“An OECD Perspective on Regulatory Reform in China”

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By Scott Jacobs, Managing Partner, Jacobs and Associates for the CCNM, Organisation for Economic Co-Operation and Development, Paris, France

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I. INTRODUCTION AND MAJOR CONCLUSIONS

1. An efficient and market-oriented regulatory environment is needed to create the incentives in which trade and investment liberalization will support longer-term economic growth in China.

   • In a narrow sense, regulatory reform can help China meet the legal obligations of the international trading system 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. Effective regulatory reform can be a useful benchmark for credible commitment to the international trading system, and, as trade and investment develop, can help avoid costly conflicts between trading partners.

   • In a wider sense, regulatory reform should be seen as a pro-active strategy that complements trade and investment liberalization in boosting potential growth in China. As part of a mix of macroeconomic and structural policies, regulatory reforms, properly designed and implemented, can increase private investment (domestic and foreign), business start-ups, and incentives for efficiency among private and state-owned enterprises in China. These effects should boost over-all productivity performance and potential long-term growth, and comprise a valuable tool in the national strategy for poverty reduction. As subsidies and monopolies for state-owned enterprises are
eliminated, regulatory reform is also necessary as a defense against pressures on regulators to increase protections for incumbent firms.

2. Regulatory reform is not new to China, beginning in the late 1970s with the decision to open the economy to direct foreign investment. Chinese authorities at national and regional levels have taken many positive steps since then to construct the framework of credible rules, legal systems, and institutions needed for a market economy and to comply with WTO obligations. The high rate of economic growth in recent years is partly due to the success of these legal reforms. The Chinese state is now in the midst of an even more far-reaching transformation: from owner of production to arms-length regulator of competitive markets. In the 1999 revision of the Constitution, the scope for market reform greatly expanded when the government and the Communist Party committed to protection of private ownership within a socialist market economy. Many other important laws in areas such as energy, communications, and competition policy will be issued in the coming years.

3. China’s economic performance is, however, undermined by severe regulatory problems. First, regulatory risks are high, reducing investment and competition by increasing the cost of capital. Second, transactions costs are high due to an overly-complex, multi-layered, often arbitrary, and interventionist regulatory environment that is vulnerable to corruption. Third, in many sectors, China suffers from substantial internal and external regulatory barriers to entry and competition. In other areas, regulation distorts incentives and misallocates resources. Fourth, there is substantial under-regulation. China suffers in many sectors from too little regulation, poor enforcement, and under-institutionalization. Insufficient regulatory safeguards reduce confidence in markets by consumers and investors. Fifth, 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. Sixth, infrastructure bottlenecks, partly due to the lack of market-oriented regulatory regimes, raise production costs throughout the economy. These problems will not be overcome quickly, and legal and regulatory inefficiencies and risks will be higher in China than in OECD countries for the foreseeable future.

4. Deregulation and creation of market-based regulatory regimes and administrative capacities are late compared to other market reforms, and this lag increases the risks of costly market failures. The Asian Development Bank has noted that, “During the last two decades, the PRC's transition to a market economy has outpaced the development of the legal and regulatory framework.”1 Even where high-quality national laws have been adopted to satisfy WTO criteria, creation of new institutions and implementation capacities has lagged behind, and hence the effects of many legal reforms have not yet been felt in the marketplace.

5. Transformation of the role of the state is occurring simultaneously with fast economic growth and rapid social change. Many problems arising in China’s regulatory system are purely transitional issues normal during such rapid change, but other problems are structural and will be resolved only with continued, more co-ordinated, and more comprehensive reforms. The government must further develop its capacities to regulate behavior in a competitive market. Ultimately, the success of regulatory reform will depend on the consolidation of the rule of law throughout China’s complex governing structures, including regional, provincial, and municipal administrations. Better law enforcement is an urgent matter. In the global trading system, if China’s domestic legal system cannot uphold legal obligations, disputes will move to

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1 See www.adb.org/countries/highlights/PRC
international fora such as the WTO, where they will be multilateral, costly and damaging, and will raise the cost of foreign capital for the whole economy.

6. In addition, regulatory reform involves more than efficiency considerations, particularly in a country where social stability and regional inequities are continuing concerns and where there is no general safety net for the unemployed. Business failures and unemployment will increase as structural reform and the “controlled collapse” of many SOEs accelerate, and will create major political problems. Many regulatory issues in China cannot be resolved only by regulatory reform, because they stem from larger issues of governance, accountability, and policy trade-offs such as how to manage change while preserving stability. The real effects of regulatory reforms are, therefore, highly uncertain. China’s practice of experimentation – trying out reforms in localized areas before extending them nation-wide – reduces the risks of reform.

7. To identify areas where OECD experiences could be useful to China as it moves forward, this paper surveys some important regulatory challenges facing China’s reformers. A medium-term perspective is necessary for major change, but the Chinese government can, in the short-term, take concrete steps to move closer to good international practices, with potentially large rewards in market performance and investor confidence. This paper examines regulatory reform from a broad perspective, focusing on systemic issues of institutional capacities and interactions that cut across economic sectors, layers of government administration, and ministerial jurisdictions. Such an approach is necessary because many regulatory problems facing China can be resolved only with a coordinated and strategic approach based on market principles applicable across the whole of the governing system. These systemic issues can be easily neglected by governments fragmented into many policy bodies, and in trade negotiations focused on specific points of conflict.

8. There is no universal model for the right regulatory system, since appropriate solutions must be designed to fit within the specific circumstances of Chinese values and institutions, and its stage of economic development. However, since China is competing in a global economy for capital and markets, international expectations and experiences for high-quality regulatory regimes can provide a source of valuable information. The rich pool of OECD-country experiences can be useful in setting goals and designing reforms. A consensus is growing among industrialized economies – with both common law and civil law systems -- about good regulatory practices based on competition, market openness, and public management principles. This emerging consensus, based on a decade of work at the OECD, is increasingly used as the benchmark for international trade agreements. The key elements of this consensus are contained in the 1995 OECD Recommendation on Improving the Quality of Government Regulation and the 1997 OECD Report on Regulatory Reform. The OECD’s recommended framework for regulatory reform is contained in Annex 1.

9. Continuing cooperation between the Chinese government and the OECD on regulatory reform would be of mutual benefit in accelerating convergence of good practices. Many of China’s regulatory problems exist and have been addressed to some extent in OECD countries. The priority areas identified in this paper where China’s regulatory reforms could benefit from the experiences of OECD countries are:

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2 Kim Woodard, Chairman & CEO, Javelin Investments, China. Interview with Scott Jacobs, July 2001.

Improving regulatory transparency through more systematic publication, public consultation, and notification procedures is a high priority, since this is where China lags furthest behind good international standards. China has not yet adopted a strategy to meet WTO transparency obligations, and such a strategy will be difficult given the size of the country and the many layers of administration. OECD countries offer a wide range of public consultation approaches that may be adapted to China’s needs. A dialogue on transparency could begin with an OECD conference in China presenting various methods of public consultation to support development of a general transparency strategy in the Chinese government.

Enhancing the capacities of regulators to choose efficient regulatory solutions consistent with market needs will reduce the risks of costly mistakes and market failures in China. In the current transition phase, when markets are changing quickly, the risk of making bad regulatory decisions is very high. Investors in China cite many cases where laws were adopted without clear understanding of market impacts. The method used by most OECD countries to assess potential market impacts in advance is regulatory impact analysis. China’s national administration, where most laws are drafted, should design a regulatory impact analysis program for major laws. OECD experiences could prove useful in designing a practical system that is phased in over time.

Accession to the WTO opens the door to broader and deeper reforms in China, extending beyond specific treaty obligations, that require longer-term planning, coordinated institutional reforms, and sustained commitment. Improved regulatory planning, coordination, and oversight from the center of the government, and monitoring by the National People’s Congress, are necessary to rationalize fragmented regulatory institutions and promote the adoption of good regulatory practices against strong resistance. OECD countries offer many examples of how regulatory reform programs can be promoted and coordinated through new institutions at the center of government.

China is rich in rules, but, as in most OECD countries, adopting a rule is easier than implementing it. Application and enforcement of China’s laws and other regulations have lagged behind the establishment of national policy reforms, imposing unnecessary costs and uncertainties on the market, and allowing scope for unethical behavior. In many regulatory areas, the legal system has been captured by local political and economic interests. In addition, disputes about enforcement are not easily resolved due to weak and poorly-trained judicial and police institutions. Chinese authorities are taking substantial steps to upgrade the capacities of the judiciary, and to improve the transparency, efficiency, and neutrality of enforcement, but more fundamental reform (beyond the scope of this paper) is needed to establish a truly independent judiciary as the keystone of the rule of law. The reforms discussed in this paper to improve regulatory transparency, consultation, assessment, oversight, and accountability would contribute significantly to improved enforcement. More progress could be made by revision of the Law on Law-making so that it becomes a more detailed administrative procedure law.

Opening the internal market in China might create as much or more wealth than opening to external trade. China’s internal market is highly fragmented. Regulatory barriers to the movement of goods and services across regional, provincial, county, and even urban jurisdictions create enormous hidden costs by weakening competition, increasing production costs, and reducing quality of products and services (see also the chapter on
competition policy in this report). These internal barriers will become even more troublesome as China opens to international trade and investment. A unified internal market in China might, however, exacerbate regional economic inequities by accelerating structural change in the least efficient and poorest regions. OECD countries – federal countries and regional groupings such as the European Union – offer concrete solutions to easing internal regulatory barriers across multiple jurisdictions. In key areas where regulatory regimes are too decentralized in China to operate efficiently, more centralization should be considered, as was done for the banking sector.

- Building autonomous regulators to oversee increasingly competitive utility sectors is necessary if consumers are to enjoy lower prices and better services, and if China is to benefit from world-class services. The utility sectors – primarily communications, energy, transport, and water – are characterized by a fast-changing mix of SOEs and private firms regulated by many kinds of contracts and many administrative bodies. The regulatory institutions now in place in these sectors were mostly designed for state-provided services, and will not function well in this complex market environment, due to conflicts of interest, fragmentation, inefficiency, and lack of transparency. Building on the steps already taken in securities and insurance sectors, and on good practices in OECD countries China should create autonomous regulators that can pursue long-run optimal policies and establish market confidence.

II. PROGRESS ON REGULATORY REFORM IN CHINA

10. Regulatory reform in a transition country is not essentially a deregulatory task, but a mix of new regulation, deregulation, and re-regulation, backed up by legal and institutional reforms, to support increasingly competitive markets. Pro-market regimes are composed of economy-wide policies (such as commercial law, competition law, consumer protection, and corporate governance) and sector-specific policies (such as banking and telecommunications regulatory regimes), operating within a credible system of the rule of law. As seen in Russia, and to a lesser extent in Eastern Europe and China, changes in ownership are not enough. Poor and inadequate regulatory structures permit abuses and corruption to flourish in emerging markets, undermine investor and consumer confidence, and destroy rather than create economic value.

11. China’s long-term development plans (2010-2020) are to transform its planned economic system into a market economic system, which requires the reorganization of state-owned enterprises so that they can compete better in an increasingly liberalized, open, and integrated economy. The Chinese government has stated that it aims to maintain a balance among reform, development and stability. Reform, as the motive force of development, should promote social and economic development to raise people’s living standards. However, continuing ambiguity about the role of the government in the market economy will complicate the many difficult decisions facing the Chinese government with respect to the scope, intensity and speed of reform. China considers stability as “the prerequisite of reform and development,” and warns against “chaos” in the markets. These concerns have been used to justify anti-competition regulations and have encouraged an inconsistent approach to regulatory reforms.

4 See China’s 1999 and 2000 Individual Action Plans (IAP) for APEC.
The Chinese government has recognized weaknesses in its legal and regulatory systems and has set a target to establish an appropriate framework for a market economy. Its current efforts follow more than two decades of reform.\(^5\)

- The first wave in 1978 – 1992 began after the Cultural Revolution with China's decision to open to international cooperation and to welcome foreign direct investment. During the 1980s, a legal framework developed that helped China to become an attractive FDI destination among the emerging economies. The first comprehensive civil legislation - General Principles of Civil Law - was promulgated in 1986.

- The second wave of law reform began in the early 1990s, with the decision to establish financial markets that would be increasingly open to foreigners, and continued through end-2000. This was a period of intensive law-making: more than 3,000 national laws were adopted, followed by 800 regulations by the State Council.\(^6\) The Provincial Peoples’ Congresses adopted more than 7,000 regulations. Administrative regulations approved by central and local governments exceeded 30,000. China also signed many international agreements. This massive body of law covered nine aspects of legal reform: 1) regulations formalizing market players, such as corporate law, joint ownership law, and joint ventures; 2) contract law and fair competition; 3) management of the budget and central bank; 4) social security issues such as labor law; 5) establishment of a framework for infrastructure and pillar industries such as railways, electricity, and civil aviation; 6) foreign trade law and customs law; 7) IPR such as patent law; 8) conservation of natural resources and the environment, grasslands and forestry law; and 9) monitoring of market practices, such as administrative penalties. Progress was made in improving transparency and accountability throughout the regulatory system. In 1997, for the first time, the 15th National Congress of the Communist Party of China explicitly cited the rule of law as a guiding principle in its official document, and proposed to create a comprehensive legal framework with Chinese characteristics by the year 2010.\(^7\)

- The current WTO-inspired wave of reform, which will probably continue for five to ten more years, has resulted in intense efforts to revise laws and regulations on trade, technology transfer, investments, banking, insurance, securities, taxation, customs, intellectual property, telecommunications, health, professional services and other subjects to bring them into compliance with the WTO regime and to make the adjustments required by market access commitments.\(^8\) In this phase, the Chinese government will place more attention on improving the quality, efficiency, and implementation of law-making and administration, including enforcement. SOE reforms will proceed in parallel.

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\(^6\) The primary organs of state power are the National People's Congress (NPC), the President, and the State Council. Members of the State Council include Premier Zhu Rongji, a variable number of vice premiers (now four), five state councilors (protocol equal of vice premiers but with narrower portfolios), and 29 ministers and heads of State Council commissions.


13. During the past 20 years of reform, China made impressive progress in creating the legal framework for competitive markets. One sign of success is that market mechanisms have become much more important in setting prices, increasing supply, and adjusting demand. By the end of 1999, 94.8 percent of prices\(^9\) were set by the market, while the comparable figure for 1989 was less than 10 percent. Reforms of investment and financing have strengthened the role of risk in investment and further widened channels of financing for enterprises. New regulators have been created for securities, banking, and insurance markets. China has increased its efforts to reform state-owned enterprises. The public sector remains dominant, but diverse sectors of the economy are developing side-by-side, so that the national economy is gradually becoming more market-oriented.

III. WHY IS FURTHER REGULATORY REFORM NEEDED IN CHINA?

14. A fundamental objective of regulatory reform is to improve the efficiency of national economies and their ability to adapt to change and to remain competitive. OECD countries offer a persuasive body of evidence of the positive effects of regulatory reform (see Box 1). Regulatory reform has positive effects on the demand side, by increasing consumer income, and on the supply side, by increasing efficiency and innovation. Reform that reduces business burdens and increases the transparency of regulatory regimes supports entrepreneurship and market entry. Regulatory reform can have upstream and downstream effects by easing constraints on growth. OECD country experiences demonstrate, in fact, that “regulatory reforms, within the right institutional framework, could be among the most significant of the policies aimed at alleviating poverty and inequities.”\(^{10}\) In China, the rank of regions

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<th>Box 1: The major benefits of regulatory reform in OECD countries</th>
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<td>The progress, strategies, and results of regulatory reform have been documented by the OECD in a multyear program of comparative research (see <a href="http://www.oecd.org/subject/regreform/">www.oecd.org/subject/regreform/</a>). These assessments demonstrate how, against a backdrop of basic market rules, a comprehensive approach to regulatory reform across related policy areas creates positive synergies. Liberalizing trade, empowering market competition, and reforming government institutions are mutually supportive elements of the first generation of reform. Stable macroeconomic policy, flexible labor markets, appropriate regulation of capital markets, and complementary structural reforms provide a supportive environment, and often a context of strong growth, that facilitate adjustments that follow from regulatory reform. A multi-sectoral approach also boosts gains, since the benefits of sectoral reforms are amplified when competition is vigorous in upstream and downstream sectors. The major benefits of regulatory reforms have been:</td>
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<td>• Boosting consumer benefits by reducing prices for services and products such as electricity, transport, and health care, and by increasing choice and service quality. Price reductions are due mainly to increased productivity. After reform, gains are seen in all types of productivity: labour, capital and TFP. Service quality has generally improved after reform. Concerns that reform would reduce safety are not borne out, probably because regulatory protections were not reduced in reformed sectors.</td>
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<td>• Reducing the cost structure of exporting and upstream sectors to improve competitiveness in regional and global markets. Improving productive efficiency by reducing costs for critical inputs such as communications, land, and transport services boosted the growth of Mexico’s export sector. Reform also enhances investment. Inward investment in Japan grew fastest in deregulated sectors such as distribution, financial services, and telecommunications. A supportive effect of regulatory reform is to</td>
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\(^9\) Total value of products and services ruled by market prices/total value of products and services

expand the scope for trade. In Japan, regulatory reform reduced trade tensions due to possible regulatory barriers, and improved the trading environment.

