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Development in the PRC: A Preliminary Assessment**

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## **Downsizing Administrative Licensing System and Private Sector Development in the PRC: A Preliminary Assessment**

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Ideological suspicion against private sector development has been gradually dissipating in the People's Republic of China (PRC). Ideological change has resulted in the Chinese Communist Party (CCP)'s revision of its constitution to allow private entrepreneurs to qualify for Party membership and amendment of the state constitution to enshrine the private economy as an important pillar of national economy. Creating jobs for first-time job seekers and laid-off workers through developing the private sector is placed high on the CCP's agenda. Private enterprises are now permitted to enter many sectors once monopolized by state enterprises and to create new market sectors. Both foreign-invested and domestic companies face less restrictions on acquiring state assets. Further private sector development requires a reform of the regulatory regime to make it more business friendly and encourage investors to invest. Reforms of the regulatory regime include two parts: to downsize licensing systems and to enhance government's regulatory capacity in policing markets and coping with various forms of market failure. This paper focuses on the first part of regulatory reforms. The significance of this part lies in its relevance to the improvement of the business environment on the one hand and implementation of PRC's commitments to the World Trade Organization (WTO) on the other.

This paper is structured in the following way: It first introduces the background and impact of the administrative licensing system on private sector development. Then the paper outlines the contours of administrative license downsizing. Emphasis will be placed on a discussion about Administrative Licensing Law. In the end, the implementation of downsizing measures will be evaluated. This paper argues that administrative license downsizing has been selectively implemented. Many local governments have kept the licensing activities that should be either annulled or handed over to upper-level governments. Based on an institutional analysis, this paper argues that the institutional features of PRC's bureaucracy have shaped the incentive systems of local bureaucrats in a way unfavourable for successful implementation of license downsizing. For pursuing local economic growth, local bureaucrats have more incentives to keep burdensome licensing systems than to reduce the ranged business activities requiring licenses. The high costs of policy coordination and supervision enable local bureaucrats to hide their activities from the scrutiny of their political masters. The institutional weaknesses in the mechanisms for reining in local bureaucrats allow local bureaucrats high discretion in distorting many national policies going against their interests, administrative license downsizing included.

### **Significance of Downsizing Administrative Licensing Systems**

In Western countries, regulatory reforms are responses to the challenges posed by perceived failure of public ownership and Keynesianism in sustaining economic growth, the pressure of globalization for policy convergence, and the demand on governments for cutting business costs and saving public resources at the time when raising tax rates to satisfy public demands has become difficult (Janow, 1998: p.216). Downsizing administrative licensing systems is one of the regulatory reform measures. It involves cutting the number of licenses required in business activities, simplifying the procedures in obtaining licenses, and curtailing government's licensing authority. Through downsizing, the PRC government hopes to improve administrative efficiency, economize the use of state resources, combat corruption, and above all, bolster its

performance legitimacy. The downsizing merits scholarly attention for several reasons. The first is the implications of administrative license downsizing on promoting private sector activity which has the potential of significantly contributing to PRC's economic growth and social stability. An increase in business is conducive to job creation. A study of 80 countries concluded that from 1984 to 1998, private firms created 4 – 80 times as many jobs as public sector firms. In PRC, almost all the 27 million new jobs created between 1996 and 2001 were in the private sector (Asian Development Bank, 2003: p.97). Huang and Di (2004) traced the economic development of Zhejiang and Jiangsu, the two eastern PRC provinces almost identical in broad economic and social fundamentals back to the late 1970s. They argued that Zhejiang's economy outperformed Jiangsu's in the end because of the former's thriving private sector, a consequence of a more friendly business environment. A function of business environment is the regulatory burden. Measured by the World Bank's regulatory quality indicator – an indicator measuring the incidence of market-unfriendly policies and businesspeople's perceptions of regulatory burdens, PRC's regulatory quality has deteriorated relative to other countries. In 1996, the regulatory quality of approximately 47% of the surveyed countries was rated lower than PRC's. In 2004, the percentage dropped to 35% (The World Bank, 2004).<sup>1</sup> A survey of the business managers of 138 domestic firms in six cities revealed that the burdensome licensing process was the top challenge to doing business among the five most widely cited barriers of market entry (see Table 1). The other four challenges (policy restrictions, local protection, industrial monopolies, and limited market size) were to different extents caused by the regulatory framework. The American Chamber of Commerce in Shanghai reported that the businesses of 92% of its 238 surveyed member companies were affected by unclear regulations, 91% by bureaucracy, and 87% by inconsistent interpretation of regulations. Corruption, a pervasive social problem that has caught much scholarly attention, was quoted by "only" 70% of the respondents as a major challenge to business (American Chamber of Commerce in Shanghai, 2004).

**Table 1** Types of Entry Barriers Reported by the Managers of 138 PRC firms

Licenses	Policy Restriction	Local Protection	Industry Monopoly	Market Size
34.8%	29.0%	11.6%	17.4%	7.2%

Source: Ross Garnaut, Ligang Song, Yang Yao, and Xiaolu Wang, *Private Enterprise in China* (Canberra, A.C.T.: Asia Pacific Press; Beijing: China Center for Economic Research, 2001), p.45.

Second, downsizing administrative licenses is a strategy for harmonizing PRC's investment policies with its WTO commitments. The WTO commitments oblige PRC to increase its regulatory transparency, ensure consistency among different levels of legislation, and administer its trade regime uniformly across the country. During the reform era, governments at various levels have retreated from directing economic production and resource distribution on the one hand. On the other hand, they have acquired new regulatory power based on secretive official documents known as *hongtou wenjian* (red-heading documents). Though they carry the same or sometimes even greater weight than laws and regulations, they are inaccessible to the public. Until recently, local governments of all levels can issue these official documents arbitrarily regardless of national laws and administrative decrees issued by upper-level

<sup>1</sup> Even though the figure does not suffice to prove that the quality of PRC's regulatory framework has worsened, it signifies that the PRC government lags behind other countries in improving regulatory quality.

governments. In 2001, 14% of these documents, once creating over 80% of administrative licenses, reportedly conflicted with various laws and regulations (Lai, 2003: pp.171-172; Yu and Tan, 2005). The inherent inconsistency and secrecy in the administrative licensing system have not only resulted in an unpredictable investment environment but also gone against the above WTO commitments. An investigation into license downsizing is conducive to evaluating how far the PRC government is able to implement its WTO commitments, and to what extent these commitments have been implemented.

The third reason is a methodological one. As an evaluative study, examining license downsizing has several advantages over much of the existing literature examining PRC's regulatory reform. A common approach of existing literature is to select particular sectors of an economy as case studies. Energy, telecommunication, financial services, and civil aviation are much researched areas in the literature. A weakness of this approach is that in PRC, all the above four sectors are still largely under state control. The impact of the regulatory reform in these sectors on private sector development is not significant. On the contrary, administrative licenses exist in a wide spectrum of economy, including both public and private sectors. Moreover, an important output indicator of downsizing is the number of administrative licenses slashed. The number of licenses before and after downsizing provides a convenient benchmark for evaluation.

This paper explains the implementation outcome of license downsizing by focusing on local institutional features that shape local bureaucrats' behavior. "Local bureaucrats" refers to the government officials working in sub-national governments. Their role in license downsizing merits scholarly attention due to their impact on the outcome of most national policies. Local bureaucrats account for 93.1% of all bureaucrats in PRC. The figure ranks it the fourth highest, after the 96.74% of Uzbekistan and Russia, and 94.87% of Kazakhstan, among the 205 countries and regions surveyed by World Bank.<sup>2</sup> In the meantime, the PRC government hires the largest number of bureaucrats (19.91 million) in the world and the bureaucracy is far bigger than the second-placed Indian (8.21 million). However, its central bureaucracies (a staff of 1.33 million) are slimmer than their counterparts in India (2.74 million), US (2.64 million), UK (1.80 million), Colombia (2.00 million), and Egypt (1.35 million) even though the geographical size and population of the latter three are much smaller than PRC's. Furthermore, central government's responsibility for sub-national governments' payroll and other expenditure has shrunk considerably since the 1980s when administrative and financial authority was gradually decentralized. Central government has to rely heavily on sub-national governments to provide both manpower and money for implementing most of its policies, including downsizing administrative licenses. PRC has 31 provincial-level governments (excluding the two Special Administrative Regions of Hong Kong and Macao), 333 prefectural-level governments, 2,861 county-level governments, and 44,067 township-level governments, all of which have had some sorts of authority over creation of business licenses until recently. Given the huge number of sub-national governments, monitoring of these bureaucrats is extremely difficult. The huge number of local governments, the relatively small central bureaucracies, and consequent difficulties in monitoring have given local bureaucrats high discretionary power and enabled them to shape national policies according to local institutional features and locally-defined state objectives.

