governing China’s gas market. This creates uncertainties for investment and causes difficulties in conducting business related to gas transportation and distribution. There have been widespread calls for China to produce a “Natural Gas Law”, but there still doesn’t seem to be a political consensus about the urgency and necessity for such a law. Lack of competition due to the monopoly structure of the gas industry and the lack of transparent and unified regulation is considered key constraining factors in China’s gas market development.

47. In 1998, the Chinese government merged the Ministry of Posts and Telecommunications and Ministry of Electronics Industries to form a new Ministry of Information Industries (MII). Subsequently, China Telecom, the country’s monopoly carrier, was divested from MII as part of an effort to separate government from enterprise. MII is both a policy body and a regulatory body for China’s information industry, which include all sectors of information and communications technologies (ICT) and services (broadcasting excluded). It also allocates spectrum, licenses network access equipment and develops standards. The regulation of market entry remains the authority of the State Council. Moreover, NDRC has

11 See Feng (2001) for a review of reforms of China’s network industries.
12 Cf IEA (2002), Gao & Qin (2004) and USITO.
to be consulted and reported to on any key decisions on price regulations. There is an increasing appreciation of the possible benefits of an autonomous regulatory authority for the telecom sector. Article 4 of the Telecoms Regulations promulgated by the State Council [in 1998] states that the supervision and regulation of telecom services shall abide by the principles of “separating government from enterprise, breaking up of monopoly, encouraging competition, and promoting development” and “openness, fairness and impartiality”. A report prepared by a MII study group in 2002 recommended the creation of an independent regulatory organization for the telecoms industry such as the China Insurance Regulatory Commission. As for Gas, some of China’s trade partners have argued that the absence of a specific telecom law and independent regulatory authority adds unnecessary uncertainty to market operators.

48. China’s securities markets developed in the late 1980s, at first without any specific regulatory framework. The State Council Securities Commission (SCSC) was established in 1992 to regulate the securities markets, with the China Securities Regulatory Commission (CSRC) as an “executive branch” responsible for the supervision and regulation of the securities markets. Although in principle a regulatory body with some resembles to regulatory authorities in other developed market economies, the absence of clear rules or appropriate checks and balancing mechanisms rendered to CSRC be ineffective. The SCSC and the CSRC were merged in April 1998 to form one ministry rank unit directly under the State Council, with the power and functions of the CSRC have been strengthened. The primary task of CSRC is to secure the healthy development of China’s still fledgling securities and futures markets. The enactment of China’s Securities Law in July 1999 has brought some clarity to China’s securities and futures market, as well as to CSRC functions, defined in Chapter 10 of the Securities Law. On several occasions, CSRC’s regulations decisions were challenged in courts by regulated companies, illustrating the gradual development of check and balancing mechanisms. Experiences from SCSC have served as inspiration in the subsequent establishment of China’s Insurance Regulatory Commission (CIRC) in 1998 and China’s Banking Regulatory Commission (CBRC) in 2004.

49. Therefore, as the paragraphs show, China has made some progress in reforming the public utility sectors, but much remains to be done. In sectors such as gas, rail and telecommunication, reforms are still relying largely on marginal changes to regulatory institutions and regimes created for state-provided services. Although new or reorganized state-owned companies were meant to be independent of the ministry, they frequently have retained close ties. The policy interests of the state are not separated clearly enough from the interests of commercial entities. Administrative agencies frequently use their regulatory power to benefit the companies in which they have an interest.

50. There is no single right institutional model for these regulatory authorities. Institutional designs must be contextual, and based on flexibility and responsiveness.