- **Reducing vulnerability to external shocks by addressing a lack of flexibility and innovation in the supply-side of the economy**, which will be an increasing constraint to growth. Dynamic effects of market-opening are usually more important than anticipated through innovation and faster introduction of new technologies, services, and business practices that multiplied benefits for consumers and produced new high-growth industries. Direct and indirect effects of sectoral reform help increase flexibility in the labour market and elsewhere. These effects allow economies to adapt more quickly to changes in technology and to external shocks, and improve the trade-offs between inflation, growth, and unemployment.

- **Helping to increase employment rates by creating new job opportunities**, and by doing so reducing fiscal demands on social security. Programs to increase competition create jobs, though costs may be borne by workers who face job losses. In many countries, positive employment effects of market liberalization will be limited without further reforms to social security systems, labor market reforms, and active measures to upskill the workforce.

- **Maintaining and increasing high levels of regulatory protections** in areas such as health and safety, the environment, and consumer interests by introducing more flexible and efficient regulatory and non-regulatory instruments, such as market approaches. Many countries are adopting international standards that, while delivering high levels of protection, are also trade friendly.

15. Reform to eliminate regulatory constraints, fill the remaining gaps and further refine regulatory regimes at national, regional, county, and municipal levels will continue to play a central role in China’s economic development. Like almost all OECD countries, China suffers high costs from many poor regulatory practices – monopolization, over-regulation, under-regulation, inefficient and outdated regulation, and overt barriers to competition -- that significantly hamper its economic performance:

- Regulatory risks are high, reducing investment and competition by increasing the cost of capital. High regulatory risks slow economic adjustment and act as a protective barrier to incumbent firms and insiders vis-à-vis new domestic and foreign market entrants. Regulatory risks are inherently higher in a transition period such as that in China, but much regulatory risk in China is systemic, not contextual, arising from economic management practices that can be improved by coordination, consultation, and better policy design and implementation. A recent American Chamber of Commerce White Paper concluded that “The business climate in China is characterized by a high degree of regulatory risk; that is, the risk of loss arising from sudden changes in law, policy, or individuals in office…the government is forced to respond rapidly to changing situations. It often does so pragmatically, to deal with short-term needs, and without good coordination among different agencies and levels of government.”

In general, the more uncertain and risky is the legal/administrative environment in which economic activity occurs, the more likely it is that aggressive rent-seeking and short-term profit-taking will replace longer-term investment in a competitive climate. That is, regulatory risk reduces the value of investment.

- Transactions costs are high due to an overly-complex, multi-layered, often arbitrary, and interventionist regulatory environment that is vulnerable to corruption. Inefficient and

opaque government formalities are a major problem for market actors. Legal rights are often not clear, and public officials have too much discretion in interpreting and applying rules. Bureaucratic difficulties remain a top challenge for 67 percent of responding companies, according to an American Chamber of Commerce survey. In the banking sector, for example, formal and informal procedures are inflexible and tailored, partly for historical reasons, to the "typical" state-owned enterprise. According to a 1999 survey, applying for a loan is a bureaucratic and costly process, and about 70 percent of firms said that paperwork was a moderate or major obstacle to their application for a loan. These kinds of problems raise the cost of production, reduce entrepreneurship, market entry, and business expansion, and hence hurt consumers and weaken competitive forces throughout the economy.

- Broad and systematic deregulation is a major task. In sector after sector, China suffers from substantial regulatory barriers to entry and competition. In other areas, regulation distorts incentives and misallocates resources. Anti-competitive regulations are sometimes used to protect SOEs. Discriminatory behavior, such as preferential buying practices by state-owned firms, is common. Anti-market barriers to competition, such as provincial protectionism, reduce incentives for innovation and efficiency. Many regulations that prohibit market entry, such as current prohibitions on companies from distributing imported products and providing related distribution services of repair and maintenance, should be eliminated by WTO accession. In that sense, WTO accession is a strong deregulation policy. The foreign ministry, MOFTEC, reports that WTO-related reviews of its 1400 laws and other regulations abolished 500, amended 120, and created 26 new regulations.

- China suffers in many sectors from too little market regulation, poor enforcement, and under-institutionalization. This has been noted in policy areas such as competition policy, consumer and environmental protection, taxation, procurement, intellectual property rights, and prudential regulation in the financial sector. The State Council has called attention to many “startling problems” in the market that are caused largely by ineffective regulatory regimes:

  Great attention must be paid to economic disorder in the market. For complicated economic, social, and ideological reasons, the economic situation in the markets of some sectors is still in chaos, mainly as follows: the markets are flooded with counterfeit and shoddy goods, activities like tax evasion, tax fraud, foreign exchange fraud and smuggling have not ceased despite repeated prohibitions, commercial cheating and debt evasion are becoming more and

13 For example, China’s banking system shows “distortions arising from the legacy of central planning and the limited state of development of the financial system as a whole, although they have been perpetuated to some degree by more recent regulatory policies…. Regulatory policy is substantially responsible for the limited array of bank products and activities…. non-state enterprises continue to suffer serious financial problems, as well as regulatory and other obstacles to their restructuring and development.” See Pigott, et al. (forthcoming 2002) Implications of Trade and Investment Liberalisation for the Development of the Banking System, OECD, Paris.
14 “In many places, government regulation discourages entry in business areas with a large SOE presence. 30% of managers report encountering market barriers of some sort (IFC, 1999)” as reported in OECD (forthcoming 2002) “Implications for the development of rural industries in China,” Paris.
more serious, financial infidelities and violations of financial discipline are ubiquitous; fraud and deceptions in tender offering and bidding are quite severe in the field of engineering construction and the qualities of projects are inferior, the disorder in cultural market has caused intense complaints from the mass, and grave and super accidents occur frequently in production and management.  

Insufficient regulatory safeguards reduce confidence in markets by both consumers and investors, and the costs will increase over time. Stiglitz has observed that China’s high growth rate masked many institutional problems, but “as returns come down, investors will look more carefully at the long-run security of their investments. This will necessitate the development of a better institutional infrastructure.” Companies that comply suffer competitive disadvantages compared to companies that ignore the laws. In utility sectors where investment and higher productivity are desired, pro-competition regulatory regimes and independent regulators are needed to curb abuses by state-owned and dominant firms, and to encourage new market entry.

- Checks and balances, such as an effective judiciary to ensure proper application of the rule of law, rights of administrative procedure, and efficient dispute resolution procedures between the state and market entities, are weak, reducing the capacity of outsiders to challenge market insiders. This weakness is particularly debilitating when state-owned firms are competing with private firms, when policies are changing faster than administrative capacities, and when corruption is high. The result is an uneven playing field, confusion about property rights, and less investment.

- Infrastructure bottlenecks, due partly to the lack of market-oriented regulatory regimes, pose a threat to future growth in China and raise production costs throughout the economy. The World Bank has noted that investment in transport, telecommunications, and energy has lagged behind that in industry, and states, “Raising capital for infrastructure improvements is a major task: at least US$750 billion will be required over the next decade. Legal and regulatory changes, such as establishing a regulatory and tariff-setting structure…would improve financing mechanisms for infrastructure projects.”

16. Many of the regulatory challenges facing China will be resolved, not by adopting more laws, but by reducing intervention and, where intervention is needed, improving the capacities of its many layers of public administration – their skills, structures, accountability for performance, relation with and understanding of markets and consumer interests, and styles of operation. Administrative practices and cultures in the public sector at national and sub-national levels often do not support market competition. Nontransparent and unaccountable administration raises investment risks and risks of capture and corruption by established interests inside and outside the public sector.

17. Even with the highest-quality laws, regulatory reform will be unsuccessful without the consolidation of the rule of law throughout Chinese governing structures. Reform laws are often excellent in content, but slow in taking effect due to weak legal and implementing institutions. As the Chinese government has repeatedly stated, reforms in China should place priority on creating

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15 State Council, “Resolution of the State Council on Rectifying and Standardizing market economy order”
17 World Bank website, “The World Bank and China”
a strong legal system and credible, effective institutions that protect market competition against abuses, establish a level playing field for new market entrants, and promote appropriate incentives for efficiency. The principles of such a legal regime are legality, neutrality, transparency, efficiency, and accountability. Protecting these principles requires positive state action, as discussed below. Box 2 explains in more detail the characteristics of the rule of law as expressed in regulatory regimes.

Box 2. Regulatory Institutions and the Rule of Law

Regulatory powers lie at the center of the system of law. In democratic systems, regulations are developed through accountable processes of rule-making through which State powers and actions are defined and limited. The regulatory system functions in accord with principles of decision-making in which both government and citizens have rights and responsibilities. Regulatory decisions are deemed to be "legitimate" precisely because they are the result of the processes of the rule of law.

Rules and laws are nothing more than operational statements of how government power is to be exercised. Regulations, by defining the use of government power, simultaneously limit government power. Zhenmin Wang points out that “This understanding of the role of law is inconsistent with traditional Chinese legal thinking, in which the law is regarded as an instrument for rulers to govern the ruled.”

Regulations should not be viewed as tools by which government controls citizens, but as compacts between government and citizens in which the behaviour of both is clearly understood and agreed upon for the benefit of society. This view expresses a great advantage of regulation over most other approaches to policy setting: regulation is typically more interactive, transparent and explicit in establishing the limits of government authority. Hence, the use of regulation within a rule of law is the exact contrary of the society described in Kafka's *The Trial*, in which citizens live in a state of perpetual uncertainty as to the exercise of state power.

The foundation of a rule of law is built from respect by both government and citizens for the legitimacy of regulation, from high-quality regulations, from openness and clarity in the regulatory system, and from processes by which regulators can be held accountable for the contents of rules. In achieving respect, communication and consultation with the public is essential.

But what is the rule of law? While there is no model of the ideal "rule of law," characteristics of the rule of law are as important to economic activity as they are to principles of fairness and justice because, by preserving fair and orderly decision-making, they build confidence among investors and consumers.

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- clarity of legal requirements and easy accessibility to rules by those affected;
- accountability for administrative decisions and actions (through clear demarcation of responsibilities and control processes to detect abuses);
- broad access to decision-making (through consultation);
- orderliness and predictability in rule-making processes;
- definitions of rationality through concepts such as "proportionality" and "reasonableness".

These characteristics of rule-making, and others important to fairness and economic decision-making, are longer-term values that do not emerge automatically. Rather, they must be built systematically into governing systems, institutions, and cultures. That is, they are products of institutional design and practice, of checks and balances within the administrative system and external to the administrative system (such as courts), and of administrative quality control capacities. Particularly if these sorts of principles are not "natural" to the governing process, or are not accepted by officials as norms of behavior, they must be carefully and explicitly built into the administrative system. This is particularly the case in transition societies, where powerful habits are opposed to the rule of law.

The degree to which governments adhere to specific principles becomes part of the general expectations, the "reputation," on investors and entrepreneurs make economic decisions. In fact, constraints imposed by the rule of law on policy-making and implementation can have a more significant impact on economic activity than do the policies themselves. In general, the weaker is the rule of law, the more uncertain and risky is the legal/administrative environment in which economic activity occurs, and the more likely it is that aggressive rent-seeking and short-term profit-taking will replace longer-term investment in a competitive climate. Entrepreneurs, for example, threatened by inconsistent application of regulations will expend capital on bribes for inspectors rather than on productive improvements or even on compliance. That "reputations" for fair and orderly regulatory processes are powerful competitive factors should not go unnoticed.


IV. REGULATORY TRANSPARENCY IN CHINA

18. Transparency is essential for regulatory quality. The OECD recommends improvements to transparency in regulatory decisions and application because it helps to cure many of the reasons for regulatory failures -- capture and bias toward concentrated benefits, inadequate information in the public sector, rigidity, market uncertainty and inability to understand policy risk, and lack of accountability. Transparency has powerful upstream and downstream effects in the policy process. It encourages the development of better policy options, and helps reduce the incidence and impact of arbitrary decisions in regulatory implementation. Transparency will be particularly helpful to the Chinese government in speeding up reforms by weakening the resistance of insider groups, reconciling various interests, and reducing conflict. Moreover, transparency helps create a virtuous circle in the market - consumers and investors trust competition more because special interests have less power to manipulate government and markets. Transparency is also rightfully considered to be the sharpest sword in the war against corruption. Regulators must work to establish a climate of confidence in which suspicions of abuses are avoided.

A. Progress on regulatory transparency in China
19. Improving regulatory transparency is a high priority in China, since it is here where China lags furthest behind OECD standards. China is not alone in facing transparency problems; in fact, regulatory transparency in OECD countries also falls short of good practices. Most regulatory transparency problems in China resemble those in OECD countries, which expands the scope for dialogue. The similarity in issues is shown in Table 1, which compares current transparency problems in OECD countries with those in China.

20. Already, China has moved steadily in the direction of increasing the frequency of consultation and the quantity of information available to market actors. In WTO negotiations, China has committed to further improving transparency in its legal system. It has agreed to publish and make readily available all relevant laws, regulations and administrative rulings of general applicability, including internal "normative documents," prior to their enforcement. Regulations and other measures will be published in a variety of ways before they are enforced, including publication in journals, newspaper, and Internet sites. Interested parties will have an opportunity to comment before implementation. In certain emergencies, opportunity for advance comment need not be provided, but a norm will never be enforceable prior to official publication. These practices are meant to be followed by all levels of government.

21. The Chinese government has not yet developed an operational strategy to implement these transparency commitments, and the WTO negotiations did not set a schedule. Cohen reasonably states that, “Implementing this enormously important change will take a few years to achieve,” but a general strategy with concrete steps for the short-term will help meet WTO obligations and speed up change. It is useful that the Chinese government has already carried out considerable education on the WTO disciplines at various levels of government. Businesses, too, are becoming aware of the WTO requirements. Once China joins the WTO, a much broader initiative should be launched based on new transparency policies and legal concepts, human resources, and tools. Here, OECD experiences and standards for transparency may be useful in providing a menu of options.

22. Complaints from trade and investment partners about inadequate regulatory transparency in China have created friction within the international trading system that, without systemic reforms, will only worsen as the Chinese economy becomes more integrated.

- A report prepared for the US Congress charges that “China's trade laws and regulations are often secretly formulated, unpublished, unevenly enforced, and may vary across provinces, making it difficult for exporters to determine what rules and regulations apply to their products.”

- Cohen has written about the days, “and there have been many, when foreign firms and their lawyers have been told that the problem under negotiation is controlled by an "internal document" that, unfortunately, cannot be shown to them.”

- In the environmental field, analysts have written that “Many electronic, loose-leaf, and hardbound references are available, but few provide the timeliness, comprehensiveness, critical commentary, and reliability required by strategic planners and legal practitioners… Although China is increasing regulatory transparency, the Chinese legal

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20 Cohen, op cit
22 Cohen, op cit.
system is historically an authoritarian system that does not accommodate the need for information required by those attempting to gauge the efficacy of their environmental compliance programs or the prudence of investment plans.  