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<sup>2</sup> The 205 countries and regions include 86 for which relevant data is missing. See (The World Bank, 2006).

### **Regulatory Reform and License Downsizing in PRC: Background**

Carlile and Tilton (1998) identified two models of regulatory reform. One is an Anglo-American tradition and increasingly European trend of correcting market failure. Behind the model are mistrust of government and worship of market: Government should refrain from intervening in markets to reduce inefficiency. Government's primary function is to ensure smooth operation of the market and to deal with such market failure as protection of public health and safety. A desirable regulatory reform is one seeking to reduce the regulatory costs on firms (such as the costs of adapting business processes to meet regulatory requirements, licensing fees, delays in obtaining regulatory approval, and time cost and bribery used for dealing with officials) to the level not higher than necessary for tackling market failure. The advocacy of antitrust, transparency, and competition is largely based on this model. The second model is a developmental state model represented by Japan, Korea, and Taipei, China. The advocates of this model have a high trust in government and believe that bureaucrats should actively foster technological development and designate particular industries and businesses for support. This model is characterized by government's extensive use of licenses to influence economic development. No companies, including domestic and foreign, are allowed to enter particular industries, alter their mode of production, or import particular products without appropriate licenses for the sake of protecting these industries from excessive competition, accumulating a technological foundation for quick modernization, and facilitating "late developers" to catch up with early industrializing countries (Carlile and Tilton, 1998: pp.1-15).

The PRC's regulatory reform exhibits both the similarities with the above two models and characteristics shared with many developing economies. The PRC's regulatory reform is a mix of corporatization, privatization, deregulation, and re-regulation. It is a response to the need for filling a regulatory vacuum left by the rolling back of the state in micro-managing the economy (Pearson, 2004: pp.567-583). The rolling back is characterized by a de-nationalization of public ownership (such as telecommunications), rise of new economic activities (such as insurance and stock exchange), emergence of market failures (such as coalmine accidents, shoddy product quality, and environmental pollution), and the perceived necessity of protecting domestic enterprises against foreign competition resulting from trade liberalization (such as banking). One aspect of the regulatory regime is a licensing system. Like their counterparts in many developing countries, bureaucrats in PRC often use various administrative and business licenses to extract rent. Removing officials' licensing authority and the opportunities for extracting rent by downsizing regulations on the private sector has become a major strategy in the latest round of regulatory reform.

Regulatory reforms are widely used to resolve economic problems because of their potential in encouraging private investment and bolstering GDP without incurring government expenditure and debt. Recent studies in OECD economies show that both the private investment level and the productivity of that investment are higher in countries with lighter regulatory burden. Estimates for a group of developing countries suggest that reducing the cost of registration procedures to the level in the United States (0.6% of per capita income) could increase private sector investment by more than 20%. A growing number of countries reducing administrative licenses and simplifying licensing procedures have achieved positive results. For example, the World Bank reported that after the municipal government of La Paz, Bolivia reduced the procedures required in business registration, the number of registered businesses increased by 20%. Similar measures in Viet Nam increased new businesses from 6,000 in 1999 to more than 21,000 in 2002. In Uganda, the new businesses increased even by four times (The

World Bank, 2005: pp.99-104; Asian Development Bank, 2003: p.97; International Finance Corporation, 2000).

In comparison to other developing countries, PRC's licensing system for regulation of business on paper is not particularly burdensome (see Table 2). However, the reality suggests a worse picture. The licensing system is arbitrary, cost inflating and inconsistent. Setting up a local retail business, for instance, needs 112 licenses from different departments. To get approval for importing certain types of foreign equipment may require six months or even longer (Meng, 2004). Bureaucrats' arbitration in revoking licenses has made an unpredictable business environment. On a single day, the government of an unnamed city illegally revoked the business licenses of 100-odd joint ventures. Beijing city once revoked the permission granted to the fast food chain giant McDonald's for establishing a restaurant in a prime location (Ambler and Witzel, 2004: p.84). In 2003, the public security bureau of Leqing city of Zhejiang province withdrew 150 business licenses of man-powered tricycles auctioned in 1999, and penalized the license holders who refused to return the licenses (Liu, 2006). Without giving compensation or grace period, an unnamed city withdrew the operation licenses of the schools below the benchmark that the government imposed arbitrarily (Zhao, 2006). The resultant unpredictable business environment, together with the inconsistency of regulations and policies of different levels of government, had put off many private investment projects involving more than one level of governments as the risk involved in these projects is either difficult to calculate or prohibitively high. Licensing barriers also precluded private sector from entering the market sectors dominated, but badly served, by state-owned enterprises. Many investors relied on personal relationships and bribery to transcend the red tape and get things done. The consequences were a lower level of infrastructure investment, lower degree of institutionalization of administration, rampant corruption, and business cost inflation (Asian Development Bank, 2003).

**Table 2 A Comparison of Selected Indicators of Business Regulations in Eight Developing Countries in 2003**

Countries \ Indicators	PRC	India	Indonesia	Malaysia	Thailand	Philippines	Brazil	Argentina	World average (Countries of low and middle income)
Number of start-up procedures	11	10	11	8	9	11	15	15	11
Time to start a business (days)	46	88	168	31	42	59	152	68	65
Employment law index*	47	51	57	25	61	60	78	66	55

\* Employment law index ranges from 0 (less rigid) to 100 (very rigid).

Source: The World Bank, *World Development Indicators 2004* (Washington, D.C.: World Bank, 2004), pp.262-264.

The burdensome regulatory framework has not a risen in a vacuum. It was established when the market system was budding and the private sector was insignificant. Many new regulations targeted big state-owned companies and reflected a higher emphasis on economic security than efficiency values. Investors were required to put down a large registered capital and undergo strict examinations before starting a business so that the risks of creditors – which were from state sector - could be

minimized. Less resourceful investors from the private sector were then barred from entering markets. Therefore the minimum capital requirement in PRC as a percentage of GNI per capita is the second highest in the world, only after the 5,627 of Syria (see Table 3). Besides that, regulators are highly interventionist in market regulation, and often oblige investors to prove their technical abilities measured against government-imposed standards before they can enter markets. The dynamics of commerce and convenience for private businesses were not regulators' main concern (Jiao, 2005; All-PRC Federation of Industry and Commerce, 2005: p.20).

**Table 3 A Comparison of the Minimum Capital Requirement in Eight Developing Countries in 2003**

Countries	PRC	India	Indonesia	Malaysia	Thailand	Philippines	Brazil	Argentina	World average (Countries of low and middle income)
Minimum capital requirement (% of GNI per capita)	3,856	430	303	0	0	10	0	0	118

Source: The World Bank, *World Development Indicators 2004* (Washington, D.C.: World Bank, 2004), pp.262-264.

The decentralized public finance system is another barrier to the formation of business-friendly regulatory regime. The PRC government has decentralized much of its economic authority to local governments to motivate them to achieve higher economic growth and enhance the regime's legitimacy. The decentralization has turned the PRC economy into, using the terms of Qian and Weingast (1995), "market-preserving federalism". However, local governments are not authorized to adjust the rate of local taxes or create new taxes. Without adequate tax revenue, local governments have to rely on extra-budgetary revenue – the part of government revenue not included from planned revenue. It encompasses both officially sanctioned and illegal levies beyond the narrowly defined formal budget (Lu, 2000: p.218; Wong, 1997: p.60; Breslin, 1996: p.129). Examples of extra-budgetary revenue include various fines and license fees. The amount of license fees is huge and therefore important to public coffers. The abolition of 78 business activities requiring licenses (or licensing items) in Zhejiang province engendered a loss of license fee revenue of 120 million *yuan* a year (Luo and Yu, 2005: p.21).<sup>3</sup> The Heilongjiang provincial finance bureau predicted that the downsizing of 152 licensing items in 2006 would reduce its revenue by 300 million *yuan*. Between May and September 2003, the licensing fee that Yanggang city, a medium-sized city in western Guangdong province had to give up due to license downsizing amounted to 22.97 million *yuan* (Xiao, 2004).