51. In OECD countries, independent regulators have most often been introduced in connection with the privatization of former state-owned enterprises and competition in formerly monopoly based industries. Independent regulators have been established with the objective to keep market interventions at arm’s length from political interference and to improve transparency, expertise, and commitments to explicit long-term policy objectives.13

13 Independent regulators can be defined as public organisations, created by legislation, with regulatory powers operating at arm’s length from ministries. Set out in public law, independent regulators are organisationally separate from ministries and have more or less narrowly defined regulatory functions in areas of policy implementation free of direct ministerial oversight. In certain cases they may exert in a limited sphere joint legislative, judicial and executive functions. Independent regulators are always subject to different kinds of control by elected politicians and judges. Many OECD countries have moved towards independent regulators, establishing separate “agencies” at arm’s length from the political system, with delegated
52. China must seek to establish regulatory authorities that match the country’s particular circumstances and needs. However as argued in OECD (2002a) an over-emphasis on the independent regulator is a mistake. The task of establishing a market-oriented regulatory regime should include all institutions with significant influence on policy design and implementation. This will help avoid unhealthy focus on single components of the system, to the exclusion of others. No single aspect of autonomy is the litmus test for success. Rather, the key question is whether the checks and balances built into the overall system are sufficient to prevent capture and bias in decision-making contrary to the core mission of long-run consumer welfare.

8. Reform of the administrative approval system

53. Most economic and social activities in China have traditionally been subject to ex-ante administrative approvals. As a legacy of the old planned economy, administrative approvals are pervasive in most aspects of economic and social life in China. Until recent reforms, there were more than 4000 activities requiring separate administrative approvals or licenses, only at the national level. The administrative approval system has long been recognized as a major source of corruption and significant regulatory barrier to doing business, given the scope of activities requiring approval through complicated procedures, combined with the significant discretion left to civil servant, lack of transparency and weak accountability mechanisms. Many local and departmental administrative licensing practices have been utilized as a tool for local protectionism. The drawbacks of this system have become very obvious in the context of opening and rapidly developing markets.

Reform of the administrative approval and licensing system could mark an profound change of regulatory practices in China

54. In recent years, reform of the administrative approval and licensing system has become a high priority of the Chinese government, leading to a range of legal, organizational and policy changes. If implemented in accordance with intentions, changes to the administrative approval system could mark profound change of regulatory practices in China. Firstly, the changes reverse the current control of many business activities from ex-ante approval to ex-post control. Secondly, the reforms set out explicit quality criteria to be adhered to when making and reviewing administrative approval. Thirdly, and partially as a consequence of the above, the reforms are groundbreaking by trying to establish clear boundaries between the market and the state, and by pushing national and local government agencies to abandon direct interference in economic and social activities.

55. In 2001 the State Council issued a decree to guide ministries’ reforms of their administrative approval practices. The decree requires government ministries and agencies at all levels to follow the following principles for issuing new and reviewing existing administrative approvals:

- **Legally sound.** All administrative approval requirements must be in line with laws, and compatible with the overall legal system. The Legislation Law must be observed.

- **Proportional and reasonable.** All administrative approvals must be beneficial to the economic development and social progress in a socialist market economy.

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– **Cost-effective.** Administrative approvals should be cost-effective and administrative approval authorities should be properly divided, procedures simplified, and “one-stop-shop” introduced.

– **Responsible.** There must be internal control mechanism to make sure that government departments carry out the administrative approval procedure timely and properly.

– **Accountable.** Laws, rules and transparent procedures should be in place to make government departments accountable to the administrative approval they make.

56. Since 2001, a special State Council Leading Group for Administrative Approval System Reform located within the Ministry of Supervision has been charged with promoting reforms of the administrative approval system.

57. Government ministries at the central government level have been asked to review all their existing administrative approvals according to the above-mentioned principles. The reviews have been carried out in consultation with effected ministries and co-ordinated by the State Council’s Administrative Approval Systems Reform Office. Three review rounds carried out and finalized in June 2002, November 2003 and May 2004 have led the 65 central government ministries, commissions, bureaus and other bodies to abolish around 1795 administrative approval items, corresponding to almost half of total items requiring administrative approval at the central level. Another 100 items have been given over to industrial associations and other intermediary agencies. The reviews showed that a large number of the existing administrative approvals had been established without any basis in existing laws and regulations. 15

9. **Reform of licensing practices and procedures**

58. Primarily relating to business activities, administrative licenses constitute an important sub-category of items subject to administrative approval. Efforts to reduce and standardise criteria for administrative approvals was give an additional push with the Administrative Licensing Law approved by the NPC in 2003 and enacted July 1 2004. The law specifies the rules for the establishment and implementation of administrative licensing, including the scope, procedure, and appeal mechanism for creating and challenging administrative licenses.