- The American Chamber of Commerce states, “Among the international practices that AmCham-China members most wish to see implemented is transparency in government…”

23. Yet the most important reasons for improving regulatory transparency in China are not international agreements, but growing domestic expectations for more government transparency. Transparency strategies must be judged primarily on whether they meet the needs of the Chinese themselves. Increasingly, the Chinese want to participate in decisions on public policies that affect their lives. There are recent cases where public debate and consultation were important in establishing policy. During development of China’s tenth five-year development plan, the government asked for comments and ideas from the public. Changes to China’s marriage laws followed an enormous campaign of consultation. The Chinese government is disclosing more information that was until recently deemed to be state secrets. For example, an air quality index for over 40 cities is now published daily on TV, partly due to requests from the public. A new law being drafted on disclosures of the results of environmental auditing will greatly increase the information available to citizens about environmental risks they face.

24. Another dynamic pushing for more government openness is the rise of Chinese NGOs, of which there are today about 70,000 now. The term “NGO” is a misnomer, because, while some of these bodies are private, particularly those concerned with environmental protection, health care, education for poor children, women’s issues, and rural development, most are privatized state-owned NGOs, such as trade unions, the Chambers of Commerce, and the All-China Women’s Federation. To avoid creating a dual-level system of transparency in which international businesses have more access than domestic consumers, a transparency policy must clearly be designed with the capacities and expectations of these kinds of domestic audiences in mind, rather than only those of the international community.

### Table 1. Current regulatory transparency problems in OECD countries, and the situation in China

<table>
<thead>
<tr>
<th>Transparency problem in some or all OECD countries</th>
<th>Situation in China</th>
<th>OECD recommendations for its Member countries</th>
</tr>
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<tbody>
<tr>
<td>Some form of public consultation is used when developing new regulations, but not systematically and with no minimum standards of access. Participation biased or unclear.</td>
<td>Improving. Public consultation is rarely used for laws or ministerial rules, but is increasing due to domestic and international pressures. The Law-making Law, however, sets no standard procedure. Consultation is haphazard, focusing on groups that are highly vocal or are selected by the regulatory body.</td>
<td>Adopt minimum standards, with clear rules of the game, procedures, and participation criteria, applicable to all organs with regulatory powers. Use “notice and comment” more often. Reduce use of “informal” consultations with selected partners.</td>
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25. A law on pension trusts adopted in April 2001 has a chapter on private charitable trusts that provides a legal framework for these kinds of NGO organizations.
<table>
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<tr>
<th>There is a systemic tendency to exclude less organised or powerful groups from consultation, such as consumer interests or new market entrants.</th>
<th>A similar problem is seen in China. Consultation tends to be with selected pressure groups, insiders, and powerful interests. There is a high risk of excluding outsiders, less powerful or organized groups. The risks of bias and capture are high.</th>
<th>Supplement existing consultation approaches with targeted approaches for affected groups. Include “outsider” groups, such as consumers and SMEs, in formal consultation procedures. Open advisory bodies to all interested persons. Take care that new approaches such as Internet are not biased against small businesses and less affluent parts of civil society.</th>
</tr>
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<tbody>
<tr>
<td>Regulatory reform program and strategy are not transparent to affected groups</td>
<td>China’s reform programme is driven by WTO requirements. There is no transparent reform strategy outside of WTO compliance. Details of specific reforms are usually unknown before decisions are taken.</td>
<td>Develop coherent and transparent reform plans, and consult with major affected interests in their development.</td>
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<tr>
<td>Information on existing regulations not easily accessible (particularly for SMEs and foreign traders and investors)</td>
<td>Improving. Regulatory bodies are taking more care in publishing regulations and laws. The OECD has noted, however, that “regulations are often not made available to those subject to them.” Problems have come up in several fields. For example, companies are sometimes asked to pay taxes that they did not know existed.</td>
<td>Creation of centralized registries of rules and formalities with positive security, use of one-stop shops coordinated across the government, use of information technologies and searchable databases to provide faster and cheaper access to regulations.</td>
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<tr>
<td>Legal and technical text is hard to understand. The complexity and opaqueness of modern regulation far outstrips the capacities of businesses and citizens to understand their obligations.</td>
<td>Laws and regulations are sometimes ambiguous in China, and their meaning can be difficult to understand.</td>
<td>Adopt practices of plain language drafting, more consultation, and market testing of regulations.</td>
</tr>
<tr>
<td>Complexity in the structure of regulatory regimes, and a lack of transparency in ministerial mandates and roles of regulators</td>
<td>This is a key problem in China. Overlapping, multiple, and unclear jurisdictions among institutions reduces the transparency of regulations. Duplication at the national level, unclear responsibilities, lack of coordination, double supervision, and redundant approvals have caused complaints in many sectors.</td>
<td>Codify laws, rationalize institutions, and adopt clear standards and procedures for decision-making.</td>
</tr>
<tr>
<td>National-subnational interface – more coordination and communication needed on interactions</td>
<td>Relations between levels of government are a major problem in China, causing problems with implementation, protectionism, and inconsistency in interpretation.</td>
<td>Establish clearer competences between levels of government; authorize coordinating mechanisms to resolve inconsistencies; checks on inconsistencies such as judicial review.</td>
</tr>
<tr>
<td>Lack of transparency at regional, state, and local levels</td>
<td>Transparency becomes worse at lower levels of administration. A major task of promoting good transparency practices in sub-national governments lies ahead.</td>
<td>Adopt identical transparency procedures at regional and local levels as at national levels to ensure integrated regulatory regimes.</td>
</tr>
<tr>
<td>RIA is never or not always used in public consultation</td>
<td>RIA is not used in China, reducing the capacity for public consultation and</td>
<td>Integrate RIA at an early stage of public consultation.</td>
</tr>
</tbody>
</table>
## Inadequate Use of Communications Technologies

| Dialogue. | More laws and regulations are available on the Internet than before, but not in authoritative form. The American Chamber of Commerce recommends that all circulars be posted on a consolidated government website. | Use Internet more frequently in making drafts and final rules available. |

## Lack of Transparency in Government Procurement

| Dialogue. | Procurement at regional and lower levels is often tied to local suppliers. Criteria for procurement are often either illegal or unclear. Laws recently adopted and under development attempt to correct this problem. | Use Internet more frequently in making drafts and final rules available. |

## Regulatory Powers Delegated to Non-Governmental Bodies such as Self-Regulatory Bodies Without Transparency Requirements

| Dialogue. | This is increasingly a problem in China as bodies with regulatory powers compete in the market. | Develop clear guidelines on the use of regulatory powers by non-governmental bodies, and extend all transparency requirements to them. |

## Too Much Administrative Discretion in Applying Regulations, and Use of Information Instruments Such as Guidance

| Dialogue. | Clearer authorities and interpretations are needed in China at the implementation stage. The American Chamber of Commerce recommends that regulations and regulatory guidance issued by all government agencies should be objective and unambiguous, and that internal standards should be published or eliminated. The use of neibu, an administrative guidance communicated directly to concerned persons, is troublesome, and incompatible with a market system. | Strengthen administrative procedures and accountability mechanisms. Eliminate use of informal regulations such as administrative guidance and instructions. |

## Inadequate Use of International Standards

| Dialogue. | Encourage the use of international standards government-wide, and track the use of uniquely national standards. |

## Lack of Clear Standards in Licensing and Concessions Decisions, Such as in Telecommunications

| Dialogue. | Demonopolization of these sectors is proceeding, and standards for market entry are clearest in those sectors such as telecommunications and finance that are of most interest to foreign investors. Continued progress is needed. | Reduce the use of concessions and licenses to the extent possible by moving to generalised regulation, announce clear criteria for decisions on concessions and licenses, use public consultation for changes in existing licenses and concessions. |

## Rationale for Decisions of Regulators Not Transparent Enough

| Dialogue. | Chinese administrations have been criticized for failing to make public the reasoning used in interpreting laws and regulations. | Apply RIA to independent regulators, ensure that independent regulators also use public consultation processes with regulated and user groups. |

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Source: OECD reviews of regulatory reform in its Member countries

### B. What is Regulatory Transparency?

25. 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. Transparency practices take many different forms in OECD countries, but OECD countries have identified several concrete practices that they deem essential to reach an acceptable level of regulatory transparency:

- Notification in advance of intent to regulate to increase confidence
- Public consultation with all major interested parties on draft regulations before decisions are made
- Publication of decisions in easily accessible form (increasingly, this means electronic dissemination of regulatory material)
- Registers of regulations and formalities with positive security
- Legislative codification to ensure a coherent legal structure
- Plain language drafting to improve readability, certainty, and clarity
- Clarification and simplification of regulatory responsibilities within the public administration, including across levels of government, so that responsibilities are clear
- Public explanations of the rationale for regulatory decisions
- Controls on undue regulatory discretion by standardized procedures for making, implementing, and changing all regulations and decisions with regulatory effects such as licenses and permissions
- Elimination of informal regulatory instruments, such as unpublished guidance and instructions, that have coercive effect.

26. OECD governments have invested considerably in recent years in making more information available to the public, listening to a wider range of interests, and being more responsive to what is heard. Consultations are becoming standardized and the amount of information is increasing, particularly as regulatory impact analysis is made accessible. A greater variety and number of interest groups are becoming involved. Older and inefficient forms of consultation that were vulnerable to capture and bias, such as restricted advisory bodies and special relationships with interest groups, are being replaced with more open and flexible consultations open to all major interests. New information capacities are permitting the establishment of centralized databases with search engines, electronic filing, and institutional re-engineering through one-stop shops.

27. Domestic trends toward more transparency in OECD countries have been reinforced by a widening set of international trade-related disciplines on regulatory transparency, such as the GATS requirements. Regulatory transparency is also improved by the growing use of international standards, which reduce search costs and increase certainty for consumers and market players.

C. Two reform priorities in China: public consultation and accessibility

28. In the short-term, two high-priority transparency issues in China are i) improving public consultation in the regulatory development phase, and ii) accessibility to regulations after they are adopted. Consultation is the active seeking of the opinions of interested and affected groups. It is a two-way flow of information, which may occur at any stage of regulatory development, from problem identification to evaluation of existing regulation. It may be a one-stage process or a continuing dialogue.
29. Concepts of open access to government legal drafts are not widely accepted in the Chinese administration. Often, in fact, draft laws are secret, and consultation is a crime. Access is limited to those special interests with good contacts inside the administration. The usual approach to public consultation has been for the National Peoples’ Congress to adopt a general law first. The government will then wait for six months to a year before issuing implementing regulations. If there are serious complaints in the interim, the implementing regulations may try to take the concerns into account. This approach is highly inefficient and unsuitable for a market environment. Because consultation occurs too late in the policy process to assess market impacts, alternative approaches, and the need for regulation, it increases market uncertainties and the costs of mistakes. This approach also limits access to those interests that are most organized and most ready to confront the government, which may not be the interests that are most important. Market risks increase because clarifications are based on implementing regulations that can be withdrawn at any time, while the original law is unchanged. Hence, this approach is simultaneously unlikely to identify major errors and to be responsive to public views, is vulnerable to capture when it does respond, and is unsatisfactory to investors in any case due to the high cost of confrontation.

30. China’s legal framework for new forms of public consultation is slowly developing. Since 1999, the Chinese government has had a policy on the use of hearings, under regulations issued by the State Commission of Planning and Development, but this mechanism has not been used much and has not worked well when it was used. Similarly, hearings are recommended for national price determinations under the Price Law. After developing a price reform plan, the department should determine if a hearing should be held, and invite selected participants representing consumers, producers, and experts. Producers must give reasons for price increases and answer questions. On the basis of the comments, the department writes a report. But this procedure was not followed in the case of the deeply unpopular increases in train ticket prices just before the 2001 spring holidays. The price increase was approved by the State Council based on a plan provided by the SDPC. No hearing was held, and the government was soundly criticized for the failing.

31. In an ad hoc fashion, other legal obligations for consultation are being created. National guidelines for water tariffs now require public consultation if tariffs are increased. Participatory mechanisms are being developed for rural poverty reduction strategies: the land administration law amended in 1998, which addresses relocation after expropriation, requires public consultation on the relocation plan, requires the plan to be made public, and establishes a redress system that ultimately leads to the judiciary. In the telecommunications sector, regulatory changes to prices must be preceded by hearings that are open to the public. MOFTEC has also been experimenting with public hearings in cases that involve trade issues.

32. A key development in improving legal transparency was China’s long-awaited, but flawed, Law on Legislation that came into force on July 1, 2000. Under the law, legislation must support “economic construction” while upholding socialism. The Law applies to the enactment, amendment and repeal of regulations issued by national and lower levels of government (military regulations have different requirements). The Law affirms the hierarchy of regulatory instruments and establishes general obligations for public consultation and publication. Regulations must be created, amended, and repealed in accord with statutory limits of authority and procedures. During the process of designing regulations, relevant government organizations and the relevant

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26 Socialism is defined as “democratic dictatorship by the people; the leadership of the Communist Party; Marxism-Leninism, Mao Zedong’s thought and the theory of Deng Xiaoping; and market reform and opening up”.
The public should be consulted through workshops, meetings, or other fora. The instruments covered by the Law are:

- laws (fa lu) adopted by the National People’s Congress, in which case consultation is to be done by the relevant special committee of the National People’s Congress, by the Legal Committee of the National People’s Congress, and by an administrative body of the Standing Committee of the National Peoples’ Congress.

- regulations of the State Council (chin jun fa gui)

- administrative regulations (gui jiang) issued by committees of the State Council, national ministries, provinces, counties, and municipalities, and by other bodies such as the People’s Bank of China regions, by counties, municipalities.

- Independent and autonomous regulations issued by special economic regions and minority groups with rule-making rights.

33. The Law-making Law has not, however, improved the quality or frequency of public consultation. It does not set minimum standards for the design of public consultation or the involvement of major affected interests, for the time period of consultation, or for the treatment of comments from the public. It does not set sanctions or remedies for failure to consult, except suggest that regulations should be repealed or revised if procedures are not followed, nor does it establish any oversight of compliance. The WTO agreement on transparency also seems flawed, because it requires that interested parties have an opportunity to comment on regulations only before they are implemented. This kind of consultation is consistent with the usual Chinese process, but, as noted above, is far too late in the regulatory process to support any genuine discussion of the need for regulation or alternative approaches. It is unlikely to produce the benefits expected in terms of regulatory efficiency, reduced regulatory risk, or wider access.

34. China should move toward more standardized consultation procedures that are more open and systematic. The design of public consultation procedures must recognise the specific cultural, institutional and historical context of China, as these factors are crucial in determining the effectiveness and appropriateness of particular approaches. An approach that works well in one country might worsen transparency in other countries. Hence, it is not possible to take a prescriptive view of what consultative tools should be used or of how and when they should be applied. For example, in China, due to the need to move forward with legal reforms without substantial delay, efficiency is vital. Regulators will need a system that collects as much relevant information as possible, as quickly as possible. To reduce the risk of capture, wide access to major interests is important, though targeted consultation procedures might be suitable where the affected interests are small in number, for example, notice and comment could be used in a limited number of cases to assess specific trade impacts. To enhance flexibility and tailor consultation to the audience and the issue, OECD countries use a mix of approaches, as shown in Box 3.

35. Flexibility in approach is needed because regulatory issues differ greatly in impact and importance, scope and number of affected groups, information needs, timing of government action, and resources available for consultation. Yet the OECD has recommended to its Members that a framework of minimum standards is needed across the whole of the government to provide consistency and confidence. Consistency in consultation approaches enhances the quality of the process in three ways. First, minimum standards provide clear benchmarks to all parties as to whether consultation has been properly undertaken, and so protects all interests. It provides clear guidance for regulatory policy-makers. This enhances confidence in the consultation process, and
reduces the risk of capture by well-organized groups. 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. There will be a faster learning process for both regulators and interest groups. Third, adopting a consistent process permits better co-ordination for regulatory initiatives across policy areas. Allowing ministries significant discretion could endanger this, either because of a lack of understanding of the requirements of a good consultation process or because of capture of the ministry by specific interests. A consistent process is a key quality control mechanism.

36. 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. This could include the extension of time limits, more intensive information provision, further iterations of consultation or specifically tailored opportunities for dialogue. Similarly, the need to depart from a standard process may arise because of the nature of the issue being regulated, such as the need to prevent opportunities for strategic behavior, requirements to meet inter-jurisdictional obligations and agreements, etc.