The level of license revenue may impact the amount of subsidies (a rather regular monthly income usually in cash and sometimes in kind) that bureaucrats receive as well. In the late 1990s, subsidies accounted for around 70 to 85% of the total income of individual bureaucrats (Chou, 2004: p.230). In view of the impact of extra-budgetary revenue on their well being, local leaders are highly motivated to create and defend

<sup>3</sup> At the end of June 2006, US\$1 = 8 *yuan*.

license revenue. They may assign a quota of extra-budgetary revenue that individual departments must generate. The levels of bonus (a more irregular cash income) and penalty are often linked to the amount of extra-budgetary revenue generated. In 1995, Yulin city in the Guangxi Autonomous Region imposed a fee collection target of RMB 12 million *yuan* on the city's round-city highway management office. The subsidies of the office's employees would be cut back if they could not reach the target. If they generated more than the target, they could retain 80% of the surplus portion for subsidies, although central government had decreed to rule out this practice (Qin, 1996). Quite often, licensing items were created purely for generating revenue but not regulating markets. An entrepreneur of Yanggang city complained that the city labor bureau required him to apply "appointment cards" (*shang gang zhen*) on behalf of all his employees. Each appointment card cost him over 100 *yuan*. The fee collected was supposed to finance government-sponsored training courses for new employees. In the end, no training was provided. Another agricultural entrepreneur complained that the traffic bureau of the city charged him some 1,000 *yuan* of vehicle maintenance fees every year without providing any meaningful maintenance service in return (Xiao, 2004).

The implication of licenses is furthered complicated by the narrow focus of local leaders' performance appraisal on local economic development and the opportunistic behaviour of local leaders resulting from a job rotation system. On the basis of a Soviet practice of industrial management in which factory managers were appraised according to sets of specific production quotas, the CCP introduced a cadre responsibility system in the early 1980s to hold local leaders responsible for specific performance indicators. The performance indicators were characterized by a heavy emphasis on economic growth, and to a lesser extent social stability and development (see Figure 1). The current performance appraisal of local leaders is largely modeled on this system. The exact performance targets vary across the country, depending on the economic structure of the regions that local leaders oversee. Many of these performance targets are related to economic development, such as the growth of industrial production, the growth of GDP, and the amount of tax and non-tax revenue generated. The achievement of these targets is linked to cadres' future advancement, the level of their bonus, and punishment.<sup>4</sup>

**Figure 1 Performance Indicators for Evaluating the County and City Governors in Liaoning Province**

Indicators	The Bureaus in Charge of Evaluation	Mark
<b>1. Economic construction</b> - GDP and growth rate - Gross value and growth rate of agricultural output - Gross value and growth rate of industrial output - Budgetary revenue (tax revenue, enterprise revenue, bond revenue and other revenue) and growth rate - Net income of peasants per capita and growth rate - Disposable income of urban residents and growth rate - Arable land preservation - Amount of major agricultural product produced and growth rate - Commercialization of agriculture - Growth rate in gross value of state property - Gross value and growth rate of remittance by state-owned	- Planning commissions - Economic and trade commissions - Statistical bureaus - Industry and commerce bureaus - Taxation bureaus	60

<sup>4</sup> For details about the system of evaluating local leaders in PRC, see (Zhong, 2003; Edin, 2003).

<ul style="list-style-type: none"> <li>and collective enterprises</li> <li>- Gross value and growth rate of tax paid by non-state enterprises</li> <li>- Gross value of fixed investment</li> <li>- Gross value of foreign direct investment</li> <li>- Gross value of foreign exchange income</li> </ul>		
<p><b>2. Social development and spiritual civilization construction</b></p> <ul style="list-style-type: none"> <li>- Birth rate</li> <li>- Number of crimes</li> <li>- Crime detection rate</li> <li>- Satisfaction of the public towards social order</li> <li>- Completion rate of voluntary education</li> <li>- Proportion of expense on science and technology to budgetary revenue</li> <li>- Number of spiritually civilized units</li> <li>- Performance in dealing with three main pollutants</li> <li>- Forest coverage rate</li> </ul>	<ul style="list-style-type: none"> <li>- Political-legal commissions</li> <li>- Family planning commissions</li> <li>- Education bureaus</li> <li>- Propaganda departments</li> </ul>	20
<p><b>3. Party building</b></p> <ul style="list-style-type: none"> <li>- Percentage of leading officials in county/city governments having attained satisfactory results on the political knowledge examination</li> <li>- Percentage of rural party branches rated excellent</li> <li>- Party member training</li> <li>- Percentage of party branches rated excellent in urban enterprises and service units</li> <li>- New party members</li> <li>- Public satisfaction with leading cadres</li> </ul>	<ul style="list-style-type: none"> <li>- Discipline inspection commissions</li> <li>- Organization departments and propaganda departments</li> </ul>	20

Source: The Study Group of the Organization Department of the CCP Liaoning Provincial Committee, "Guanyu wanshan xianshi dangzheng lingdao banzi gongzuo shizhi kaoke zibao tixi wenti de yanjiu baogao" (A Research Report Concerning Improving Performance Indicators for Evaluating the Leadership Groups in County/ City Governments), in the Research Office of the Organization Department of the CCP Central Committee (ed.), *Zuzhi gongzuo yanjiu wenxuan (shang)* (A Collection of Research Manuscripts of Organization Work, Vol. 1) (Beijing: Party Building Readings Press, 1999), p.180.

In the meantime, central leaders are often worried that local leaders may establish their own patronages – major sources of corruption and localism (or a tendency of defying central directives for safeguarding local interests). Thus local leaders are rotated to different localities at regular intervals, usually three years for county magistrates and five years for governors at provincial and prefectural-level governments but not uncommon within a shorter period of time. The performance appraisal and job rotation systems shape local leaders' incentive in the way that local leaders tend to promote the economic development in their jurisdictions, regardless of the policies' impacts on neighboring regions and the country as a whole. Because of their short terms of office, they tend to work for immediate work achievement at the expense of the localities' long-term benefits, such as improvement of business environment and product quality. Therefore, many local leaders pursue regional protectionist measures: Through licensing systems, they can raise the barriers of market entry for outside entrepreneurs, or impose a ban on the import of certain types of products to protect local business interests. A bus company in an unnamed city of Anhui province, for example, had got

approval from city government before it purchased new buses. On discovering the new buses were not manufactured in Anhui province, the city government banned the buses from being used (Zhao, 2006). Shanghai and Beijing cities supported their own car industry by instructing the taxi companies in their respective cities to use locally produced sedan cars. Shanghai even charged the non-Shanghai-made sedan cars higher license fees to affect their competitiveness (Lardy, 2002: pp.29-62). As a result of a high degree of financial autonomy and local leaders' peculiar incentive systems, local governments (especially those with small tax bases) have much motive to safeguard and expand their licensing authority.

Regulatory barriers have not stopped the PRC economy from growing. Private sector development remains robust. Foreign investment is huge. From the perspective of economic growth, downsizing administrative licenses is non-urgent if not unnecessary. Nevertheless, the accession to the WTO has made the matter different. The PRC's regulatory framework fails to live up to PRC's three major commitments which seek to expand the opportunities for foreign investors to enter PRC markets:

1) Transparency: Local governments' use of secretive *hongtou wenjian* to create new regulations is incompatible with the paragraph 332 of the Report of the Working Party of the Accession of China (hereafter "the Report of the Working Party"), stating that PRC would:

"... publish in the official journal, by appropriate classification and by service where relevant, a list of all organizations, including those organizations delegated such authority from the national authorities, that were responsible for authorizing, approving or regulating services activities whether through grant of license or other approval. Procedures and the conditions for obtaining such licenses or approval would also be published".

2) Uniform administration of trade regime: Inconsistency of regulations among different levels of government contradicts paragraphs 73, 75 and 68. Paragraph 73 reads:

"...the provisions of the WTO Agreement ... would be applied uniformly throughout its customs territory, including in SEZs (Special Economic Zones, added by the author) and other areas where special regimes for tariffs, taxes and regulations were established and at all levels of government."

Paragraph 75 reads:

"All individuals and entities could bring to the attention of central government authorities cases of non-uniform application of China's trade regime... . Such cases would be referred promptly to the responsible government agency, and when non-uniform application was established, the authorities would act promptly to address the situation utilizing the remedies available under China's laws, taking into consideration China's international obligations and the need to provide a meaningful remedy... ."

Paragraph 68 reads:

"... the central government would undertake in a timely manner to revise or annul administrative regulations or departmental rules if they were inconsistent with China's obligations under the WTO Agreement and Draft Protocol."

3) Licensing issues: Blocking market access through licenses and charging exorbitant license fees conflict with paragraphs 308 and 308(d) respectively. Paragraph 308 reads:

“...China would ensure that China's licensing procedures and conditions would not act as barriers to market access and would not be more trade restrictive than necessary.”

Paragraph 308(d) states:

“Any fees charged ... would be commensurate with the administrative cost of processing an application” (World Trade Organization, 2004).