59. As general principles, the law mandates that administrative licensing can only be applied in one of six exclusive situations:

– Activities that directly concern national security, public safety, macroeconomic adjustment and control, ecological and environment protection, and directly relate to individual health, safety of life and properties;

– Activities relating to the development of scarce natural resources, allocation of public resources and market entry in specific industries that directly concern public interests;

– In professions that provide services to the public with direct impact on public interests and social welfares, items concerning professional qualification that require special credibility, special condition, and special skills require administrative licensing;

15 Examples of activities that do no longer need central approval include: urban infrastructure construction projects, agricultural, forestry and water reservation projects not requiring central government investment/funding, real estate development and construction projects, and “social projects” undertaken and funded by local governments and enterprises. Source: www.china.org.cn/English/2003chinamarket/79439.htm
For important equipments, utilities, products and other objects that are directly related to public security, human health, safety of lives and properties, items that require approval by verification, testing, and quarantine inspection in accordance with technology standards and technology regulation require administrative licensing;

- Items that require validation of the qualification of the entities such as the creation of enterprises and other organizations;

- Administrative license requirements can also be created for other items that are required by relevant laws and administrative regulations for licensing.

60. In cases where one of these criteria is fulfilled, the law specifies that administrative licensing may not be necessary if self-regulation, market mechanisms or ex-post supervision are considered to be better alternatives.16

61. The Administrative Licensing law states that only the NPC, the State Council and the local people’s congresses have the right to determine whether an activity needs an administrative license. Licenses not covered by the above six criteria above will not have any legal status. Under the law, citizens or businesses ordered to obtain and pay for illegal licenses will be able to take legal action against relevant administrative bodies.

62. The Administrative Licensing law specifies that all administrative approvals not in line with the law will be abolished automatically by July 1 2004. The Chinese government has made significant efforts to prepare the implementation of the Administrative Licensing Law. In September 2003 the State Council issued notice for governments at all level to study and prepare for the implementation of the law.17 Another notice was issued by the General Office of the State Council in December 2003, detailing the arrangement for special training courses of ministers, provincial heads, mayors and other government officials at all levels in order to prepare for the implementation of the law.

63. Having come into force on 1 July 2004, it is still too early to say much about the effect, pace and consistency of the implementation of the law. However the very significant efforts to train civil servants and policy makers, and to guide public agencies and organizations of their (fundamentally) new obligations under the law have been momentous,18 and indicate that long term dynamic effects may be significant.

10. Improving the application and enforcement of regulations

64. Adopting a rule is easier than implementing it. To be effective in achieving policy objectives, regulation must be adequately applied and enforced, and regulated entities should have appropriate rights to redress regulations and regulatory decisions. Poor enforcement and low regulatory compliance threatens the effectiveness of policy reforms and can undermine confidence in the rule of law.


18 The State Council has required that all civil servants be trained at special training courses on the law before the end of June 2004, including all vice-ministers and vice-governors in charge of legal affairs (source: People’s Daily Online, 1 July 2004.) Moreover, “…millions of civil servants […] have taken […] tests on the law prior to its implementation date”, according to Chinese newspaper China Daily, quoted in China Economic Net, http://en.ce.cn/national/law/2004040701_1164869.shtml. In east China’s Zhejiang Province alone, more than 220 000 civil servants attended an examination in the Law in April 2004.
65. The quality of the Chinese law enforcement system is improving, as the national government takes steps to ensure fair and equitable enforcement, most notably in those policy areas, where investors have the greatest interest. The judiciary system’s lack of independence and resources is often at the center of concerns with regulatory enforcement in China. Historically Chinese courts have not had the power to strike down legislation that is inconsistent with the Constitution. In practice, however the Supreme People’s Court has pushed the limits of its delegated authority, issuing a number of interpretations of key laws. Several recent legal reforms and events suggest that China is taking tentative steps toward more robust mechanisms of constitutional enforcement.