<table>
<thead>
<tr>
<th>Box 3. Methods of public consultation in OECD countries</th>
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<tr>
<td>OECD countries use several major approaches to public consultation:</td>
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<tr>
<td>Informal consultation includes all forms of discretionary, ad hoc, and unstandardized contacts between regulators and interest groups. It takes many forms, from phone-calls to letters to informal meetings. Access by interest groups to informal consultations is entirely at the regulator's discretion. Informal consultation is carried out in virtually all OECD countries, but its acceptability varies tremendously, since it is vulnerable to capture and corruption, and risks “locking out” important interests that are not a part of the ministry’s usual network.</td>
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<tr>
<td>Circulation of regulatory proposals for public comment. A straightforward way to consult is to send regulatory proposals directly to affected parties and invite comments. This procedure differs from informal consultation in that the circulation process is more systematic, structured, and routine, and may be based in law, policy statements or instructions. Groups on the circulation list expect to receive drafts of important regulations. This flexible procedure can be used at all stages of the regulatory process. Responses are usually in written form, but regulators may also accept oral statements, and may supplement those by inviting interested groups to hearings. The circulation-for-comment procedure is among the most widely used forms of consultation. The Internet is increasingly being used for this purpose. Circulation-for-comment is a relatively inexpensive way to solicit views from the public and, being targeted, it is likely to induce affected parties to provide information. It is flexible in terms of timing, scope and form of responses. The weakness of this procedure is deciding who will be included. Circulation for comment is likely to be unsatisfactory in dealing with new and shifting interest groups, since it increases the risk of neglecting key interests.</td>
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<tr>
<td>Public notice-and-comment. Public notice-and-comment – publication of draft legal texts for public scrutiny and comment -- is more open and inclusive. Publication permits all interested parties to be aware of the regulatory proposal and to comment. Notice-and-comment was first adopted in the United States in 1946. By 1998, 19 OECD countries were using notice and comment in some situations. Procedures vary widely. The U.S. model is the most procedurally rigid: comments are registered in a formal record and regulators are not permitted to rely on factual information not contained in this public record. Notice and comment is, theoretically, more open and inclusive than other approaches. The openness of notice-and-comment procedures means that policymakers are more confident that significant views have been heard and that the risks of policy failure are known. However, many countries have found that levels of participation are low. Participation depends on the ease of response, the effectiveness of the publication, the time allowed for comment, the quality of the information provided, and the attitudes and responsiveness of regulators in their interactions with commenters.</td>
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</table>
Public hearings. A hearing is a public meeting on a regulatory proposal for interested groups. Regulators may also ask interest groups to submit written information and data at the meeting. A hearing usually supplements other consultation procedures. By 1998, 16 OECD countries used public meetings. Hearings are, in principle, open to the public, but effective access depends on how widely invitations are circulated, its location and timing, and the size of the meeting room. Public meetings provide face-to-face contact in which dialogue can take place between regulators and wide range of affected parties. A disadvantage is that they are likely to be a single event, which might be inaccessible to some interest groups, and require more planning to ensure sufficient access.

Advisory bodies. The use of advisory bodies to improve the flow of expert advice and information to regulators is the most widespread approach to public consultation in OECD countries. Advisory bodies are involved at all stages of the regulatory process, but typically early to define positions and options. There are many different types of advisory bodies -- councils, committees, commissions, and working parties. Their common features are that they have a defined mandate or task within the regulatory process (either providing expertise or seeking consensus) and that they include members from outside the government. Their relationships to regulatory bodies can vary from reacting to a regulator's proposals to acting as a rulemaking body. Advisory bodies may carry out extensive consultation processes involving hearings or other methods.

Most countries combine different consultation tools throughout the regulatory process. Informal consultation and circulation for comment approaches are likely to be used to test the views of limited numbers of key players at an early stage, while an ad hoc advisory group of experts may be created to gather reliable data before moving to notice and comment or public hearing processes which allow input from the general public.

37. The second priority in improving transparency in China is ensuring accessibility by regulated entities to regulations. This is the aspect of regulatory transparency most closely related to the rule of law. Yet it is this aspect of transparency that receives the most criticism in OECD countries. Regulatory transparency requires that governments effectively communicate the existence and content of all regulations to the public. The 1995 OECD Recommendation asks if regulations are accessible to users and recommends that: “the strategy for disseminating the regulation to affected user groups should be considered.” Concerns about growing regulatory complexity, fragmentation, inconsistency, unreadability, and problems with identifying relevant regulations are heard throughout the OECD area.

38. China, which faces similar concerns, has made considerable progress in improving accessibility to national laws and regulations after adoption. Publication of laws and other regulations in newspapers has improved, particularly for regulations affecting foreign trade, and the WTO obligations will place even tighter disciplines on publication. The two major sources for regulations are publications by the National Peoples’ Congress and publications by the State Council of all important decisions by itself and by ministries. Its list of regulations is on its website. MOFTEC publishes trade-related regulations on the Internet (www.moftec.gov.cn). Ministries also produce their own publications. Foreign Investment Service Centers compile many laws for foreign investors. There are also private searchable databases. Each year the government translates key laws into English, but a continuing concern is that the Chinese and English versions are not always identical.

39. Accessibility worsens at lower levels of government, where regulations are sometimes not published at all, although some provinces such as Shanghai do well in making their regulations known.

40. As in China, the traditional OECD responses have been to simply publish new laws and regulations in official gazettes and to require regulating ministries and parliaments to keep copies
of all current regulations available for inspection by the public. These mechanisms, while important, have come to be seen as inadequate. Regulatory inflation and rapid regulatory change mean that there is an increasing need for new efforts to permit the public to identify quickly the complete set of regulatory requirements. OECD countries use six tools to make regulations easier to find and understand:

- **Legislative codification.** Rationalisation and clarification of complex legal regimes that have accumulated haphazardly over the years often require comprehensive legal codification. Codification can improve juridical and substantive quality, and by doing do can improve accessibility and clarity.

- **Centralised regulatory registers.** The 1997 OECD Report to Ministers recommends that governments: “Create and update on a continuing basis public registries of regulations and business formalities, or use other means of ensuring that domestic and foreign businesses can easily identify all requirements applicable to them.” Efforts to count and register regulations accomplish are also useful internal management tools. Registering the number of regulations assists co-ordination among regulatory authorities by ensuring a better and more systematic flow of information within the public administration. This reduces the risk of overlapping and inconsistent regulation. In most countries that have established central regulatory registers, the rule of “positive security” has been adopted. This means that only rules that are included on the register can be enforced. Positive security has two advantages. For the user, positive security provides certainty that, if all rules on the register have been met, full compliance with the law is met. The regulator cannot demand compliance with rules not contained on the register, and the register is the authoritative source where any dispute arises as to different variants of a rule. Positive security also provides strong incentives for regulating bodies to ensure that all rules are registered and thereby ensures the integrity of the register. In China, it may be possible to create such a centralized registry of provincial, country, and municipal regulations. The Law on Law-making already requires that all regulations be registered. If a municipality makes a new regulation, it must register it with the county. Counties must register their regulations with provincial governments. Provincial governments register with the State Council. The Standing Committee of the People’s Congress has a registry of all State Council regulations, all autonomous regulations, and all provincial regulations. These existing registration procedures could be tied to publication procedures, and compiled into public databases with positive legal security.

- **Plain-language drafting of regulations.** The need for plain-language drafting of regulation has long been recognised. Governments need to ensure that regulatory goals, strategies, and requirements are articulated clearly to the public. This requires that legal texts be able to be comprehended by non-experts. A number of OECD countries have had plain language drafting policies for many years, and most of these provide guidance on how to implement these policies. The 1995 OECD Recommendation recognised the importance of plain language drafting when it asked “Is the regulation clear, consistent, comprehensible, and accessible to users?” and recommends that “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.”

- **Publication of future plans to regulate.** Publication of lists of proposed future regulations is another strategy for improving transparency. Around 20 OECD countries currently have publicly accessible registers of forthcoming regulations. Publication promotes openness in the regulation-making process. Participation of interested parties in
consultation is improved. Lists of plans to regulate also provide a means to review and co-ordinate regulatory policymaking.

- **Electronic dissemination of regulatory documents.** Advances in information technology, in particular improved data storage and the rapid development of the Internet, provide opportunities to improve the dissemination of regulatory material. As has China, most OECD countries have adopted some form of computerised dissemination of regulation, and this practice is quickly expanding. A wide variety of official publications, legal texts, administrative information, administrative forms and public procurement tenders is now available on the Internet. Access to the information is in almost all cases unrestricted and free of charge. One problem is that relevant information may be spread over different databases due to inadequate co-ordination between levels of government. In some cases, “information overload” may limit transparency gains if key data is not made readily accessible by adequate search capacities. Limited access to the internet is also a factor, at least in the short term: while rapid growth is continuing, even the countries with the greatest internet penetration boast no more than about one quarter of the population with internet access.

- **One-stop shops and regulatory streamlining.** The “one-stop shop” creates an easily accessible source of information for businesses on regulatory requirements, and should be accompanied by a determined effort to eliminate unneeded and costly approvals, licenses, and permissions, of which there are many in China. Some progress is apparent. The city of Beijing, through a determined programme, cut its administrative approvals by 40 percent in 2000. Search costs for business could be greatly reduced by a complete list of regulatory requirements from a single source. The one-stop shop usually focuses on licences, approvals, and permits, and produces a list of such requirements applicable to businesses. It can also provide application forms and contact details. In some cases, inter-governmental co-operation has allowed licence and permit requirements for all levels of government to be issued from a single point. Lists of applicable laws and lower-level rules are also now available in some countries, while delivery mechanisms have broadened to include CD-ROM copies of the database for purchase, access in public spaces such as libraries through “information kiosks” and use of the Internet. China has no one-stop shop at the national level, but Hong Kong, China has completed a government-wide stock taking exercise of business related regulatory activities and has established a computerised central database.

V. **CAPACITIES TO CHOOSE EFFICIENT REGULATORY SOLUTIONS**

41. One of the most important capacities of a quality regulator is the ability to assess the market impacts of a regulation before it is adopted. The 1995 Recommendation of the Council of the OECD on Improving the Quality of Government Regulation emphasized the role of regulatory impact analysis (RIA) in systematically ensuring that the most efficient and effective policy options were 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. The 1997 OECD Report on Regulatory Reform recommended that governments “integrate regulatory impact analysis into the development, review, and reform of regulations.”

42. 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. In its WTO negotiations, too, China has agreed that its sanitary and phytosanitary laws will be based on science, which requires a concrete assessment of need based on empirical analysis.

43. The Chinese government has some capacity through several mechanisms to assess potential regulatory impacts:

- 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 organize, for example, investigating teams to assess reforms, as was done for the banking system. The role of the Development Research Center (DRC) of the State Council is particularly important here, since the DRC employs qualified economists who have carried out many market analyses on potential regulatory changes.

- 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.

- Improved public consultation procedures will permit firms to provide the government with better information on the impacts on their business decisions.

44. These practices provide a good basis for a more systematic approach to regulatory impact analysis. Yet there is room for considerable improvement in assessing market impacts and the scientific basis for regulations, and to incorporate those assessments into public consultation procedures. Investors in China cite many cases where important laws have been adopted without a clear understanding of market impacts, and had unintended negative impacts on investment and market development:

- A regulation on encryption first came to the industry’s attention when a notification was published in the newspaper. No assessment of commercial issues or effects on IT development in China had been done, and the rule (requiring that Chinese encryption be placed on all software and hardware) would have greatly disrupted trade in computers and software. After an angry reaction from foreign firms, the government decided to clarify the rules.

- The statistical bureau decided to reduce market research activities for security concerns, which would have severely restricted information to companies. Yet the bureau had greatly underestimated the costs in terms of marketing, product innovation, and investment into China. The bureau clarified the rule later.

- Recent GMO regulations released without assessment or consultation would have negative trade effects that were not anticipated. Trade partners hope that the implementing regulations will clarify the rules.
Regulations on used equipment tried to control the problem of unreliable equipment. But the regulation was too broad and costly, and would have required a special license in every case where used equipment was imported.

In each of these cases, a simple RIA would have identified the major market impacts, and avoided confusion, embarrassment, and cost to China’s credibility. There is nearly universal agreement among OECD countries that RIA, when it is done well, improves the cost-effectiveness of regulatory decisions and reduces the number of low-quality and unnecessary regulations. RIA also improves the transparency of decisions, and enhances consultation and participation of affected groups. The Chinese government may wish to investigate implementing a more systematic approach to RIA, perhaps by expanding the roles of the DRC or other expert bodies such as the Chinese Academy of Social Sciences in regulatory development. Implementation of a fully functioning RIA system is a long-term task, involving the progressive development and dissemination of specific expertise, the refinement of implementation and control mechanisms and the achievement of a cultural change in the administration, at the political level and among stakeholders outside government. However, the OECD has developed an extensive database of country experiences and good practices that could accelerate the process in China.

Box 4. Various methods used in regulatory impact analysis

Benefit-cost analysis (BCA) is comprehensive and highly effective in addressing efficiency issues, comparing alternatives, and dealing with time preferences. It is suitable for major regulations with significant economic impacts, because it is usually the most expensive approach.

Cost effectiveness (or “cost-output”) analysis is a partial BCA, as it makes no attempt to convert benefits to monetary terms, instead evaluating them in terms of other metrics: degree of risk reduction, number of lives saved, etc. CEA is most useful where the range of realistic alternatives is confined to different means of achieving similar outcomes. It is less useful where policy proposals have a number of significant benefits attached to them, as CAE does not allow an additive approach to be taken to their evaluation. It is also of limited usefulness in answering the “threshold” question of whether regulation is required or desirable.

Compliance cost analysis is narrower still in scope, as it does not attempt to quantify benefits. The analytical requirements are further reduced and focused on costs, which are generally more easily estimable. Compliance cost approaches are of particular value where the overriding concern is whether a proposed burden is feasible, or proportionate, or reduced to the minimum.

Business (or small business) impact analysis is a partial variant of compliance cost analysis. It focuses on the costs to a particular sector, whether business generally or SMEs in particular. For much regulation, by far the largest cost burden is borne by the business sector, suggesting that this analysis will identify most direct costs. It will not capture costs to consumers, governments or other non-business groups. This approach is often used where the key concern of regulatory reform policy is that of limiting or reducing business impacts.

Fiscal or budget analysis is also a partial compliance cost analysis, considering only the budgetary implications for government of the regulatory proposal, usually a quite small proportion of total costs. This form of analysis should, however, yield quite precise results and may be particularly useful where a potentially high cost compliance and enforcement strategy is a key element of a proposal, or where multiple levels of government will bear costs.

Risk assessment attempts to quantify risks (involving consideration of hazards and consequences) to enable a rational judgement to be made as to whether government action is justified. This method is helpful in answering the “threshold” question of whether to regulate, and also contributes to policy choices about the desirable degree of risk reduction. Complications with its use derive from observed variation between “real” and “perceived” risk, or between society’s acceptance of risks of different kinds.
VI. REGULATORY PLANNING, COORDINATION, AND ACCOUNTABILITY

46. Accession to the WTO opens the door to broader and deeper reforms in China, extending beyond specific treaty obligations, that require longer-term planning, coordinated institutional reforms, and sustained commitment. The OECD has arrived at conclusions similar to those of the World Bank, that is, structural reforms should be based on a longer-term, holistic approach to problems, rather than focusing on incremental changes to individual sectors and policy decisions. While this seems sensible, it vastly complicates reform, and is hard for governments to do. This is directly relevant to many of the issues arising in China, where the transition to market-led growth is evolving so rapidly that it is straining the capacities of lagging or obsolete regulatory institutions to perform important functions such as repairing market failures and maintaining policy effectiveness.

47. The central question addressed in this section (and the rest of this chapter) is this: What new or strengthened regulatory institutions in China will increase the social welfare potential of market-led growth? Two institutional reforms that would contribute to the effectiveness of policy reforms are i) strengthening of a central capacity to coordinate a government-wide program of regulatory reform, develop strategic planning, evaluate results, and keep reforms on track against resistance, and ii) rationalization of fragmented regulatory institutions across the government.

48. The 1997 OECD report recommended that governments “create effective and credible mechanisms inside the government for managing and co-ordinating regulation and its reform.” Country experiences show that a well-organised and monitored process, driven by “engines of reform” with clear accountability for results, is important for the success of the regulatory reform policy. Most OECD governments have established central regulatory co-ordination and management capacities with government-wide responsibilities. These central regulatory reform offices include the U.S. Office of Management and Budget, the Office of Regulatory Review in the U.K. Cabinet Office, Korea’s Regulatory Reform Commission, and the Regulatory Review Office in the Productivity Commission in Australia. There is no corresponding function in the

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Risk analysis considers risks as explicit trade-offs (do offsetting risk increases occur as an indirect result of a policy choice and are these significant to its effectiveness?). It has the merit of taking a wide view of consequences but has larger analytical and data requirements.