The impacts of these commitments are profound: the PRC government is obliged to reform its business regulatory framework as soon as possible. All levels of governments in PRC can no longer use hidden documents to create licensing authority. Their licensing authority should be based on national legislations which, in turn, has to be kept in line with the WTO requirements. Business licenses should not cost more than necessary for processing license application. Creation of regional trade blocs through licensing is prohibited. If successfully implemented, these measures have the potential of fueling the growth of private sector.

### **Strategies of Downsizing Administrative Licenses**

Downsizing administrative licenses may be construed as the second stage of structural reform since the early 1980s. The first stage of reform, characterized by de-bureaucratization, de-nationalization, and greater use of market principles, comprises the strategies of bureaucracy downsizing, departments merging, reform of state-owned enterprises, transformation of government departments into quasi-governmental organizations, and civil service reform. The control on business opportunities was relaxed. Monopolies over foreign trade were broken up. Industrial ministries were either transformed into economic entities, industrial associations, or absorbed into other ministries. Market forces were phased in to replace bureaucracy in directing economic production and resources distribution. Bureaucracy was trimmed. Those remaining in bureaucracy were better educated, younger, and less obsessed by the Leninist ideas of economic management. State-owned enterprises were incorporated and exposed to greater competition. While the state retreated from enterprise ownership and economic planning, it set up and strengthened ministries and departments with economic and social regulatory functions, such as environment, food safety, work safety, financial services, telecommunication, and intellectual property rights. Meanwhile, it restricted administrative discretion and bureaucratic interference in private businesses through a legal framework. Administrative Litigation Law (1990), Compensation Law (1994), and Administrative Punishment Laws (1999) are examples in this legal framework.

Before the end of the 1990s, the PRC government launched several rounds of downsizing. In the 1998 administrative reform, most industrial ministries were either transformed into quasi-governmental industrial associations or downgraded and merged with other ministries. Many forms of administrative licenses disappeared together with these industrial ministries. In September 2001, the State Council set up an interdepartmental State Council Leadership Small Group on the Reform of the System of Administrative Licensing (*Guowuyuan xingzheng shenpi zhidu gaige gongzuo lingdao xiaozu*) to improve the coordination of downsizing. After several rounds of downsizing, the State Council gave up the authority over 1,795 licensing items. Some of these abandoned licensing items were annulled altogether whereas others were handed over to industrial associations and other intermediary agencies (Meng, 2004).

The downsizing campaign soon penetrated into many local governments (see Table 4). The process of issuing licenses has been made more transparent. Jinan city

displayed official documents concerning licenses in public libraries or on government websites. Guangzhou city published *hongtou wenjian* in Guangzhou Administrative Report and accepted subscriptions from the public. Wuhan city posted its new *hongtou wenjian* in the Public Bulletin of Wuhan People's Government every two weeks. The Bulletin was distributed to the public free of charge. Chongqing city published most of its *hongtou wenjian* in the Administrative Affairs Bulletin since January 2002. The cities of Wuxi and Shenzhen reviewed and overhauled *hongtou wenjian*. By June 2002, Shenzhen had reviewed 2,500 internal documents, annulled 878 of them, and modified 1,700 (Lai, 2003: pp.171-172). The amount of license fees which used to be secretive were made open. License applicants deposited the fees directly in the bank accounts under the scrutiny of treasury bureaus so that in principle no departments could embezzle the fees. The licensing procedures were streamlined by setting up one-stop service centres. Complaint centres and telephone hotlines were set up to keep rent-seeking behaviour in check (Yang, 2004: pp.154-175).

**Table 4 The Number of Licensing Items in Selected Governments**

Year	Governments	Original items	Items relinquished	Percentage of items relinquished
1999	Heilongjian province	2,325	1,283	55.18%
1999	Henan province	2,706	1,764	65.19%
2000	Zhejiang province	1,372	751	54.7%
2000	Tianjin city	935	N.A.	More than 40%
2000	Shenzhen city	1091	463	42.44%
2001	Shenzhen city	652	277	42.48 %
2001	Shanghai city	N.A.	N.A.	40%

Source: Wang Leiming, "Reform of Party and Government Organizations Advances Steadily" (text Beijing *Xinhua* in Chinese (7 May 1998) Translation by the Foreign Broadcast Information Service. FBIS Daily Report – China, 8 May 1998. (PrEx.7.10: FBIS-CHI-98-127); Li Gan, "Difang jigou gaige jinrui shishi jieduan" (Administrative Reform in Local Governments Is in Implementation Stage), *Zhongguo gongwuyuan* (Chinese Public Servants), No. 4 (April 2000), p.15; "Shizhengfu tisu xiaoguo xianzhu" (City Government Made Progress in Improving Administrative Efficiency), *Shenzhen tequ bao* (Shenzhen Special Zone Daily), 15 October 2001, p.A1; Hu Angang and Guo Yong, "Zhuanxingqi fangzhi fubai de zhonghe zhanlue yu zhidu sheji" (Corruption Prevention Strategies in Transition Period), in Hu Angang (ed.), *Zhongguo zhanlue* (The Strategies of China) (Hangzhou: Zhejiang People's Press, 2002), p.245.

Many licensing items annulled have been re-established later on. The number of licensing items in Shenzhen city rose to 652 in 2001 after having been slashed from 1091 to 463 in 2000 (Shizhengfu, 2001: p.A1). Guangdong province slashed the number of licensing items to 1,205 in June 2000. Soon after that, it rose to 1,519 items (Guanshe, 2006). To avoid the re-establishment of annulled licensing items, the National People's Congress (hereafter NPC, the national legislature) enacted the Administrative Licensing Law (hereafter "the Law") to institutionalize the procedures of creating licenses through restricting administrative power and increasing the transparency of licensing procedures. The drafting of the Law began in mid-1990s. It took almost five years to finish consulting various stakeholders before State Council could start drafting the Law in 2000. NPC Standing Committee reviewed the draft law in 2002 and passed it on 27 August 2003. The effective date of the Law was postponed to 1 July 2004 to allow local governments more time for aligning their license regulations with the Law (Xingzhen, 2004).

Several provisions of the Law are noteworthy: Article 12 states that only six broad market sectors require licenses for market access, though what constitutes the six

broad market sectors is vaguely defined.<sup>5</sup> In parallel with PRC government partial centralization of economic authority from sub-provincial to provincial-level governments since the late 1990s,<sup>6</sup> Article 25 removes the licensing authority created by sub-provincial governments. All the licensing authority of sub-provincial governments must be either based on national laws or delegated from provincial-level governments. Provincial-level governments, in turn, are restricted by Article 15: The licensing items created by provincial-level governments may be valid for one year at most. Upon expiry, an enactment from the provincial people's congress (legislature at provincial level) is required to keep the licensing items valid. Furthermore, this Article addresses the issues of regional protectionism: It prohibits local governments from using licenses to limit market entry and import of product, services and labor. Article 13 signifies the retreat of governments from licensing, stating that government departments should not create licensing items when business activities can be effectively regulated by: 1) citizens, legal entities, and "other organs"; 2) market competition; 3) industrial associations; 4) post-verification.

Several provisions are to take on rent-seeking behavior. Article 27 prohibits license-issuing departments from compelling license applicants to purchase particular products produced by the departments or their subsidiary enterprises. Article 58 allows departments to charge license fees only if: 1) the fees are stipulated in laws or administrative decrees, and; 2) the public has prior knowledge of the fees. This provision reflects the Law's convergence with paragraph 308(a) of the Report of the Working Party, stating: "China's licensing procedures and conditions were published prior to becoming effective". In contrast to the user charge principle widely used in industrialized countries, Article 58 requires licensing departments to cover administrative costs of issuing licenses by their budgets. This requirement is even stricter than the commitment in the Report of the Working Party paragraph 308(d) discussed above, which permits charging license fees to cover operating costs.

Transparency issues are addressed in the following provisions: Article 5 states that unless state or business secrets or privacy are involved, internal *hongtou wenjian* cannot be used as sources of licensing authority. Article 19 states that before introducing new licensing items, provincial-level governments should consult the public through public hearings - a means of consultation increasingly popular in PRC. Article 42 mandates departments to inform applicants of the result of their license applications in 60 days. Article 50 embraces the rule of "silence as consent", stipulating that if departments fail to respond to license holders' applications for renewing their licenses in thirty days, the licenses will be automatically renewed. These articles converge with the requirement in the paragraph 308(f) of the Report of Working Party about speedy decisions on license applications.

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<sup>5</sup> These six sectors are: 1) Industries involving "national security, public safety, macro-economic management, environmental protection, public health, personal safety and property protection"; 2) Industries involving scarce natural resources exploitation and public resources allocation; 3) Professions involving public interest and service provision to public (such as legal and accounting professions); 4) Sale of equipment, facilities, products involving public safety, public health, and personal safety and property; 5) Restricted industries; 6) Other industries covered by other laws promulgated by the National People's Congress and its Standing Committee and administrative decrees by State Council.