66. Together with the Administrative Litigation Law and the State Compensation Law, the License Law provides a set of legal mechanisms through which citizens can challenge state action. Under the Litigation Law, citizens have the right to petition the NPC Standing Committee for review of administrative regulations that they believe contradict the Constitution or national laws. Under the Administrative Licensing Law, as mentioned in the previous section, a citizen arbitrarily denied a license by an administrative agency can challenge such decisions in court. Courts also have the power to grant compensation to claimants. In practice, litigants face a number of obstacles in using the available mechanisms to challenge administrative decisions. The scope of both the State Compensation Law and Administrative Litigation Law does not enable citizens to challenge acts or administrative decisions with general applicability. Moreover, official resistance and procedural defects have been reported as important obstacles. China’s judiciary continues to be subject to a variety of internal and external controls that significantly limit its ability to engage in independent decision-making.

67. There is still considerable scope for improvement. Complaints about poor enforcement – inconsistent, too little, or too much – are widespread. Some of the main reasons for the unpredictable enforcement practices are listed in Box 5 below.

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**Box 5. Transitional and structural reasons for unpredictable enforcement in China**

*Multiple layers of government.* China’s regulatory enforcement system is highly decentralised and poses formidable co-ordination and consistency issues. Almost all of the staff who inspect and enforce regulations are employed at provincial, county and urban levels, with little accountability to the national ministries for their actions. Local governments have regulatory and enforcement powers in most policy areas. Many local inspectorates must also be funded locally, further diminishing control from the centre.

*Local protectionism and capture of the enforcement process.* Powerful, sometimes corrupt, interests at local levels often have strong influence on regulatory enforcement decisions affecting competitors.

*Inadequate checks and balances on enforcement actions.* A major problem is excessive discretion at national and sub-national levels of administration. Provincial, county, and municipal levels of administration exercise liberal powers of interpretation of regulatory requirements, a discretion not controlled by the Law on Law-making. China’s administrative procedure laws do not define the rights of citizens affected by regulatory decisions with respect to disclosing compliance interpretations in advance, explaining decisions publicly, and limiting delays.

*Lack of effective judicial review.* As a result of ineffective judicial review mechanisms, China’s...
enforcement personnel are often not constrained by external judicial accountability under principles of administrative law. Courts are not empowered to interpret administrative regulations – ultimate authority over the interpretation and application of such rules rest with the issuing agency. One consequence of the limited power of Chinese courts in that many court judgments are not enforced. Local governments are the most significant source of external interference in judicial decision-making. Local governments are able to exert influence on judges because they control local judicial salaries and court finances and also make judicial appointments. The Communist Party also influences judicial decisions in both direct and indirect ways.

Sanctions and penalties may not deter violations. A further problem is the enforcement of judgments and the collection of penalties. Court decisions are often not enforced promptly or at all. Sanctions are sometimes disproportionately low compared to the profits of violating the law.

Intrusive and excessive regulation. Inspectors in most policy areas have a wide range of opportunities to intervene in business decisions. Business licences, for example, are often given for very short periods, perhaps six months to a year. The frequent use of permissions and approvals rather than general regulations expands the enforcement problems, because these regulatory instruments inherently increase discretion, particularly when the criteria for these decisions are not clear and independent checks are not available.


68. Recent efforts to improve judicial review and administrative appeals mechanisms are important and needed, but it may take a long time before significant results start to show. China’s judiciary continues to suffer from a host of complex and interrelated problems, including a shortage of qualified judges, pervasive corruption, and significant limits on judicial independence. As mentioned, the Chinese government has made progress in its efforts to improve the capacity, efficiency, and competence of its judiciary, but progress is likely to be incremental due to the breadth and complexity of problems, limited resources, tensions between judicial independence and judicial accountability, and limited concepts of judicial independence.