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29 In proposing reform approaches, it might be useful to examine experiences, not only in the OECD, but also in the most developed parts of China. Since 1996, for example, Hong Kong, China has been carrying out a “Helping Business” Program whose goal is to make Hong Kong, China attractive to domestic and overseas businesses. The Program cut red tape, deregulated and transferred services out of the public sector to the private sector where appropriate market conditions prevailed. The aim of the Program is to eliminate and simplify regulations which hinder Hong Kong, China’s ability to innovate and grow, and provide a more open and fair environment to achieve growth and improve competitiveness, while maintaining the necessary standards and disciplines. The “Helping Business” Program is being run with advice from a Business Advisory Group which comprises of a mix of prominent local businessmen and senior government officials. In April 1997, Hong Kong, China established The Business and Services Promotion Unit (BSPU), a organisation dedicated to assume responsibility for the “Helping Business” Program.
national Chinese government. In several countries, national legislatures have established committees for continuing oversight of regulatory reform activities.

49. There are three reasons why the Chinese government may want to consider strengthening oversight and responsibility for regulatory reform at the center of the national government, such as in the State Council, and in the National People’s Congress.

50. First, mechanisms at the center for managing and tracking reform inside the public sector are needed to keep reform on schedule against delay and resistance. Certainly, the primary responsibility for reform must be at the level of the ministry, department, or regulator, where the expertise lies and where policies are formulated. Yet it is difficult for ministries to reform themselves, given pressures from vested interests. Promoting reform across years, levels of government, and multiple institutions requires the allocation of specific responsibilities and powers to agencies at the centre of government to monitor and promote progress as a whole. This will be necessary to ensure compliance with government-wide policies, such as new transparency disciplines, for example.

51. Second, it would be desirable if China took a more systematic approach to establishing the institutional and legal infrastructure to promote competition. Successful reform depends on clear reform plans, long-term and credible commitment, and continuing investment in building strong institutional capacities in governments. A multi-year, coordinated program, if implemented, in itself strengthens market confidence, and boosts long-term investment.

52. Managing a broad, coherent reform program over several years is one of the most difficult tasks of governments, yet those countries that have succeeded, such as Hungary and Mexico, have shown the greatest gains in economic development. Economies in transition can particularly benefit from a strategic view of the reforms needed for the evolving market environment. A broad reform policy can help establish priorities across a wide range of reforms, keep reform moving to produce results more quickly, identify reform gaps, identify emerging risks of market failures during the transition due to regulatory inadequacies, and suggest synergies, linkages, and sequencing across reforms. Strategies are needed to help ensure that short-run regulatory decisions are consistent with broader longer-term policy objectives, so that regulatory change does not occur in an ad hoc manner. Conversely, reforms that are fragmented, episodic, or compartmentalized are likely to be incomplete, inconsistent, and vulnerable to capture by vested interests. This increases the risks of disappointment and costly policy failures. The risks of incoherent reforms increase in rapidly changing markets.

53. A lack of strategic planning in China reduces the benefits of the many reforms underway. Almost all reforms now underway in China are sectoral in nature. The major reforms are driven by external pressures – primarily financial risks and WTO negotiations – rather than by strategic planning to establish the foundations for growth over the next 5 to ten years. If regulatory reforms are ad hoc collections of sectoral market-opening measures designed to satisfy foreign critics, market liberalization will be slow, unsatisfactory, and prone to failure. Strategic planning would reduce the risks of market failures in the transition period, and would be consistent with Chinese values of stability and risk-aversion.

54. Over the longer-term, the evolution of the national regulatory system can be speeded up by the right management structure. Dynamic change can be driven by central units with longer-term, cross-cutting views. The central regulatory reform units should be responsible for continuing adaptation and improvement of regulatory systems as external conditions change, information comes available, and new problems arise.
55. Third, accountability for results is poor. Ministries must report to the National Peoples’ Congress on progress in implementing the five-year economic plan, but in practice there is little evaluation of the concrete effects of laws and other regulations once they are adopted. Evaluation tends to be crisis-driven, stimulated by major disasters and media attention. Each ministry may internally monitor the impacts of its policies, but these results are usually not reported to the State Council or made public. A system of periodic reporting to a central body such as the State Council and the National Peoples’ Congress, perhaps supported by independent assessments by expert organisations such as the Development Research Council, would help detect regulatory failures faster and permit timely mid-course corrections. The State Council’s Economic and Financial Committee is reputedly becoming more active in monitoring the performance of the autonomous regulatory bodies in the financial sector, which is a useful step.

56. The design of a central regulatory reform unit is highly contextual, and depends on the legal and power relationships between various parts of the governing structure. The rapid pace of pace in China has tended to reduce the capacity of the national government for longer-term planning. For example, the former State Commission on Economic Reform, which once prepared economic reform plans in the State Council, has become the Administration Office of Economic Reform, and its new functions are more concerned with short-term planning and crisis management. However, China has several bodies that might, working together, serve as the basis for more concentrated oversight of regulatory reform.

- The Office of Legal Affairs in the State Council already plays a central role in drafting legislation, overseeing procedures, reviewing substantive and technical quality, and monitoring regulatory activities at national and provincial levels, and has a number of expert policy committees. It also holds the registry of regulations produced by the national and provincial governments.

- The State Economic and Trade Commission in the State Council has a role in coordinating between ministries to ensure that there are no contradictions in trade affairs. This coordinating role could be expanded to include other regulatory matters.

- The WTO Leading Group at the level of the State Council has played an important coordinating function for the ambitious regulatory reforms needed to meet WTO obligations. A new office in MOFTEC that monitors compliance with WTO may be a useful ally in monitoring reform efforts, though its powers over other ministries are limited.

- The Development Research Center could assist in assessing and monitoring change, but it has no policy authority.

- In the National People’s Congress, the Standing Committee has the scope and power to function as an effective oversight body for general regulatory reform plans. The Legislative Affairs Office also has broad monitoring responsibilities that might be useful in a more proactive and policy-oriented function. The role of the National Peoples’ Congress in driving structural change is interesting. More and more congressmen come from private sectors and provincial administrations. Perhaps as a result, in recent years, the Congress has become more active in proposing new legislation and changes to laws. Provincial congresses, too, are more active. Delegates to the Congress can initiate investigation into a specific law, which they are doing more frequently, perhaps three or four investigations each year. Their results can be publicized in the media and on their
website, and used for future revisions of legislation. This investigative function, if systematized, could be extremely valuable in upgrading the quality of law in China.

- In several OECD countries, central bodies are supported by other reform-minded bodies, such as ministries of finance, and competition and trade authorities that develop advocacy capacities. Competition authorities in about half of OECD countries have roles in reviewing regulatory proposals for their potential impacts on market entry and competition. When a competition body is created in China, it should have strong advocacy powers and capacities. Private sector bodies, such as advisory bodies or private initiatives, can also be helpful and should be encouraged.

57. Another reform that would contribute to the effectiveness of policy reforms is rationalization of fragmented regulatory institutions across the government. It is often difficult to identify not only the regulations in China, but also the regulators. The Chinese government has explicitly recognized this problem, and the State Council has ordered: “The division of responsibilities among various governmental departments shall be clear-cut, avoiding the overlapping of functions which may cause repetition or slips in management and thus harm the market economy.”

58. It is hard to escape the impression that, in many sectors, regulatory reform will be difficult or impossible without radical reform of the government institutions that regulate. Many of China’s administrative bodies have regulatory powers derived or delegated from multiple and not always consistent laws. Institutional confusion often mirrors confusions in the underlying legal frameworks. Regulations are fragmented, both vertically and horizontally, across multiple agencies at national and sub-national levels, each with unclear and overlapping powers. Many regulatory powers are allocated based on historical and archaic duties, such as price controls (State Council) and SOE oversight (Ministry of Finance), perhaps working under different laws, rather than on the design of a coherent, transparent, and efficient regulatory regime. In the distribution sector, for example, regulators at the national level include the Government Commission for Economy and Trade, the Internal Trade and Market Bureau, the Commission for Planning and Development, the Price Bureau, and a quality and standards bureau under the State Council. Provincial governments have similar institutions. There is usually little co-operation and communication between regulators working on the same sectors, and no one has the authority to resolve conflicts.

59. Some regulators also have commercial interests in the regulations that they promulgate. For example, a law adopted in 2001 contained a new standard for operating systems for changing a keystroke to a Chinese character. The regulator who designed the code is also the owner and receives royalties from its use.

60. As reform progresses in China, it will be important to rationalise these government structures. New regulatory institutions should be designed around the principles of simplicity, accountability, transparency, efficiency, and neutrality, with particular attention given to avoiding conflicts of interest and rapidly identifying and resolving any inconsistencies between regulators. These kinds of institutional changes are not easy, since they usually face deep resistance by the institutions being reformed and by their clients. OECD countries have found that the central regulatory reform body and a comprehensive strategy are useful in overcoming sectional interests and jurisdictional battles in developing new regulatory bodies.

30 State Council, People’s Republic of China, “Resolution of the State Council on Rectifying and Standardizing market economy order”, Beijing
VII. ENFORCEMENT OF REGULATIONS WITHIN THE RULE OF LAW

61. China is rich in rules, but, as in most OECD countries, adopting a rule is easier than implementing it. The quality of the Chinese law enforcement system is increasing as the national government takes steps to ensure fair and equitable enforcement, most notably in those policy areas where investors have the greatest interest. Accountability is getting better, partly due to more scrutiny by the media and complaints from foreign firms. The National Peoples’ Congress has begun to carry out high-profile missions to monitor enforcement at local levels, as it did for the securities law in 2001. Ministries are using their current downsizing as an opportunity to upgrade the quality of their staffs, and consistency of enforcement seems to be improving in areas such as customs, where all staff are employed by the national administration rather than local governments. In a few key areas such as banking, the national government has re-centralised regulatory authorities to ensure a consistent and neutral regime China-wide.

62. Judicial review is still a weak link in China in the overall structure of interlocking institutions that should establish the incentives and pressures for high-quality administrative action. Cohen notes, however, that the current situation should be understood in light of the significant progress achieved over several years in reforming the judiciary:

“A court system that now handles well over five million cases a year has been erected from the shambles of the Cultural Revolution, as has a nationwide organization of prosecutors. The legal profession has been revived and includes about 120,000 practitioners plus large numbers of government legal specialists and in-house counsel to PRC companies. The China International Economic and Trade Arbitration Commission (CIETAC) has become the busiest international commercial arbitration organization in the world, and virtually every Chinese city of any size has its own domestic arbitration commission eligible to handle foreign-related as well as domestic disputes. Civil, administrative and criminal procedure codes and an arbitration law have been enacted to guide the operation of these burgeoning institutions, and laws governing the conduct of judges, prosecutors and lawyers have also been adopted. Specialized court divisions have been created to deal with intellectual property matters and other foreign-related economic disputes… There is widespread hope…that WTO entry will boost the country's prospects for establishing a genuine legal system - not merely rule by or through law but a rule of law to which the Party and government as well as all other people and entities are subject.”

The quality of economic judgments from Chinese courts is improving, such as decisions settling disputes over contested Internet domain name. The Supreme People's Court has sought to educate the courts about the new tasks that will arise from China's entry into the WTO. In the WTO process, China has committed to improving judicial review of administrative actions relating to trade matters, and this reform could assist in broader reform of the administrative review system.

63. Yet there is room for considerable progress throughout the entire enforcement structure. Application and enforcement of China’s laws and other regulations have lagged behind the establishment of national policy reforms, imposing unnecessary costs and uncertainties on the market, and allowing scope for unethical behaviour. Essential coordination between the public administration, the judiciary, and the police in enforcing laws does not always work well. Some commentators have indicated that a double standard exists in the enforcement of some

regulations, differentiating SOEs from foreign firms and new market entrants. Complaints about over-enforcement, inconsistent enforcement, and under-enforcement are common. Poor enforcement and hence low regulatory compliance threatens the effectiveness of policy reforms and undermines confidence in the rule of law.

64. Improving regulatory enforcement is a multi-faceted, political, and longer-term task that goes beyond regulatory reforms into consolidation of the rule of law, but useful progress could be made by certain legal and institutional reforms. In addition to larger governance issues such as accountability and relations with interest groups, which this paper does not address in detail, there are many transitional and structural reasons for unpredictable enforcement in China:

65. **Multiple layers of administration.** China’s regulatory enforcement system is highly decentralised and poses formidable coordination and consistency issues. The degree of decentralisation in regulatory enforcement in China is, in fact, greater than that in any federal country in the OECD, and even greater than that for European Union laws enforced by its member states. China’s national government is quite small by OECD standards. 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, including investment project approval, safety standards, tax compliance, labour and environmental regulations. For example, parallel to the national Ministry of Health, each province has a Bureau of Health. The State Administration of Industry and Commerce has local branches in all provinces and cities, which are responsible for approving businesses and issuing business licenses. Many local inspectorates must also be funded locally, further diminishing control from the center. Even customs posts are financed by local governments or self-financed from fees. The flow of information between levels of government is insufficient, and national ministries usually do not know how vigorously the laws are being enforced, and have little authority to monitor or take corrective action. Local governments that do not implement laws face few penalties.

66. **Local protectionism and capture of the enforcement process.** The following section in this paper discusses the problem of opening China’s internal market by reducing regulatory barriers to intra-China trade. Powerful, sometimes corrupt, interests at local levels often have strong influence on regulatory enforcement decisions affecting competitors.

67. **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.

68. Despite reforms, judicial review of administrative actions is still very limited in China compared to OECD countries. As a result, China’s enforcement personnel are remarkably free

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32 It is claimed, for example, that “safety inspections" of electronic products are often more rigorous and expensive for imports than for domestic products. Testimony of Dave McCurdy, President, Electronic Industries Alliance, Before the United States-China Security Review Commission Regarding Bilateral Trade Policies and Issues between the U.S. and China, August 2, 2001

33 By contrast, ministries in OECD countries are subject to various kinds of independent administrative courts and other forms of external judicial review. In France, for example, there are many control mechanisms, such as a network of Administrative Tribunals headed by the Council of State and the
from external judicial accountability under principles of administrative law. This is partly due to
the fact that Chinese courts are not independent (despite the Constitution’s guarantee of
independence), but are in practice part of the local government and party. Judges have no tenure,
and are usually appointed, promoted, compensated and removed by local party and government
officials. They have strong incentives to give more weight to local interests and protections than
to legal requirements. Cohen states that the courts are actually under the control of the local Party
Political-Legal Committee, which coordinates their conduct with that of the local prosecutor's
office, police and justice department. Most judges have little or no legal training, although this is
improving.

69. The lack of effective judicial review in China combined with expanding market needs
for clearer rules encourages a range of alternatives:

- Arbitration procedures in CIETAC are increasingly built into private contracts. While
  such arbitration has clear advantages over the current court system, the fact that larger
  and foreign firms are increasingly using arbitration mechanisms to avoid long judiciary
  procedures may discriminate against smaller and domestic entities who rely more on the
courts for redress.

- An administrative review system is being reformed to expand and speed up review of
  administrative decisions. In 2000, almost 70,000 individual cases were accepted for
  review.34

- Development of informal and sometimes corrupt relationships between businesses and
  public officials (the famous Chinese guanxi networks) is frequent. Businesses use their
  private contacts inside the relevant administration to resolve problems. Fear of disrupting
  these essential relationships with local officials, and perhaps of retribution by angry
  officials, discourages businesses from formally challenging decisions in court.

- The National People’s Congress may provide quasi-judicial reviews. The 2000 Law on
  Law-making specified procedures by which the Congress’ Standing Committee can be
  asked to review and invalidate administrative actions that violate Chinese law, and makes
  it possible to seek a determination by the Standing Committee that government actions
  violate the Constitution (China does not have an independent constitutional court).

- The State Economic and Trade Commission operates as a kind of ombudsman in trying to
  mediate complaints of businesses about problems at the provincial and regional levels.