<sup>6</sup> In recent years, the PRC government partially centralized some administrative authority from sub-provincial to provincial governments. The control of bureaucracies of administrative regulation, financial regulation and commodities management such as the bureaus for industry and commerce, quality technology supervision bureaus, pharmaceutical supervision bureaus, and securities supervision commissions have been removed from sub-provincial governments. These bureaus are made to report to superior functional bureaucracies which, in turn, are responsible to provincial-level governments. For detail, see Mertha (2005), pp.791-810; Heilmann (2005), pp.643-668.

Though the Law does not contain any provisions about setting up a redress system, this does not rule out the channels for entrepreneurs to seek redress on licensing issues: Administrative Review Law confers on citizens the right of seeking redress on licensing issues. Administrative Litigation Law entitles citizens to the right of suing the departments abusing their licensing authority. Citizens have become more litigious in challenging licensing decisions after the passage of the Law. In Sichuan province, the number of court cases involving administrative licenses was 91 between January and December 2003. The figure rose to 638 during the period between 1 July 2004 (the day on which the Law came into effect) and 30 May 2005 (Gao, 2005). Within one year after the Law was effective, Guangzhou city received 9 cases of administrative review and 20 cases of administrative litigation (Lo, Qiu, and Li, 2005).

As suggested in the paragraph 308(a) of the Report of Working Party about publishing PRC's licensing procedures and conditions prior to their effective day, the State Council issued Directive No. 412 and published a list of 500 licensing items two days before the Law came into effect. No departments can issue licenses on matters beyond these 500 items, down from 4,000 items in 2002 (Meng, 2002). Most of the licensing items fall under the jurisdictions of market regulatory departments, such as General Administration of Civil Aviation, Ministry of Information Industry, China Insurance Regulatory Commission, China Securities Regulatory Commission, State Development and Reform Commission, and Ministry of Commerce (see Figure 2).

**Figure 2 Distribution of Licensing Items among Central Bureaucracies**

<b>Ministries and Commissions under the State Council</b>	<b>No. of Items</b>	<b>Organizations Directly under the State Council</b>	<b>No. of Items</b>
Ministry of Information Industry	21	General Administration of Civil Aviation	44
Ministry of Railways	21	General Administration of Press and Publication	14
State Development and Reform Commission	17	General Administration of Customs	12
Ministry of Commerce	18	State Administration of Radio, Film and Television	11
People's Bank of China	15	State Environmental Protection Administration	8
Ministry of Public Security	9	State Food and Drug Administration	8
Ministry of Finance	7	State Administration for Religious Affairs	7
Ministry of Water Resources	7	General Administration of Quality Supervision, Inspection and Quarantine	7
State Commission of Science, Technology and Industry for National Defense	7	State Forestry Administration	5
Ministry of Health	6	State Administration for Industry and Commerce	4
Ministry of Communications	6	National Tourism Administration	3
Ministry of Education	6	State Administration of Taxation	2
Ministry of Justice	5	State Administration of Work Safety	1
Ministry of Labour and Social Security	5	General Administration of Sport	1
Ministry of Culture	4		

Ministry of Construction	3	<b>Administrative Offices under the State Council</b>	<b>No. of Items</b>
Ministry of Personnel	2	Information Office	2
Ministry of Agriculture	2	Overseas Chinese Affairs Office	1
Ministry of Land and Resources	2	Hong Kong and Macao Affairs Office	1
Ministry of State Security	1		
Ministry of Civil Affairs	1	<b>Administrations and Bureaus under the Ministries &amp; Commissions</b>	<b>No. of Items</b>
Ministry of Science and Technology	1	State Administration of Foreign Exchange	31
		State Oceanic Administration	6
<b>Institutions Directly under the State Council</b>	<b>No. of Items</b>	State Administration of Foreign Experts Affairs	5
China Insurance Regulatory Commission	38	State Bureau of Cultural Relics	6
China Securities Regulatory Commission	23	State Tobacco Monopoly Administration	2
China Banking Regulatory Commission	5	State Bureau of Surveying & Mapping	1
Xinhua News Agency	2	State Post Bureau	1
China Earthquake Administration	1		
China Meteorological Administration	1		
<b>Total number of licensing items: 419*</b>			

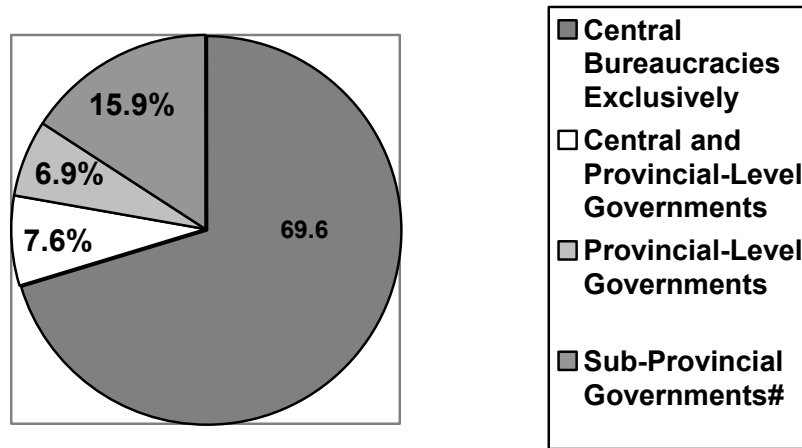
\* The figure is higher than the 386 licensing items stipulated in Directive No. 412. The discrepancy in figure is due to the involvement of more than one department in certain licensing items and the consequential double counting.

Source: *Zhonghua renmin gongheguo guowuyuan ling di xiyier hao* (Directive No. 412 of The State Council of the People's Republic of China), [http://www.gov.cn/zwgk/2005-06/20/content\\_7908.htm](http://www.gov.cn/zwgk/2005-06/20/content_7908.htm), accessed on 8 February 2006.

The State Council has centralized most of the licensing authority. Central bureaucracies are responsible for almost 70% of these items (see Figure 4). Centralization may go to the extent that the provincial and sub-provincial branches of some central organs like Securities Regulatory Commission, Insurance Regulatory Commission, Banking Regulatory Commission, Ministry of Railway, and State Environmental Protection Administration have become central organs' executive agents and had absolutely no authority on licensing. The provincial branches of Ministry of Information Industry and Bank of China are allowed to keep only two licensing items. Less than 16% of the licensing items have been assigned to sub-provincial governments. This centralization policy is conducive to standardizing commercial practices, implementing trade-related policies uniformly across the country, and tackling the problems of inconsistent regulations. To reinforce downsizing measures, State Council promulgated "Several Opinions on Supporting and Directing the Development of Non-State Sector Such As Private Sector" in February 2005. This decree covers a wide range of policies, such as bank credit, market access, and corporate governance, and license charges. It aims to restrict local governments' authorities in entrenching regional protectionism and collecting exorbitant fees through licensing systems. Article 1 rules out restrictions on non-state sector in all market sectors except those stipulated by law. Article 33 prohibited local governments from charging private enterprises fees illegally.

All the fees must be based on national laws, State Council decrees, and regulations of Ministry of Finance and price control bureaus.<sup>7</sup>

**Figure 4**      **Distribution of Licensing Items**



# The category of “Sub-Provincial Governments” refers to the licensing items either under the exclusive jurisdiction of sub-provincial governments, or administered jointly with provincial-level governments and/or central bureaucracies.

Source: *Zhonghua renmin gongheguo guowuyuan ling di xiyier hao* (Directive No. 412 of The State Council of the People’s Republic of China), [http://www.gov.cn/zwgk/2005-06/20/content\\_7908.htm](http://www.gov.cn/zwgk/2005-06/20/content_7908.htm), accessed on 8 February 2006.

**Evaluation and Analysis**

Some successful cases of implementing Administrative Licensing Law have been reported. Central government and Guangdong province declared the previous regulations on chemical industries void and revoked subordinate departments’ licensing authority on chemical industries (Yu and Tan, 2005). Wuhan city declared 48 government documents that created licenses ineffective. Ningxia province annulled 170 items of administrative licensing. Liaoning province annulled almost half of its licensing items (Xingzhen, 2004). Gulou district of Nanjing city reduced its licensing items from 278 to 53 (Mao and Ming, 2005). Chongqing city planned to reduce the processing time of license applications for construction projects involving land acquisition from 350 days to between 110 and 150 days. If the downsizing was successfully implemented, the city government predicted that license fees worth hundreds of thousands *yuan* could be saved (Lan, 2006). Guangdong province annulled the Regulations on Pesticide Management, implying that no licenses were necessary for trading pesticides. The province also permitted foreign investors to trade pesticides by the end of 2004 and fertilizers by the end 2006 respectively. Domestic private entrepreneurs were granted equal footing with foreign investors, and may enter all the markets open to foreign investors (Yu, 2005).