69. Two recent initiatives launched by the Chinese government to control excessive administrative discretion may prove to be very helpful to some of the interlocked institutional and structural weaknesses undermining legal enforcement. Firstly, reform of the administrative approval and licensing system, as discussed in sections 8 and 9 in many respects goes to the root of the problem. By abolishing and simplifying the vast number of existing rules, the universe of bad regulation subject to potentially poor enforcement will be reduced. Moreover, the newly established criteria for making and reviewing administrative approvals may enhance regulatory predictability and accountability.

70. The same effect – enhanced regulatory predictability and accountability – is likely to be the consequence of the Chinese government’s broad and general push to improve administration in accordance with the rule of law. The “Guideline for Advancing Administration in Accordance with the Law”, published in April 2004, sets out six basic requirements for rule-of-law based administration, see Box 6, and includes a range of specific guidelines on administrative decision-making, enforcement as well as conflict resolution and administrative monitoring mechanisms.
Box 6. Guiding principles for public administration in accordance with law in China

**Legality.** All administration has to be conducted in strict accordance with laws, regulations and other administrative rules. No executive branches are allowed to make decisions violating the rights of citizens, legal persons and other organizations or increasing burdens and obligations to them.

**Proportionality.** Administrative bodies must conduct administrations according to the principles of fairness and justice. It should be unbiased and non-discriminatory. Administrative discretion should be excised in line with laws, independent of irrelevant factors. Means should be justified as necessary and appropriate.

**Transparency.** With the exception of activities concerning national security, state secrets, commercial secrets and individual privacy protected by laws, all administrations should be conducted in an open and transparent way, and citizens, legal persons and other organizations should be consulted. The administration should be conducted in accordance to the legal procedure as mandated by laws and regulations so as to safeguard the rights of the stakeholders to be informed, to participate and to seek aid.

**Efficient and customer orientated.** Administrative bodies must carry administration in an effective, efficient way. The time limit should be observed, and high quality service assured. Administration should be carried out in a way that is convenient to citizens, legal persons and other organizations.

**Credibility and integrity.** Information disclosed by administrative bodies should be comprehensive, accurate, and real. Administrative decisions should not be revoked without resorting to proper legal procedure. Losses incurred to any affected bodies resulted from changes of administrative decisions for the sake of national or public interests should be compensated.

**Accountability.** Administrative bodies will be empowered by laws and regulations to conduct administrative activities and implement administrative rules. Administrative bodies should be also made accountable for any wrong doings. The aim: administrative bodies are empowered by laws; power goes with responsibilities, power is monitored and checked, violation of laws will be made accountable, and violation of legal rights should be compensated.

11. Conclusions

71. This chapter has reviewed some of China’s recent efforts to improve regulatory capacities and to build a regulatory environment on the basis of the rule of law. China’s potential benefits from regulatory reform are significant, as is the potential downside if a number of severe regulatory problems are not addressed.

72. Among the most pertinent challenges are the excess discretion provided to civil servants in interpreting, issuing and implementing regulations, as well as the lack of appropriate resources and independence of the judiciary. Building appropriate capacities to develop and co-ordinate new regulation is another challenge, involving the development of institutions, procedures and criteria to prepare high-quality regulation.

73. China has taken a series of radical steps to construct a framework of credible rules, legal systems, procedures institutions needed for a market economy. China is gradually moving toward a system based on rule of law. Law-making processes are becoming gradually more standardized and co-ordinated. WTO requirements have been an important driver behind improvements in regulatory quality. But there is still reason to be cautious about the impact in the absence of further reforms. China’s regulatory processes are becoming more transparent and participatory, although reforms have been uneven and often not empowering citizens to effect real change. Reform of the Administrative Approval and Licensing system could mark a fundamental change of regulatory practices by – to a large extent – abolishing ex-ante licensing, by making very clear criteria for regulation making, and by establishing similar criteria for regulatory reviews.

74. Although recent reforms are extremely promising and dynamic, a complete resolution of some of the interlocked institutional and structural weaknesses that undermine a full endorsement and realization of the rule of law will eventually require reforms – essentially political reforms – that are well beyond the scope of this chapter.
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