- As part of the larger oversight strategy for regulatory compliance, the State Council is
  trying to strengthen what it calls “the social supervision system” consisting of “trade self-
discipline, media supervision and mass participation.” The State Council has resolved to
  “make full use of the functions of structures like chambers of commerce and trade
associations, etc. to educate, supervise and constrain enterprises to consciously abide by

Mediator’s Office, which are judicial bodies with the task of judging alleged administrative abuses against
citizens.

34 Ling Li (2001) Presentation on China’s Regulatory Reform in Foreign Trade and Investment, at the First
Workshop of the APEC-OECD Co-Operative Initiative on Regulatory Reform, 19-20 September 2001,
Beijing.
the laws and rules. Further strengthen public supervision through mediums engaged in television, broadcasting, newspapers, periodicals and networks and the like.\(^{35}\)

70. The courts will only gradually assume the oversight role needed to improve certainty and due process for the public. It is particularly important in China in the coming years for the government and courts to provide an effective and practical judicial infrastructure for dispute settlement, since the government’s role as mediator and arbitrator among interests will gradually diminish as its economic intervention is reduced.

71. *Sanctions and penalties may not deter violations.* A further problem is the enforcement of judgements and the collection of penalties. Court decisions are often not enforced promptly or at all\(^{36}\). Sanctions are sometimes disproportionately low compared to the profits of violating the law.

72. *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. The build-up of regulations in the 1990s (30,000 new administrative regulations) has also made the problem worse. Contrary to what might be expected, reliance on more detailed regulations does not avoid delegation of broad discretionary powers to regulators because rules tend to concentrate on procedural details (obligations) rather than on setting down substantive criteria for decisions (policy results). In OECD countries, an accumulation of procedures actually increases the arbitrary nature of administration, because it becomes impossible to know or comply with all requirements, leaving administrators to decide which rules to enforce, and how. Paradoxically, the Chinese legal system seems to be characterised by both too much detail and too much discretion.

**Box 5: Enforcement of intellectual property rights in China**

Much of the criticism about enforcement practices in China focuses on the protection of intellectual property rights (IPR). The contents of China’s IPR laws meet global standards, but enforcement against powerful incentives to cheat has proved a continuing problem. According to representatives of the business community, companies cannot rely on law enforcement authorities to enforce the law. Instead, they hire private detective agencies to collect evidence of violations, which they turn over to the police for action. Judgements against violators are not always implemented. Sanctions may be either criminal or administrative, but criminal sanctions are rarely applied and the administrative sanctions are not sufficient to deter violations.

To address these issues, investors have called for China to establish a coordinated IPR enforcement policy among levels of government, strengthen IPR enforcement agencies, and reform the judicial system to ensure that foreign firms can obtain access to effective judicial relief.

73. The regulatory reforms discussed in this paper will support the trend toward better enforcement in China. Certainly, a determined program to eliminate the many unneeded and costly approvals, licenses, and permissions would go a long way to resolving the problem.

\(^{35}\) State Council, “Resolution of the State Council on Rectifying and Standardizing market economy order”

\(^{36}\) Cohen notes that “the record of Chinese courts in enforcing their own judgments and orders is amazingly poor.”
74. However, full resolution of the interlocked institutional and structural weaknesses that undermine legal enforcement will require reforms that are well beyond the scope of this paper. Development of a truly independent judiciary is essentially a political reform, since the courts are currently an extension of the power of the party and the government. Cohen calls for “systemic court reform,” that includes transferring powers to appoint, promote, compensate and dismiss judges to the Supreme People's Court; granting judges security of tenure; and prohibiting the interference of Party, as well as government and other influences, in judicial decisions. The newer OECD countries that have overhauled their judicial systems and created procedures for independent review of administrative practices might be of interest to China in its own reforms (see Box 6 on judicial reform in Hungary).

75. Based on the experiences of OECD countries, another tool that the Chinese government might wish to consider in controlling excessive administrative discretion is elaboration of administrative procedure laws. China has already constructed a framework of administrative law, including an Administrative Litigation Law (1990), the State Compensation Law (1994, to respond to grievances of unlawful official conduct), the Law on Administrative Punishments (1996), and the Law on Law-making (2000, as discussed above). Similarly, many OECD countries are adopting or amending administrative procedure laws to improve the orderliness of administrative decision-making, to define the rights of citizens more clearly, and to detail standard procedures for making, implementing, enforcing and revising regulation. By adopting these practices in legislative form, they are effectively transformed into rights that the public can assert. By strengthening citizens’ rights and controlling arbitrary regulatory actions, these acts are fundamentally changing the relationships between the public administration and the citizen. The importance of these kinds of reforms for improving certainty and reducing regulatory risk in the market, while enhancing accountability, can hardly be over-estimated.37

- In some countries, such as Italy and Spain, the silence-is-consent or tacit authorisation rule switches the burden of action entirely: if administrators fail to act within time limits, the citizen is automatically granted approval.

- Japan used its 1994 administrative procedure law to attack the problem of administrative guidance by forbidding the use of coercive guidance and establishing transparency standards for voluntary guidance.

- In the United States, the cornerstone of the regulatory system is the 1946 Administrative Procedure Act, which established a legal right for citizens to participate in rulemaking activities of the government on the principle of open access to all.

- Reforms to the Mexican Federal Law of Administrative Procedures in 1996 established a broad framework of principles for regulatory quality and measures to enhance administrative transparency and consistency. These include rights of public access to information possessed by regulators, a clearer administrative appeal mechanism, time limits for authorities to respond to a public request for information or authorisations and minimum criteria to be followed by public officials during an inspection.

- In Hungary, the 1987 Act on Legislation established the limits to legislative action, defined the different types of regulatory instruments, regulated the process of preparing them, distributed the responsibilities of the different bodies involved in the process, and set out other important aspects such as the use of public consultation. The Act was

37 Jacobs, Scott (1999), op cit
heavily revised in 1999 and 2000 to improve these administrative controls, with an emphasis on legal harmonisation with the European Union.

- A series of amendments to the 1958 Administrative Procedure Law was the platform in Spain to increase accountability and transparency across the public administration, that is, to move away from the authoritarian traditions of the Franco regime to new relations between government and citizens. The powers of the Spanish central government organisation were redefined to separate the political from the administrative levels throughout the administration.

- Korea has adopted in recent years several significant pieces of legislation providing controls on administrative discretion. The Administrative Procedure Act of 1996, which took effect in January 1998, sets out general requirements for making and implementing regulation, establishes the Administrative Appeals Commission to hear a wide range of administrative disputes and limits the use of informal “administrative guidance”. The Administrative Disclosure Act seeks to make transparent the reasons underlying administrative decision-making in a range of areas. The Basic Act on Administrative Regulations, as the primary legislative driver of regulatory reform, includes additional procedural requirements for law-making (including Regulatory Impact Assessment and consultation) and emphasises transparency. Resistance to this legislation within the administration was strong. The Administrative Procedures Act was passed only after a decades-long battle against major opposition from the bureaucracy, which worried about the limits on administrative discretion implied by greater transparency and stricter procedures.

76. Administrative procedure acts are flexible tools. They can have wide scope, including requirements for:

- Making regulation: Consultation requirements at different stages of regulatory development, preparation of regulatory impact assessments; consideration of alternative instruments; publication requirements; dates of entry into effect; duration (including automatic “sunsetting”) and disallowance.

- Implementation and enforcement: Accessibility of regulations; rules on incorporated material; general rules on extent and exercise of administrative discretions, including publication of objective criteria for judging applications, time-limits for decision-making, publication requirements for administrative decisions, requirements to give reasons for rejecting applications.

- Revision and amendment: Application of general procedural rules to amendments of existing regulation, rules on updating of incorporated material such as international standards.

- Appeals and due process. Hearing procedures before disciplinary actions for violation Rights of regulated entities in appealing rules and administrative actions such as enforcement and sanctions.

Box 6. Reform of the judiciary and appeals mechanisms in Hungary
Reforms in Hungary have concentrated on establishing a more independent and efficient judiciary. A clear separation between the executive and judicial branches was established. In particular, the courts became independent from the Ministry of Justice and a specific management body for the judiciary, called the National Judicial Council, was set up to execute a larger budget to modernise the courts, to organise training programmes and to oversee judges and take disciplinary actions. To improve efficiency and rapidity throughout the system, the government added a new level to the three-layer system involving local, county and supreme courts. The new level of courts inserted between regional courts and the supreme court will hear appeals in cases against decisions of the local or regional courts.

These reforms respond to the numerous criticisms of the past few years concerning the slowness and cost of the system. Usually, a plaintiff needs two or three years for a first decision; and this can extend to five years in complex cases. Consequently, an important backlog of cases accumulated in the courts, particularly at the local and supreme level. More independent management should also tackle the other two major weaknesses of the system. The first concerns the material conditions of the courts which often lack support-staff and technical facilities. Second, the new National Judicial Council should be able to focus on the long term challenge of improving judgements through better selection, training and skills of judges with skills to work in a market economy.

Hungary has a rich array of check and balance mechanisms in which constitutional bodies protect citizens against administrative abuses, and in particular regulatory excesses. As a complement as well as a substitute to its administrative and judicial system, a plaintiff in Hungary can use three other venues and institutions to complain against a regulation or a regulatory decision.

The Public Prosecutor’s Office is entitled to examine the legality of an agency’s decisions and may initiate a formal motion to review the decision. If the agency does not agree with its findings, the Public Prosecutor may turn to court or submit motions to the Constitutional Court for rulings on constitutional issues. An important point is that the Prosecutor’s role goes beyond a pure supervision of legality, as he or she can act as a public attorney in the course of judicial proceedings. An advantage compared to the judiciary review is that it can intervene at an early stage, to investigate a potential unlawful action or practice and recommend redress. Another interesting feature is that the Public Prosecutor has local branches in addition to its headquarters in Budapest.

The Ombudsmen perform activities quite similar to those of the Prosecutor but are mainly concerned with violations of constitutional rights. They are appointed by the Parliament and report exclusively to it. Special ombudsmen have been set up to protect certain constitutional rights, such as the rights of ethnic minorities and data protection. The Ombudsmen can also act independently in their designated field. Based on past complaints, the Ombudsmen have suggested changes to laws and regulations in their annual report to the parliament.

The Constitutional Court has played an outstanding role since the change of regime. As in most countries, a specific procedure permits individuals to directly appeal to the Constitutional Court against alleged violations of their rights by a law or regulation. Additionally, if a court rules that a certain procedure violates the Constitution, it has the right to suspend such procedure through an injunction and turn the case to the Constitutional Court.

VIII. OPENING THE INTERNAL MARKET IN CHINA

Opening the internal market in China could well boost China’s overall growth as much or more than opening to external trade. China’s domestic market is inefficient in part because it is highly fragmented, as is noted in most of the reports in this OECD study. Regulatory barriers to
the movement of goods and services across regional,\textsuperscript{38} provincial, county, and even urban jurisdictions create enormous hidden costs by weakening competition, increasing production costs, and reducing quality of products and services. Such barriers affect markets for many products and services including construction, automobiles, chemicals, retailing, and procurement. Some local officials apparently will even fine a restaurant if it does not serve local beer. The American Chamber of Commerce recently concluded, “There are very few truly national markets but rather an assortment of local markets regarding each other suspiciously.”\textsuperscript{39} Some foreign investors believe that local protectionism is now increasing as subsidies decline and competition intensifies.

78. These internal barriers will become even more troublesome as China opens to international trade and investment, and internal barriers become violations of international treaties subject to international mediation.

79. Fragmentation of the internal market in China arises from several sources. It is a result of the enforcement issues discussed above, in which the legal system has been captured by local interests; of the self-sufficiency doctrines of the Mao years; and of under-financing of local governments who use approvals, fees, and fines to raise revenues. Not all of the local protections are illegitimate, however. Pressure is high on local officials to find jobs for the unemployed, and the easiest method is to protect local producers. A fully competitive internal market in China might exacerbate regional economic inequities by accelerating structural change in the least efficient and poorest regions. China’s overall market structure is characterized by low national concentration and regions containing duplicate enterprises operating at less than minimum efficient scale.\textsuperscript{40} Chinese policy places a high priority on assisting the accelerated development of the central and Western regions.\textsuperscript{41} A fragmented internal market in China is, therefore, part of the policy of stability and regional development, and reforms must be carefully designed.

80. No study has been done of the costs to China of its fragmented internal market, but evidence suggests that the static and dynamic costs are high:

- Without market-opening reforms, the OECD report on banking in China concludes, “Enterprise restructuring efforts, the development of SME, and formation of new enterprises [will] continue but [will be] still seriously hampered by government intervention and regional protectionism. Partly as a result, financial performances of the SOE sector [will] improve only slowly, with a large segment of enterprises still making losses or only marginal profits after liberalisation.”\textsuperscript{42}

- In the electricity sector, the State Development Planning Commission found that “the potential benefits from inter-provincial and inter-regional trade have not been aggressively pursued… In any instance…in which the size of the market is constrained

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\textsuperscript{38} In its economic plans, China has implemented a regional administrative level intermediate between the central and provincial levels.
\textsuperscript{39} American Chamber of Commerce White Paper
\textsuperscript{41} The share of national GDP of China’s Eastern region is 2.2 and 4.4 times of the Central and Western regions, respectively.
by considerations other than technical and economic, one can anticipate, at a minimum, higher maximum prices and greater price volatility than would otherwise be the case.\footnote{State Development Planning Commission, China (2000) Report of the “Workshop: New Waves of Power Sector Reforms in China,” with the assistance of the World Bank and The Energy Foundation, 9-10 October 2000, Beijing, pp 9 and 11.}

\begin{itemize}
\item The report on competition policy in this study notes that, “…to realise the benefits of the opening of its borders, it is important that China take further steps to deal with existing and anticipated anticompetitive restrictions within its borders.”\footnote{OECD (forthcoming 2002) “Competition Law and Policy – Realising TIL’s “First Round Impacts” and Enhancing its Contribution to Economic Growth, Efficiency, and Social Welfare”, Paris}
\end{itemize}

81. Standardization and centralization of regulatory powers is not the right answer to local protectionism in most policy areas. This is partly a question of practicality in a country of China’s size. Cohen raises a cautionary note here: “Will it be practical or even wise to attempt to enforce uniform administration of rules in different parts of a country possessed of such diverse regional conditions?”\footnote{Cohen (2001), op cit.}

82. It is recognizes the political realities of China’s decentralised structures. The State Council is maintaining decentralised decision-making in economic matters, with corrective oversight by the State Council where reforms are not progressing well. It has resolved that it will

\begin{quote}
Institute the system of full responsibility by the governor of a province (chairman of an autonomous region or mayor of a municipality), governments of provinces (autonomous regions, municipalities) shall organize and lead the work of rectifying and regulating the economic order of their markets. Governments at all levels shall define the key points for the work of rectification, make specific arrangements and strengthen the supervision and inspection. For regions that have not done the work of rectification well, and for regions where the economic order of the markets is confused and can not be rectified effectively for a long time, responsibilities of key responsible persons and related responsible persons of the local governments shall be investigated and affixed according to the law and the discipline.\footnote{State Council, “Resolution of the State Council on Rectifying and Standardizing market economy order”}
\end{quote}

83. Just as important, China’s decentralised governing structures can be beneficial for development. China’s provincial, county, and urban system has advantages in speeding up regulatory reform, because it introduces flexibility and establishes positive incentives to compete on the basis of good economic management. Not all reform is top-down in China – many beneficial reforms are bottom-up. The two provinces who were the top recipients of foreign investment by end-1999 -- Shanghai (a special economic zone since 1980) and Guangdong (among the very first of the provinces to open to foreign investment in 1979) – are precisely those with reputations for being better managed, less corrupt, and more transparent. The system of special economic and autonomous regions further increases flexibility and stimulates innovation, experimentation, and demonstration projects with substantial benefits for reform. The opening of coastal cities and special economic zones has been extraordinarily successful: these areas have around one eighth of the Chinese population and one seventieth of the total area in China, but...
their collective GDP was 20% of China’s total GDP in 1999, and they claimed around 40% of FDI.\(^{47}\)

84. Consumer sophistication will erode protected local markets as consumers demand more choice and quality, but China will not simply grow out of this problem. Expansion of foreign trade after China’s WTO accession is not likely in itself induce a large increase of interregional trade.\(^{48}\) Many of the issues are institutional and structural, and concrete steps are needed.