Caution is necessary for interpreting the success. The data about annulling licensing items and the government activities in implementing the Law were supplied by local governments and seldom checked by their supervisory governments. Besides that,

<sup>7</sup> In 2003 administrative reform and merging of central ministries, price control bureau was put under National Development and Reform Commission. The details of the directive can be found in: (Guowuyuan, 2005).

attribution problems should also be considered. An objective of downsizing administrative licenses is to improve business environment through increasing government efficiency and resolving regional protectionism. Most business managers interviewed in a survey felt that government efficiency had been improved and regional protectionism had been alleviated after the Law came into effect. However, there is no knowing whether the improvement is due to license downsizing or other measures. Furthermore, managers' perception change was reported before the Law was effective, as suggested by an earlier longitudinal survey (see Table 5). The most chosen option "unchanged" reflects that the change in government efficiency is not really significant.

**Table 5 Surveys of Managers on Business Environments**

Questions	2003			2005		
	Improved	Unchanged	Deteriorated	Improved	Unchanged	Deteriorated
Do you think government efficiency has improved?	41.6%	47.2%	11.2%	40.2%	46.3%	13.5%
Do you think the problem of regional protectionism has improved?	25.4%	59.7%	14.9%	31.8%	60.0%	8.2%

Source: Centre of Human Resources Research and Training, Development and Research Centre, the State Council, *Qiyè jingyingzhe dui hongguan jingji xingxi ji gaige redian he panduan* (The Opinions and Suggestions of Entrepreneurs towards the Economy), [http://www.drc.gov.cn/view.asp?doc\\_ID=030466](http://www.drc.gov.cn/view.asp?doc_ID=030466), accessed on 28 February 2006; Centre of Human Resources Research and Training, Development and Research Centre, the State Council, *Qiyè jingyingzhe dui jingji huanjing he gaige redian de panduan – 2005 zhongguo qiyè jingyingzhe wenquan diaocha baogao* (The Opinions of Entrepreneurs towards the Context and Hot Issues of Economic), [http://www.drc.gov.cn/view.asp?doc\\_ID=032802](http://www.drc.gov.cn/view.asp?doc_ID=032802), accessed on 28 February 2006.

Examples of unsuccessful implementation of the Law are numerous. Private entrepreneurs in Guangzhou city were denied licenses to run businesses of agricultural factor inputs because the agriculture bureau ran the same business (Yang, 2005). A survey of 1,500 citizens in seven cities suggested that the Law failed to live up with the public expectation on its ability to improve administrative efficiency. The survey, conducted by Social Survey Institute of China at the end of 2004, revealed that 73% of the respondents did not feel the Law had improved administrative efficiency; 76% of the respondents thought that local government had watered down the effect of the Law; and 49% believed that individual bureaucrats had circumvent the Law (Jin, 2004). In creating a pro-competition business environment, policy has achieved only limited success. A survey of business managers in 2005 revealed that 34%, 58.1%, and 7.9% of the respondents thought the problems associated with barriers to market entry have been alleviated, unchanged, and worsened, respectively. Discriminatory administrative licensing procedures remained the most cited factor impeding business expansion, with 42.9% of the respondents thinking so, followed by discriminatory quality inspection standards (38.2%), exorbitant fees and unpredictable taxation policies (27.8%), restrictions on import and sale (23.5%), and discriminatory price restrictions (17.3%) (Centre of Human Resources Research and Training, Development and Research, the

State Council, 2005). It has to be noted that about 17% of the respondents in the survey are affiliated to state-owned enterprises. State-owned enterprises are better protected by governments at various levels and find it easier to bypass administrative barriers. If respondents from state-owned enterprises had been excluded and only private entrepreneurs had been counted, the percentage of respondents expressing negative opinions about licensing issues would have been even higher.

It may take several years before the real impact of the license downsizing measures become obvious. At this stage, it can be concluded that the success is mixed. Many measures of the central government cannot be realized. Lu characterized policy executors' distortion of national policies in communist countries as communist neo-traditionalism, a concept first used by Walder (1986) in analyzing the bureaucratic behavior in Chinese communist regime. Lu argued that very often bureaucrats in communist regimes refused to adapt themselves to the "modern" (such as rational, empirical, impersonal) bureaucratic structures imposed by political elites. Instead they reshaped the processes behind the structures to reinforce and elaborate traditional (or patrimonial) modes of operation (Lu, 1999). The case of downsizing administrative licensing helps to illustrate the argument. Many parts of the Administrative Licensing Law have been reshaped to adapt to old licensing practices. According to the State Council Directive No. 412, provincial governments are permitted to keep 144 licensing items (Zhonghua, 2005). However, Sichuan province keeps 383 items in the end (Gao, 2005). Fujian province keeps 445 items (Fujian, 2006). Selective implementation may appear in the form of substantial delays. Private businesspeople are allowed in the trade of agricultural factor inputs – such as seeds, fertilizers, and pesticides – according to the Article 12 of the Law. By the end of 2005, Guangdong provincial bureau of industry and commerce neither put an end to the state monopoly of the trade nor permitted private sector to enter the trade (Yu and Tan, 2005; Yu, 2005). Certain localities violated Article 58 of the Law prohibiting license fees. A license for selling chemical products in Guangzhou city was worth more than 20,000 *yuan* in early 2006, one and a half years after the Law came into effect (Yu and Tan, 2005). Foreign-invested enterprises in Lianyungan city of Jiangsu province with a registered capitalization of US\$3 million or above have to obtain at least 11 licenses and pay a license fee of 15,000 *yuan* before starting any businesses. The city also violated Article 26 and failed to designate one department to handle license applications involving more than one department. Among its 50 departments with licensing authority, only the urban management department followed this Article. Also the city government did not annul all licensing items according to laws: 109 out of its 428 licensing items remained in force illegally (Yan, 2005: p.44; Chen, 2005: p.75). The efforts at alleviating legislative inconsistency and creating a uniform trade regime have been compromised. Some departments of Guangzhou city have broken Article 5 of the Law and referred to internal documents or even department head's personal opinions in considering licensing issues. The city's industry and commerce bureau justified some of its licensing authority by quoting the internal *hongtou wenjian* "State Council Directive No. 68" issued in 1988 (Yu and Tan, 2005; Yang, 2004).

PRC's WTO commitments of increasing regulatory transparency, setting up a uniform trade regime, and reforming licensing systems may be considered deep economic integration – a country's convergence of its economic policies with international rules. Haggard argued that while the agenda of trade liberalization in deep integration has the potential for augmenting overall welfare benefits, it remains unclear whether deep integration can augment welfare benefits to particular countries, regions of a country, and/or industries. Infant industries in developing countries may lose out if developing countries harmonize their regulatory policies around the norms of developed countries (Haggard, 1995: pp.2-4). The notion is particularly true to the countries like

PRC which have no effective mechanism to redistribute the gains of free trade from beneficiaries to losers. In view of the damage to the losers, the WTO permits developing and the least developed member countries to maintain certain protectionist measures for safeguarding their infant industries. Following this line of reasoning, PRC should not have committed to uniform administration of trade regime given that its regional development varies greatly (See Table 6), and the benefits to different localities could have been maximized by liberalizing trade at various degrees. Since the policy design of downsizing measures has not considered the reality, the downsizing measures cannot serve the needs of many localities and are opposed by local governments.

**Table 6 The GDP Per Capita of PRC in Various Provinces - 2003**

<b>Affluent Coastal Provinces in the Southeast</b>				
Provinces	GDP per capita ( <i>yuan</i> )		Provinces	GDP per capita ( <i>yuan</i> )
Beijing	26,035		Shanghai	38,919
Tianjin	24,585		Jiangsu	17,077
Zhejiang	20,453		Fujian	15,272
Shandong	13,852		Guangdong	17,542
Average GDP per capita: 21,717 <i>yuan</i> (Median GDP per capita: 18,998 <i>yuan</i> )				

<b>Less Affluent Inland and Coastal Provinces in the Northeast and South</b>				
Provinces	GDP per capita ( <i>yuan</i> )		Provinces	GDP per capita ( <i>yuan</i> )
Hebei	10,663		Shanxi	7,545
Inner Mongolia	9,148		Liaoning	14,447
Jilin	9,454		Heilongjiang	11,753
Anhui	6,340		Jiangxi	6,781
Henan	7,417		Hubei	9,127
Guangxi	5,739		Hainan	8,451
Hunan	7,080			
Average GDP per capita: 8,765 <i>yuan</i> (Median GDP per capita: 8,451 <i>yuan</i> )				

<b>Least Developed Western Provinces</b>				
Provinces	GDP per capita ( <i>yuan</i> )		Provinces	GDP per capita ( <i>yuan</i> )
Chongqing	7,328		Shaanxi	6,605
Sichuan	6,364		Gansu	5,091
Guizhou	3,575		Qinghai	7,468
Yunnan	5,755		Ningxia	6,820
Tibet	6,994		Xinjiang	9,969
Average GDP per capita: 6,598 <i>yuan</i> (Median GDP per capita: 6,713 <i>yuan</i> )				

Source: National Bureau of Statistics, *Ge diqu shengzhen zhongzhi he zishu* (GDP and Index of Various Region), <http://www.stats.gov.cn/tjsj/ndsj/yb2004-c/html/C0310ac.htm>, accessed on 1 February 2006; National Bureau of Statistics, *Gediqu huxu, renkouxu, xingbeibi he hu guimo* (The Number of Household, Population by Gender, and the Size of Household), <http://www.stats.gov.cn/tjsj/ndsj/yb2004-c/html/D0407ac.htm>, accessed on 1 February 2006.

Conflict with local needs and opposition of local governments does not suffice to explain selective implementation of the WTO commitments and license downsizing. The CCP has several leverages over sub-national governments to ensure their subservience. First, the CCP controls the appointment of the leadership of provincial-level and prefectural-level governments (the level of governments immediately below provincial

level). Political credentials and loyalty are more important considerations than work-related knowledge and abilities in making appointment decisions, especially to the positions of party secretaries whose main duties are to operationalize central policies and supervise governors and mayors in executing the Party line. In principle, only those loyal to the CCP center and willing to vigorously pursue central policies can be appointed (Bo, 2002; Burns, 1989). Second, the leaderships of the CCP and state apparatus at different levels of governments are interlocked. Only reliable party members are appointed to head the state apparatus. Third, leading party members' groups (*dangzu*) are set up in state apparatus for making major decisions. These *danzu* are manned by reliable party members. Fourth, the CCP uses a position rotation policy and avoidance schemes to make local leaders more responsive to central directives. Under the schemes, local leaders change their postings regularly and are posted away from their birthplaces. Since they cannot stay in office for a long time and have to work in a region where they have few friends and kin, building their own patronage is difficult. Therefore in principle they have little incentive to be responsive to local interests and defend local interests against central directives. Last but not the least, the CCP communicates with the bureaucrats in central bureaucracies and localities about its policies through political education in workplaces and propaganda *xitong* (a grouping of bureaucracies responsible for disseminating "correct" political thoughts through mass media, school education, and cultural activities). With similar outlook, consensus within bureaucracies over national policies can be more easily reached (Lieberthal, 1995: pp.183-215).

Why can local governments defy central policies in downsizing administrative licenses even under strict political control? An analysis of the institutional features of the local political landscape can provide an answer. Institutional features here refers to both the formal rules and informal practices that regularize individuals' behavior and structure the relationships among individuals in polities and economies (Hall, 1992: p.96). The relationship between central and local leaders can be construed as a principal-agent relationship. From a principal-agent perspective, agents have strong incentives to hide information or falsify reports to their principals because the information may provide clues for their fault-finding principals and expose their wrongdoings. The consequential informational asymmetry undermines the effect of command control. The problem is especially serious when the implementation of principals' tasks entails many actors, and each actor monopolizes certain kinds of information that affects monitoring. The more actors are involved, the more information will be hidden, and the higher supervision and coordination cost will be involved in soliciting agents' compliance. Agents' roles of being gatekeepers of information also turn them into veto points in policy implementation (Lam, 2005: p.641).<sup>8</sup>

The institutional feature of "fragmented authoritarianism" – a term borrowed from Lieberthal for depicting PRC's bureaucracy – makes it even more difficult for principals to collect adequate information for monitoring and coordinating agents. "Authoritarianism" indicates the concentration of political and economic authority in the state, a common strategy adopted by authoritarian states in governance. "Fragmented" refers to the wide dispersion of state authority among different functional bureaucracies horizontally, and different levels of governments vertically, and the lack of coordination among these authority holders in taking concerted actions. Since PRC's bureaucracy is constructed by a command-and-control approach, structural processes in the bureaucracy place high emphasis on vertical reporting but low priority on lateral communication at both governmental and departmental levels. Under this system,

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<sup>8</sup> For details about PRC bureaucrats' coping strategies in dealing with close monitoring, see (Huang, 2002).

bureaucrats are encouraged to follow orders from above but not coordinate with other bureaus. Effective lateral communications among functional bureaucracies are limited. When disputes take place among different authority holders during policy implementation process, they have little incentive to settle the disputes by themselves. Nor do they have authority to dictate if they are at the same administrative ranks. Thus they are inclined to refer their disputes to their supervisory organs. If they have different supervisory organs and these supervisory organs are at the same administrative rank, the disputes may be referred to even-higher ranking organs. The process may be repeated up along the administrative ladder until the disputes reach the Standing Committee of Politburo, the highest decision-making body holding absolute arbitration power. Since the Standing Committee of Politburo lacks the time, expertise, and information to involve itself in these disputes, resolving disputes are difficult. Key information about the issues in dispute flows upward and downward through the administration, and may be missing or distorted through the several rounds of reinterpretation by various information gatekeepers (Lieberthal, 1992: pp.1-32).

The institutional features have affected license downsizing as well. Various levels of government and their departments have some sorts of licensing authority and are involved in license downsizing. The implementation of downsizing is contingent on the concerted actions of numerous local actors with diverse interests. Consensus towards the action plans and schedule of downsizing is hardly reached. To address the problem of authority fragmentation and difficulty in coordination and supervision, the central government has started partial centralization of authority from sub-provincial to provincial-level governments since the late 1990s. The 31 provincial-level governments have been given more authority in monitoring sub-provincial governments and aligning local practices with national and provincial legislations. Central government can then focus its attention on provincial-level governments and monitoring of policy execution can be made easier. A recent evaluative study suggests that central bureaucracies cannot tap much more information from the policy of partial centralization. Heilmann pointed out that the securities regulators in Shanghai city, previously under the Shanghai Municipal Government, were incorporated into a central government regulatory commission. Due to geographical distance, communications between central and Shanghai regulators were not based on regular exchanges but on ad hoc meetings and unsystematic data transfers. Consultations and coordination remained inadequate (Heilmann, 2005: p.646). Moreover, many local bureaucrats reportedly resisted the partial centralization policy. They believed that if their departments remained accountable to local governments at corresponding levels rather than to the departments at next higher-level governments, they had greater chance of being appointed to people's congresses or people's political consultative conferences and retaining political influence after their retirement (Yang, 2004).

In view of the difficulty in monitoring and soliciting compliance through a top-down approach, O'Toole argued that policy makers should use a bottom-up model to achieve implementation success. Policy makers should either modify the incentive systems in the administration or adjust policy content by involving policy executors in the policymaking process to induce appropriate behavior on the part of policy executors, and to align policy executors' interests with broader collective benefits (O'Toole, Jr. 1989: pp.312-339). License downsizing remains a top-down implementation model. The inputs from local actors in policymaking processes are not actively solicited. The incentive systems marked by a linkage of extra-budgetary revenue with the level of subsidy and bonus remains unreformed. Some local governments have tried to sever the link to reduce the incentive for individual departments and bureaucrats to defend their licensing authority and the associated extra-budgetary revenue. In 2003, Beijing city decreed to

level out the subsidies to the city's bureaucrats. Individual bureaucrats at the same rank were entitled to the same amount of subsidies, regardless of the level of extra-budgetary revenue individual departments generated (Chou, forthcoming). Nevertheless, not many local governments can follow the Beijing model as their tax bases are much narrower. Some of them are so short of funds that they can neither fully cover the expenditure on fundamental education and health care, nor pay their employees on time. Licensing authority can help to create a source of revenue. As a consequence, local governments may annul only the items with limited potential for revenue generation and keep others illegally (Yan, 2005: p.44; Chen, 2005: p.75).