- The regulatory reforms discussed in this paper – improved transparency and consultation, impact analysis, strategic planning and oversight, clearer rights and more precise requirements in administrative procedures, and market-based regimes for utility sectors -- will help reduce internal barriers by disclosing conflicts, improving coordination, and identifying costs earlier. These good regulatory practices are needed in regions, provinces, counties, and municipalities to avoid undermining the benefits of regulatory reform at the national level. Assessments of the capacities of sub-national governments to implement good regulatory practices would be useful.

- To the extent that internal barriers arise from weaknesses in the legal system, consolidation of the rule of law will also gradually eliminate many barriers.

- National laws will not change practices quickly, but continued construction of a market-based legal system hostile to local protectionism is necessary, and is in fact proceeding. A tendering law adopted in 1999 for public construction projects mandates open and competitive bidding for all contracts over a low threshold (implementing regulations have not yet been issued), and a law under development will open all other government procurement to competitive bidding. New State Council regulations “Prohibiting the Implementation of Regional Barriers in the Course of Market Economy Activities” came into force in April 2001. These rules basically assert the rule of law by prohibiting “units and individuals…from obstructing, or interfering with, entry into the local market of non-local products or ‘construction services’ in any manner in violation of laws, administrative regulations or State Council regulations…thereby restricting fair competition.” The regulations allocate responsibility among government departments for correcting types of protectionist conduct, and contain penalties for officials engaging in protectionist conduct. Remedies for injured parties are meagre: units and individuals have the right to reject regional barrier conduct, and the right to report such conduct to the appropriate authorities. In September 2000, amendments to the Product Quality Law came into force. Among other requirements, they prohibit the practice of excluding products produced outside the local area (or administrative system) if the goods meet quality standards and introduce a system of review for parties dissatisfied with the results of spot checks.

- Reform has been fastest where clean lines of national control are established. In those few key cases where regulatory regimes have become too decentralized in China to operate efficiently in national markets, more centralization should be considered, as was done for the banking sector, customs, and price controls. The vertical restructuring of banking supervision under the People’s Bank of China has effectively stopped cases


where local governments ordered banks to make loans to support local projects, blocked capital flows out of the area, and interfered with insolvency proceedings. (Although local governments still distort capital flows by guaranteeing bank loans to enterprises with state ownership, which reduces their costs relative to private firms.)

- Where regulatory powers and problems are shared between levels of government or between governments at any one level, more co-ordination and information-sharing are essential to successful reform. The State Council is, in fact, encouraging more coordination in enforcement: “Cooperative action and coordination shall be made between all regions and departments in investigating trans-regional law-violating activities.” The centralized regulatory registry recommended in this paper would be a substantial step toward more transparency in China’s sub-national rules. Italy’s experiences with its State-Regions Conference, a permanent body composed of the Prime Minister and the Presidents of the regions, might be interesting for China. Italy’s Conference has been increasingly engaged in preparing and negotiating, promoting and monitoring agreements on co-ordination and activities between the centre and the regions. Italy’s central government and its regions have co-operate through a series of administrative and regulatory relationships, such as obligatory sharing of information, joint proposals, requests for advice, conventions, consultations, and even sharing of offices.

85. Like China, OECD countries – notably federal countries and regional groupings such as the European Union – have struggled with the tensions of decentralized regulations within national and global markets. They have also tried to balance local diversity and innovation with the need for national standardization. Although China’s domestic situation is unique for historical, geographic, and cultural reasons, OECD experiences with the many strategies needed to create efficient unified markets across multiple legal jurisdictions might offer concrete solutions to China in easing internal regulatory barriers. European single market institutions such as the European court for internal trade issues might be adaptable. Concepts of commercial passports and mutual recognition might be used to avoid the situation where businesses must obtain individual licenses and approvals in every jurisdiction where they operate.

VIII. BUILDING REGULATORS IN CHINA FOR THE UTILITY SECTORS

86. Reform in China is beginning to address the utility sectors, which are “among the last remnants of the planned economy.” Substantial improvements in efficiency and service quality are possible in these sectors. To avoid dangerous market failures, however, it is imperative that liberalization of China’s utility sectors proceed on the basis of a thorough consolidation and rationalization of regulatory institutions. The results of reforms in the utility sectors will be largely determined by the quality of its regulatory institutions set up to guide the multi-year reform process within the general policy framework. Transforming the structure of a network-based industry, such as electricity and communications, from monopoly to competitive markets

50 State Council, “Resolution of the State Council on Rectifying and Standardizing market economy order”
requires a sophisticated and evolving regulatory structure. Timing and sequencing of policy changes can be crucial, as can flexibility in meeting changing technologies and competition.

87. In reform of these sectors, much attention is paid to the issue of the independent regulator (called “autonomous regulator” in this paper). In China, a step toward more autonomous regulators was made in 1988, when regulatory powers were moved out of the line ministries, who were responsible for production, into the SETC in the State Council. The regulators in the SETC are not autonomous regulators by OECD standards, though, because they are still incorporated directly into the policy apparatus. Another step was taken in 1998, when more autonomous regulators were established for banking, securities and insurance, although still under the State Council.

88. The reasons for setting up autonomous regulators -- to shield market interventions from political and commercial interference and to improve transparency, expertise, stability, and commitment to optimal long-run policy -- are well known. In China’s legal system, these are particularly attractive objectives. There is little doubt that, compared to regulatory functions embedded in line ministries without clear mandates for consumer welfare, autonomous regulators are a sound improvement. In OECD countries, the impacts of market-opening have been greatest in precisely those sectors -- financial services and telecommunications -- where autonomous regulators are most prevalent (though the causality is not clear).

89. Yet things are not that simple. There is no single area of regulatory reform where more bad advice is given than in the design of autonomous regulators. As many countries have discovered too late, there is no single right institutional model for these institutions. Institutional designs must be contextual, and based on flexibility and responsiveness. In part, this is because the surrounding institutional and historical context is unique for each country. The “independent commission” model as it is used in the U.S. system cannot be easily transplanted to other countries due to different constitutional structures between the executive and the legislative, differing roles for parliamentary and judicial oversight, differences between systems of governance, and different traditions of policy-making and public debate. In designing autonomous regulators, reformers have many options to consider. Scott Jacobs has identified eleven major design issues and specific strategies used in OECD countries, which are listed below in Table 2.

90. Moreover, an over-emphasis on the autonomous regulator is a mistake. Autonomous regulators are not a panacea, and governments tend to rely too much on under-equipped and unsupported autonomous regulators to carry out tasks that are beyond their capacities. What is needed is a larger system approach to institutional redesign, since a regulatory regime is an interdependent system. 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.

91. Reformers in China should adopt the concept that autonomy is the result of a well-designed mix of incentives, authorities, and procedures involving a range of actors. 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. This question of the right checks and balances can be answered only if we take into account the larger system in which the autonomous regulator operates. Institutional design, accountability, and transparency should be

designed to work in an integrated fashion in the Chinese context. This will help put more emphasis on overall credibility and market results.

92. To establish the right checks and balances, the Chinese government should design for each utility sector at least two institutions, and establish a series of procedures. It should design:

- A regulatory policy body within the relevant ministry or State Council body that is responsible for the broad policy framework for market liberalization, network investment, restructuring, stranded costs, and financing of universal service obligations
- An autonomous regulator that is functionally separate from the ministry, the State Council, and producers in terms of staffing, budgets, and major regulatory decisions, including licensing, pricing and cost modeling, access, and consumer protection.

It should create procedures that ensure:

- Efficient and rapid dispute resolution
- Full consultation with market actors before a decision is taken
- Public disclosure of the rationale for decisions
- Ethical conduct of regulators
- Accountability for decisions against the criterion of maximizing consumer welfare through efficient markets

93. Credibility among market actors (investors, producers and consumers) is the single most important characteristic of an effective regulator, particular as new market actors such as foreign investors and consumers enter the market. The degree of credibility materially changes the risks of market entry and the behavior of market actors. High credibility boosts market outcomes, while low credibility undermines or blocks the benefits of markets. Credibility comes both from design and performance. The behavior of the regulator is not known in advance, but the regulatory institution and procedures can be designed explicitly to establish and maintain credibility, and reduce the risks of behavior that reduce credibility.

94. In China, there is substantial confusion in the regulatory regimes for the utility sectors. China is moving to break up monopolies, separate the public administration from commercial interests, and permit more market entry and competition in these sectors, but is still relying largely on marginal changes to regulatory institutions and regimes created for state-provided services. The policy interests of the state are not separated clearly enough from the interests of commercial entities. As a result, there is an increasing gap between institutional styles, capacities and regulatory frameworks, and the actual needs of competitive markets.

95. As discussed above, oversight of sectors is usually divided among several bodies at the national level: price controls are set by the SDPC, investments approved by the SDPC or other bodies, and other regulatory decisions by the relevant committee of the State Council and the responsible ministry. In some sectors, bodies with commercial interests still hold regulatory powers. Regulatory powers are also wielded by sub-national levels of administration. In some sectors such as electricity, the national market is divided into several regional markets governed by different bodies. There is little capacity to coordinate and resolve conflicts and inconsistencies between these various regulatory and policy bodies.

96. A good example of the need for more attention to institutional reform is the energy sector. China has committed to modernize its energy sector, which is inefficient and unable to
prevent periodic power shortages. Reforms are in progress. The power sector, dominated by six regional integrated firms, has been corporatized and decisions are increasingly taken on a commercial basis. Private ownership of power assets was legalized in the 1995 Electricity Law. Significant foreign investment has flowed into China’s electricity sector: by 2000, foreign funds accounted for 10 percent of China’s total power investments through a variety of contractual arrangements such as BOT, TOT, and joint ventures. The State Power Corporation of China (SPCC), established in 1997, holds through a holding company the ownership rights of the provincial power companies. Investments above a threshold are approved by the central government, but are financed out of equity and debt. Prices are moving closer to costs, particularly in the richer coastal areas. SPCC is still a single buyer, but reforms plan to permit larger consumers to choose their suppliers (which would liberalize prices for those consumers), to integrate the regional markets, and to unbundle generation, transmission, and distribution.

97. Yet there are no corresponding decisions on the design of institutions to oversee the sector during this complex transition. Currently, the SDPC regulates prices for end-users and approves contracts with provincial-level units of the SPCC and all investment projects. The State Economic Trade Commission has established a small new body on electricity power that regulates on the basis of the industrial reform plan. The Ministry of Finance oversees SOE operation and hence their profits. The SPCC (which is owned by the State Council) is responsible for grid maintenance and regulates access to the grid, becoming both regulator and owner. Another serious problem is regional protectionism. Provincial corporations are the most important market entities and routinely deny access to transmission to protect local generation. An unfortunate but predictable result is that IPPs face increasing, not decreasing, discrimination in gaining access to the grid. Each of these regulatory bodies operates under a separate legal source and with different objectives, because there is no unified law for regulation of the sector. Expertise in identifying the correct market solutions is low throughout the regulatory system. Furthermore, there is no competition authority in China to support the regulator in enforcing competition principles against abuses of dominance. A weak judiciary will find it difficult to enforce decisions against incumbent firms.

98. The Development Research Center has prepared a set of recommendations for institutional reform. It suggests that at the national level a centralized, independent regulatory body – the National Electric Power Regulation Commission – be established, with corresponding regulators at the regional levels. It recommends preparation of a unified law and principles to guide the regulator. Management of the SOEs operating in a competitive market is a problem as yet unresolved, but is critical since their accounting standards and profits will help determine the nature of regulatory decisions.

99. Other sectors offer a mixed picture. The telecommunications sector is under the supervision of the Ministry of Information Industry, which combines regulatory and policy functions, but which has spun off the operator into a commercial firm. Regulation of the railways is combined in the Ministry of Railroads, who is both owner and regulator.

100. A fundamental redesign of the regulatory institutions in the utility sectors should be based on international expectations. Standards of good regulatory practices are increasingly the benchmarks for judging investment risk, and hence the level and quality of investment. OECD countries have not reached any consensus on good designs for autonomous regulators, but their experiences, particularly where reforms have had several years to mature, will reduce the risks

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54 See State Development Planning Commission, op cit.
that China would put into place the wrong regulatory system, which would slow structural adjustment and impose costs for many years.

### Table 2. Strategies for an effective and credible autonomous regulator

<table>
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<tr>
<th>1. Efficient and co-ordinated regulatory systems</th>
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<tbody>
<tr>
<td>Clear allocation of responsibilities, based in law, among the several bodies responsible for sectoral policy, market regulation, competition policy, and dispute resolution. Overlaps defined and resolution is clear.</td>
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<tr>
<td>Coordination and referral procedures at the working and policy level between the relevant institutions</td>
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<tr>
<td>Close monitoring by an outside policy or parliamentary body of the fit between regulatory regimes and China’s energy needs</td>
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<tr>
<td>Convergence between related sectors (electricity and gas) is reflected in policy institutional coordination and adaptation</td>
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<tr>
<th>2. Efficient scope of regulatory bodies</th>
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<tr>
<td>Industry-specific and multi-industry scope is defined by the need for a specialised body vis-à-vis efficiencies from shared activities, reduced risk of regulatory capture, and avoidance of distortions due to regulatory inconsistencies across related industries. This will depend in part on whether the related industries are liberalising at the same speed.</td>
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<th>3. Stability in market oriented policies (optimal contract commitment versus flexibility to rebalance interests of market actors, consistent adherence to market principles)</th>
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<tbody>
<tr>
<td>Clear mission statement set in law to serve consumer interests by encouraging open competition, adherence to competition principles, and customer choice (no general “public interest” mandate)</td>
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<tr>
<td>Regulator set up before regulatory reform is carried out</td>
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<tr>
<td>Stability in underlying legislation, with few major revisions in transition phase</td>
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<td>Adequate tenure for regulators (5-8 years?)</td>
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<th>4. Accountability for results</th>
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<tr>
<td>Regular public reports showing progress against mission statement</td>
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<td>Periodic parliamentary oversight, assisted by expert parliamentary staff to correct information disadvantages</td>
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<td>Establishment of consumer advisory body or other consultative committees with formal powers to advise, question, and publish reports</td>
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<td>Independent review of market results and regulator’s performance (by independent advisory body or the competition authority?)</td>
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<tr>
<th>5. Effective autonomy: Low risk of influence of market decisions by political interests, low risk of capture by incumbent and dominant firms</th>
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<tbody>
<tr>
<td>Clear mission statement oriented to maximising consumer welfare and consumer choice</td>
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<tr>
<td>Generalised agencies (multi-sector) are less susceptible to capture than are specialised agencies</td>
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</table>
Appointments of agency heads are made for defined period, non-renewable, with clear and limited removal criteria such as corruption.

Ex ante review of regulatory decisions by ministries is highly limited or non-existent; ex post review limited to procedural issues.

Budgets are earmarked, or set outside of the ministry, or financed through levies on end-users, network users, or license holders (normal government auditing procedures apply).

Clear accountability for defined market results.

Transparency in explaining the reasons for decisions and their relation to consumer welfare.

Staffing is independent of ministry (secondments are clearly transitional in nature).

Oversight by competition authority reduces risk of capture.

### 6. Clear authority of the regulators

- The powers of the regulator must be defined clearly and room for discretion at the general level should be minimised.
- Information collection authority is needed vis-à-vis market actors.
- Inspections, sanctions and other quasi-judicial functions must be clear, convincing and efficiently wielded, either by the regulator or by a third party.
- Criteria for licenses, concessions and other forms of regulation by contract must be clearly defined in advance.
- Procedures for amending licenses and concessions must be clearly defined in advance.

### 7. Efficient governance of the regulator

- Efficient decision and dispute resolution procedures within the autonomous regulator (If a commission is appropriate, how should it be structured for credible and rapid decision-making? One or multiple commissioners? Odd or even numbers? Staggered terms or not? Only the UK and Finland have single-commissioner models, and the UK will soon switch to multiple commissioners).
- Clear lines of decision with minimal pre-decision reviews by separate bodies.

### 8. Professional credibility of regulators

- Professional competence and integrity are key to choice of regulators.
- Vigorous conflict of interest provisions are in place.
- Oversight by ethics body against clear ethical standards.
- Revolving door policies are established.
- Pre-set period of appointment, with no re-appointment.