Furthermore, licensing authority can help to create locally owned conglomerates with certain monopoly power and form a stable source of revenue. Downsizing administrative licenses works against the industrial growth of the regions where the industries are not competitive enough to survive and grow without protectionist measures. Without monetary compensation, it is difficult for them to relinquish their licensing authority. Besides that, the performance appraisal system still places heavy emphasis on local leaders' abilities to develop the local economy and links the appraisal result with career advancement and punishment. This system compels local leaders to narrow their focus on local economic growth and downplays collective interests. Undoubtedly license downsizing can help to improve the local business environment, attract more investment, enlarge tax bases, and fuel economic growth in the long run. But regular job rotation discourages local leaders from committing to policies that can hardly achieve immediate results.

Several institutional features entrench local leaders' incentives to promote short-term local economic growth. The first is a lack of pro-reform interest groups or a strong functional bureaucracy representing the societal actors who benefit from the downsizing of the licensing regime. After investigating 50 countries' regulatory reforms in the telecommunication industry, Li, Qiang, and Xu (2005) argued that successful regulatory reforms are more likely in countries with strong pro-reform interest groups such as financial sector and urban consumers who are frequent users of telecommunication services and beneficiaries of a reformed telecommunication industry. The major opponents are the incumbent telecommunication operators who have vested interests in the old regulatory systems. The countries whose regulatory reforms are less successful are those without institutionally significant beneficiaries from the reforms. In regards to license downsizing, the major beneficiaries are private entrepreneurs whilst the bureaucracies issuing licenses have vested interests in the old licensing regime. The institutional position of PRC private entrepreneurs is very weak. The PRC denies autonomous interest groups with institutional positions participation in the policy process. The strict control of the formation of civic associations makes it difficult for private entrepreneurs to organize collective actions. All-PRC Federation of Industry and Commerce, the state-sanctioned national association representing private enterprises, is like a government's executive arm more than its Anglo-American counterparts which proactively advocate the interests of their members, join alliance with legislators and functional bureaucracy, and lobby on behalf of their members. Without beneficiaries having strong institutionalized positions, license downsizing easily loses momentum in the face of bureaucratic resistance.<sup>9</sup>

The second feature is the ineffectiveness of the legislation review mechanism. To assure consistency among different levels of laws and regulations, several OECD countries have established central regulatory registers and enforced only the rules that

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<sup>9</sup> For details about how private entrepreneurs influenced local governments and their institutional positions in the policy process, see (Saito, 2003; Dickson, 2003).

are included in the registers (OECD, 2002, p.373). PRC has its own legislation review system under which the NPC wields the review authority. The NPC promulgated the Law of Legislation in 2000 to operationalize the review process. This Law identifies a hierarchy of Chinese laws with the Constitution as supreme. The laws enacted by the NPC should prevail over the State Council's administrative decrees which, in turn, prevail over local laws. Local administrative decrees are placed at the bottom of the hierarchy (Articles 78–80). The Standing Committee of the NPC is responsible for reviewing and striking down lower-level legislation contradictory with Constitution and laws (Article 88).<sup>10</sup> Beneath its Law Committee, the Standing Committee of the NPC set up a Judicial Review Office (*Fagui shencha bi an bangongshi*) to provide the Law Committee with expert advice on legislation review. Review of consistency among administrative regulations and local people's congress regulations was left to the State Council, its Ministries, or local-level administrative agencies (Article 86). Since the promulgation of the Law of Legislation, the Standing Committee of the NPC has received some 20 requests for legislation review. But the Standing Committee of the NPC could not take any action in response because it had not worked out a review procedure. The Judicial Review Office had only a staff of less than thirty officers. This was far from enough to reviewing all legislations and decrees (Wen and Hua, 2004: p.31).<sup>11</sup>

The third institutional feature is high ambiguity in the laws aimed at delineating administrative authority. For example, administrative punishment law obliges local governments to hold public hearings when they plan to introduce a “relatively large amount of penalty” or a provision about “revoking” (*diaoshao*) licenses. To evade the constraints, some departments do not introduce penalties but collect “guarantee money”. They do not revoke licenses but “recall” licenses (Ma, 2006). The ambiguity in the Regulations of Management of Dangerous Chemical Products is another example. The regulations, issued by the State Council in March 2003 states that manufacturers of dangerous chemical products, including “mildly poisonous agricultural-used pesticides” have to obtain licenses first before they can start their businesses. But the definition of “mildly poisonous pesticides” is unclear. Some agricultural bureaus classified fertilizers and pesticides into dangerous chemical products and justify their insistence on keeping the licensing authority over the trade of fertilizers and pesticides. By this means, the bureaus may keep their authority to deny private entrepreneurs necessary licenses to run businesses of fertilizers and pesticides, and fend off competition against similar businesses affiliated to the bureaus (Yang, 2005). Some local governments circumvent the Administrative Licensing Law by transferring their licensing authority to subordinate industrial associations or other government-sponsored intermediary entities. These associations and entities are known as service units (*shiyue danwei*). Though they are charged with administrative functions, they are not counted as administrative entities: Administrative entities usually refer to government departments. The licensing items that service units take charge of are not counted as administrative licenses and therefore not bound by the Law (Han and Yang, 2005).

Courts have the potential for curbing power abuse. Unfortunately, that the PRC's courts lack prowess to rein in the administration is the fourth institutional feature entrenching local leaders' incentive to safeguard their licensing authority. The power of interpreting laws and administrative decrees does not rest on courts but people's

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<sup>10</sup> In reality, this provision can be applied in different ways. In 2005, the Standing Committee of NPC received a petition from a peasant in Hebei province protesting that the provincial regulations on land management violated the national Law of Land Management. Before the State Committee of NPC took actions, Hebei provincial people's congresses amended the provincial regulations to keep them consistent with the Law. For detail, see (Yang, 2005).

<sup>11</sup> A more comprehensive evaluation of the Law of Legislation can be found in (Zou, 2004: pp.50-53).

congresses. The deputies of people's congresses, however, work for the congresses on a part-time basis. Most of them have received no legal training. No subsidies are given to them to hire legal consultants or supporting staff. It is difficult for them to accumulate expertise and to spare time for law interpretation. Unlike the judges in Western democratic countries which guarantee judiciary stability and impartiality through life employment, PRC judges' terms of office are decided by Party branches. Courts are dependent on Party branches and local governments and vulnerable to intimidation from Party and government officials. Thus PRC judges are reluctant to challenge government decisions. More importantly, PRC political leaders reject the liberal notion of a neutral state. Courts have to decide cases according to a normative agenda determined by the regime (Peerenboom, 2001). Even though occasionally courts may exert their prowess and rule against local governments, local governments' resistance can easily foul the rule enforcement. In early 2006, the city court of Tolufan, Xinjian Autonomous Region reportedly ruled that a township government violated an entrepreneur's property rights and had to compensate him. The township government ignored the ruling and the ruling could not be carried out (Lu, 2006). The limitation of existing laws and judiciary makes it difficult for businesspeople to challenge administrative decisions and safeguard their rights. Without powerful constraints, many local leaders have incentives to ignore the laws and policies going against their interests, Administrative Licensing Law and other measures of license downsizing included.

## **Conclusion**

On top of improving the business environment, license downsizing has the potential for changing bureaucrats' behavior towards private businesses through institutionalizing the operational mode of the administration on the basis of PRC's WTO commitments. The downsizing centers on removing the licensing authority of local bureaucrats and changing the practice of creating market barriers and rent seeking by the use of an overly complicated licensing system. The PRC government has slashed most licensing items and issued laws and regulations to prevent annulled licensing items from being re-established. Sub-provincial governments have to refer to national laws and regulations before making decisions on licensing issues, and gain the approval from provincial-level governments in order to establish new licenses. Provincial people's congresses have taken some of the licensing authority from provincial-level governments and weakened the latter's ability in licensing issues.

The selective implementation of the downsizing illustrates that the masterminds behind the policy have failed to adequately consider the structural features of local institutions through which the downsizing policy is carried out. Since the policy entails numerous implementers whose interests are diverse and activities are poorly coordinated, a command-and-control approach in implementing the policy neither solicits voluntary compliance from implementers nor generates adequate information for policymakers to monitor policy implementation and exercise sanctions. Besides that, the incentive systems in local governance go against the policy in the implementation process: The performance appraisal systems of local leaders and job rotation system encourage local leaders to narrowly focus on the short-term economic growth of small localities but ignore the welfare of wider regions and the long-term policy of improving investment environment. Licensing authority conducive to achieving the immediate result of economic growth by fending off competition against local enterprises and their products is therefore much sought after. Since local governments are required - at least to a large extent - to be financially self-sufficient, the potential of the licensing authority to form local governments' major source of revenue provides strong incentive for the local government without a broad tax base to thwart license downsizing. Other

institutional features such as weak institutional positions of private businesses, ineffective legislation review mechanism, and deficient legal system make it possible for local leaders to bypass the formal rules.

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