### 9. Impartiality and transparency in procedures, instruments, and reasoning for decisions

- Explicit public consultation procedures at the policy development phase to which all interested parties have equal access.
- Defined role of advisory bodies with sunshine provisions for their operation.
- Clearly defined communications with the incumbent firms.

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A defined set of instruments for decisions is necessary, with clear procedures for each. A range of options should be available so that the regulator can respond to changing economic situations, but in taking any actions the regulator must be held accountable.

Licenses and concessions must be used only in non-competitive markets; in competitive markets, general regulations are preferred.

Regulatory impact analysis should be used and made public to assess market impacts of decisions.

Publication of all decisions and rationales for decisions

Vigorous oversight of industry self-regulation

10. Adequate technical capacities of the regulator

- Sufficient human expertise on generation and transportation in areas such as technology, accounting, economics, and law
- Number of employees proportional to tasks and market (in United States FERC, about 470 deal with electric power)
- Recruitment and pay uses market practices rather than civil service rules
- Ability to hire external expertise

11. Efficient dispute resolution

- Appeals rights are structured to avoid paralysis or costly delays by litigation (restricted to undue process or to substantive issues?)
- Dispute resolution is functionally separate from ministry and regulatory body (independent appeals body?)

Source: Scott Jacobs, 2001, from various sources

IX. CONCLUSIONS

101. Section I summarizes the main conclusions of this paper. Establishing the institutions and market environment needed for successful adjustment to trade and investment liberalization requires a strategic and integrated regulatory reform policy. Experiences in OECD countries offer no models for China, but many of the wide range of tools accepted as good regulatory practices by OECD countries could be adapted to meet the development needs of China. A dialogue between China and OECD countries to exchange information could accelerate convergence in regulatory areas that are critical to China’s economic progress and to its capacity to comply with international commitments.
Annex 1

POLICY RECOMMENDATIONS FOR REGULATORY REFORM

FROM THE OECD REPORT TO MINISTERS ON REGULATORY REFORM, 1997

The seven recommendations which follow are drawn from OECD country experiences, as elaborated in the sectoral and thematic background reports which formed the basis for this Report. The recommendations are intended to provide governments with steps they can take to improve regulations themselves and regulatory processes within public administrations. The recommendations, which should be viewed as an integrated package, apply broadly across sectors and policy areas, and implementation will differ among countries, depending on differences in public policies, policy trade-offs, reform priorities and needs, and legal and institutional systems. If adopted, they can help governments to update and streamline the regulations and formalities that have accumulated over years, and to set into motion a continuing process of regulatory disciplines inside public administrations that will protect the gains of reform in the future. By establishing a common set of disciplines, they will improve international transparency and understanding of national regulatory systems.

Recommendations

1. **Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.**
   
   - Establish principles of "good regulation" to guide reform, drawing on the 1995 OECD Recommendation on Improving the Quality of Government Regulation. Good regulation should: (i) be needed to serve clearly identified policy goals, and effective in achieving those goals; (ii) have a sound legal basis; (iii) produce benefits that justify costs, considering the distribution of effects across society; (iv) minimise costs and market distortions; (v) promote innovation through market incentives and goal-based approaches; (vi) be clear, simple, and practical for users; (vii) be consistent with other regulations and policies; and (viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.
   
   - Create effective and credible mechanisms inside the government for managing and coordinating regulation and its reform; avoid overlapping or duplicative responsibilities among regulatory authorities and levels of government.
   
   - Encourage reform at all levels of government and in private bodies such as standards setting organisations.

Regulatory reform should be guided by coherent and transparent policy frameworks that establish concrete objectives and the path for reaching them, and that enjoy sustained political commitment. Different programmes may be needed, depending on the type of regulations being reformed and the objectives of reform. Such programmes will both enhance the credibility of reform, and reduce the costs of reform by signalling to the wide range of potentially affected interests what is to come. The emphasis on broad programmes is deliberate, since the likelihood of success is increased by including at the outset the full mix of policies needed to gain full benefits of reform. Programme effectiveness depends also on how well it is carried out, and here
country experiences show that a well-organised and monitored process, driven by “engines of reform” with clear accountability for results, is essential.

Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed inside and outside the administration to keep reform concrete and on schedule, and to avoid a recurrence of over-regulation. It is often difficult for regulators to reform themselves, given countervailing pressures. Also, reform must often be co-ordinated across multiple areas if it is to be effective. Governments have created wholly new bodies for this purpose, or have given existing bodies new duties. Such mechanisms will need to be supported by other reform-minded bodies, such as ministries of finance, and competition and trade authorities that develop advocacy capacities. Private sector engines of reform, such as advisory bodies or private initiatives, can also be helpful and should be encouraged. International co-operation on trade and investment, such as regional integration initiatives, can also be powerful in promoting reform.

Governments should develop familiarity with a broad range of new policy tools that can improve policy effectiveness and reduce costs, while promoting innovation. These tools, used alone or with regulation, are based on the idea that incentives are better than commands. They include information disclosure; economic incentives such as taxes and charges; voluntary agreements; and creation of new markets through tradable property rights. Where regulation is used, flexible performance-based approaches allow firms to find the most cost-effective solutions. However, the risks of self-regulation and voluntary approaches -- undue influence by private interests, barriers to competition, and lack of transparency and accountability -- need to be rigorously managed by programme design and application of competition policies.

2. Review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.

- Review regulations (economic, social, and administrative) against the principles of good regulation and from the point of view of the user rather than of the regulator.

- Target reviews at regulations where change will yield the highest and most visible benefits, particularly regulations restricting competition and trade, and affecting enterprises, including SMEs.

- Review proposals for new regulations, as well as existing regulations.

- Integrate regulatory impact analysis into the development, review, and reform of regulations.

- Update regulations through automatic review methods, such as sunsetting.

Governments should implement the concept of life-cycle management of regulations, in which principles of good regulation are applied in initial decisions on new regulations and in continuing reviews throughout the life of the regulation. Today’s pace of change in technologies, economic opportunities, and social conditions means that outdated and unneeded rules penalise countries more and more. Systematic regulatory review according to standardised criteria of effectiveness and need can produce very large payoffs in terms of reduced costs and improved effectiveness. Automatic mechanisms, such as sunsetting, are used in some countries to ensure that periodic review takes place on schedule. The size and complexity of the task means that effective review is a long-term task requiring careful management and prioritisation. Suggested
review priorities include technologically dynamic sectors; product standards that impede trade and investment; government formalities such as licenses and permits, particularly those that overload SMEs; and duplications and inconsistencies between levels of government.

Most countries have carried out partial reviews of existing regulations, but very few do this systematically or periodically. Some countries have adopted processes to review proposals for new regulations against consistent quality criteria. Yet it has been difficult to make real progress. One reason is that past review efforts have often been superficial and focused on marginal changes to complex regulatory regimes that have not significantly improved the total regulatory environment. To produce real change, comprehensive review and rebuilding of entire regulatory regimes is often necessary. This is called “scrap and build” in Japan, and “reinventing regulation” in the United States.

To add structure, rigor, and transparency to regulatory review, regulatory impact analysis (RIA) is essential. RIA should be used to assess benefits, costs and distributive impacts of regulations, alternative approaches, and proposals for reform; and disproportionate impacts on SMEs. Most OECD countries and the European Commission have implemented RIA programmes, and there is broad consensus that, properly done, RIAs can be effective in helping to produce the most effective, least cost instruments, though they require additional resources.

3. Ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied.

- Ensure that reform goals and strategies are articulated clearly to the public.

- Consult with affected parties, whether domestic or foreign, while developing or reviewing regulations, ensuring that the consultation itself is transparent.

- Create and update on a continuing basis public registries of regulations and business formalities, or use other means of ensuring that domestic and foreign businesses can easily identify all requirements applicable to them.

- Ensure that procedures for applying regulations are transparent, non-discriminatory, contain an appeals process, and do not unduly delay business decisions.

The content of regulations is important, but just as important is the accessibility and application of regulations. Transparency and fairness are essential to establishing a stable regulatory environment that promotes competition, trade and investment. The value of consultation with affected interests is clear. A well-designed and implemented public consultation programme that is not excessively burdensome can help identify more effective regulatory approaches, avoid costly and unintended impacts, improve compliance, and lower costs. Consultation can improve market access by increasing regulatory transparency, and it can reduce transition costs since affected parties have more time to plan. It can also improve the legitimacy and credibility of government actions. OECD governments have invested considerably in recent years in making more information available to the public, listening to a wider range of interests, and being more responsive to what is heard. A wide range of approaches has developed, including publication of future plans, hearings, advisory bodies, and publication of drafts.

Access to regulations is a continual challenge as rules become more technical, complex, and interlinked. In Norway, the regulatory system has been approached as an “information system” linking governments and citizens. “Textual clarity, high consistency among the
provisions, and a structure easy to understand and to which the user may relate” are emphasised. To improve access and security, Mexico is currently establishing its first comprehensive Federal Register of Business Formalities. A new Legislative Instruments Act under consideration in Australia would establish a Federal Register of Legislative Instruments, where regulators will be required to register all existing regulations. The register will provide “positive security,” that is, regulations not in the register could not be enforced. Information technologies add new possibilities. In 1995, Sweden was building a comprehensive electronic listing of regulations, with text on issues such as motives, magnitude of costs and effects. Many of the federal regulations in the United States are now available to affected parties over the Internet.

4. **Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.**

- Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways.

- Enforce competition law vigorously where collusive behaviour, abuse of dominant position, or anticompetitive mergers risk frustrating reform.

- Provide competition authorities with the authority and capacity to advocate reform.

Exemptions from national competition laws have accumulated in numerous sectors, including energy and utilities, transport, communications, and agriculture. Such exemptions have reduced economic performance by allowing anti-competitive practices -- such as abuses of dominant position, cartel conduct, and anti-competitive mergers. An essential reform is to reverse such exemptions and apply the general competition law as widely as possible. This is particularly important in the period after regulatory reform, because such abuses can frustrate the emergence of competition by blocking entry or fixing prices. Vigorous enforcement of laws against cartels will be needed where years of regulation have taught firms to co-operate instead of compete. Without determined action, the benefits of reform can be lost.

Competition authorities can be valuable allies in the reform process. Through general advocacy and enforcement actions, they can attract attention to problems created by poor regulation. When reforms are implemented, they can use enforcement and publicity to ensure that the objectives of reform are achieved. To be effective, competition authorities must develop capacities for advocacy inside governments, be able to intervene where more competition would benefit consumers, and effectively enforce the law. Adequate resources are necessary if they are to be effective.

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.**

- Review as a high priority those aspects of economic regulations that restrict entry, exit, pricing, output, normal commercial practices, and forms of business organisation.

- Promote efficiency and the transition to effective competition where economic regulations continue to be needed because of potential for abuse of market power. In particular: (i) separate potentially competitive activities from regulated utility networks, and otherwise restructure as needed to reduce the market power of incumbents; (ii) guarantee access to
essential network facilities to all market entrants on a transparent and non-discriminatory basis; (iii) use price caps and other mechanisms to encourage efficiency gains when price controls are needed during the transition to competition.

Despite the fact that almost all economic activity today occurs in markets where competition can work efficiently, economic regulations that reduce competition and distort prices are pervasive. They take many forms at various levels of government, ranging from legal monopolies that block competition in entire sectors, to a host of less visible restrictions on starting up and operating businesses, such as quotas on business licenses and shop opening hours. Yet economic regulations have often proven to be extremely costly and ineffective means of achieving public interest goals. In the absence of clear evidence that such regulations are necessary to serve public interests, governments should place a high priority on identifying and removing economic regulations that impede competition.

In general, public policies such as protection of health, safety, and environment are better served by using competition-neutral instruments, such as well-targeted social regulations and market incentives, to change behaviour in competitive markets, rather than using economic regulations to restrict competition. For example, governments need to ensure that providers of professional services are qualified in their fields; however, maintaining such protections does not require control of economic aspects such as the number of firms, or their size, services, and prices.

Replacing monopolies with competitive markets is a particularly complex task. In almost every country, the transition period from legally-created monopoly to effective competition has proven more difficult and protracted than anticipated. When legal monopolies are eliminated, governments must stand ready to use competition law, and price cap and quality of service regulations to prevent incumbents from abusing their initial dominant position. Regulatory reform should aim to create vigorous competition as quickly as possible to make such intervention unnecessary. Competition can and should be introduced into markets upstream and downstream from regulated distribution networks in public utilities (water, gas and electricity). Separating the monopoly network from competitive activities through either physical or accounting means is necessary to ensure non-discriminatory access by firms upstream and downstream to the monopoly facility and to prevent other distortions such as cross-subsidies.

6. Eliminate unnecessary regulatory barriers to trade and investment by enhancing implementation of international agreements and strengthening international principles.

- Implement, and work with other countries to strengthen, international rules and principles to liberalise trade and investment (such as transparency, non-discrimination, avoidance of unnecessary trade restrictiveness, and attention to competition principles), as contained in WTO agreements, OECD recommendations and policy guidelines, and other agreements.
- Reduce as a priority matter those regulatory barriers to trade and investment arising from divergent and duplicative requirements by countries.
- Develop and use whenever possible internationally harmonised standards as a basis for domestic regulations, while collaborating with other countries to review and improve international standards to assure they continue to achieve the intended policy goals efficiently and effectively.
Expand recognition of other countries' conformity assessment procedures and results through, for example, mutual recognition agreements (MRAs) or other means.

Rigid and discriminatory regulations and lack of transparency in regulatory procedures can impede the free flow of trade and investment and block access by efficient foreign firms. Reform in these areas is needed if countries and firms are to gain the benefits of expanding international trade, investment, and the spread of innovative and efficient business practices.

A range of unilateral, bilateral, and multilateral approaches can be used, but in each case transparency and other principles mentioned above are required so that these approaches evolve toward an open and non-discriminatory system. Regulatory reform that reduces regulatory costs and restrictions is inherently market-opening. Where countries share common regulatory goals, greater use of harmonised standards can create benefits from scale economies and transparency, though governments need to review vigorously the quality of international standards to assure that public policy goals are served. Market-based measures can also reduce trade distortions. Non-transparent and duplicative conformity assessment adds costs to international business, especially SMEs, and countries should take steps to mutually accept certification of products and allow free entry with no duplicative procedures. To solve this problem, abolishing regulation and changing third-party certification to suppliers’ declarations is one of the most efficient approaches. If this is not possible, unilateral recognition is also efficient. MRAs can be another effective alternative. MRAs should ensure the competence of foreign assessment bodies so that the public maintains confidence in the quality of imported products and services.

7. Identify important linkages with other policy objectives and develop policies to achieve those objectives in ways that support reform.

- Adapt as necessary prudential and other public policies in areas such as safety, health, consumer protection, and energy security so that they remain effective, and as efficient as possible within competitive market environments.

- Review non-regulatory policies, including subsidies, taxes, procurement policies, trade instruments such as tariffs, and other support policies, and reform them where they unnecessarily distort competition.

- Ensure that programmes designed to ease the potential costs of regulatory reform are focused, transitional, and facilitate, rather than delay, reform.

- Implement the full range of recommendations of the OECD Jobs Study to improve the capacity of workers and enterprises to adjust and take advantage of new job and business opportunities.

Development of the broad reform programme suggested in Recommendation 1 is intended to locate regulatory reform within a wide and coherent policy framework involving the most beneficial mix of policies. Failure to identify policy linkages and trade-offs, costs, risks, and market incentives heightens the risk that regulatory reform can fail or damage other public policies. In most cases, governments can take steps to minimise the magnitude and duration of costs and risks, and thereby expand the scope for reform. When broad-based reform leads to deep structural change, stabilisation and transitional policies may be considered to ease the path to competitive markets. Costs of possible job losses in more competitive environments will be lessened if the macroeconomic environment promotes sustainable growth and if the capacity of workers and businesses to adjust and take advantage of new job opportunities is increased. The
OECD Jobs Study set out a broad programme of action to improve labour market performance. Its implementation would reduce adverse employment effects in transition stages.

One barrier to reform is the fear that it will erode safety, health, and consumer protection. Governments should assess the potential for higher risks in more competitive markets, and should intervene as appropriate, using the substantive principles of good regulation to ensure both that social objectives are not jeopardised and that new regulations are efficient within competitive markets. In some cases, governments may need to allocate more resources to safety, environmental and consumer protection to maintain oversight of expanding markets.