Regionally Decentralized Authoritarian Regulatory Regime of China

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FINDING THE RIGHT BALANCE OF REGULATION FOR ECONOMIC DEVELOPMENT:
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Regulation and Political System

• Regulation is a sub set of law enforcement
• Efficacy of law enforcement depends on the political system
  – Separation of powers
  – Judicial independence
  – The political system determines either a regulatory regime follows rule of law, or it rules by law, or it is a rule of person
• Cross country evidence: stable and effective regulation follows rule of law
  – Affects stability/sustainability of long run growth
The Chinese Political System

• I characterize the Chinese political system as regionally decentralized authoritarianism (RDA)
  – Highly centralized politics controls all top positions via the monopolistic ruling party
  – No separation of powers; no judicial independence
  – Unchallenged monopolistic ruling party
  – Highly decentralized administrative implementation and resource allocation
    • Different from other authoritarian regimes

• The party defines sub-national jurisdictions

• All subnational levels’ legislatures/courts are controlled by the part at that level
China’s regionally decentralized regulatory regime

- Under the RDA regime every subnational party-government controls over all legal-economic matters within its jurisdiction
- Local courts are not independent from local governments
  - Judicial system malfunction because of this
- Thus, a law based regulatory regime would not operate
- Any thing can operate must be administrative
- The regulatory regime has to be based on subnational governments’ admin capacity
Quota System in Decentralized regulatory regime

• The regulatory regime involves local government deeply
• Quota is a device between central and local governments
  – As a device for planning, assessment, and incentives
• Examples: quota based regulatory regime
  – Land conversion quota: regulate land use through regions
  – Credit quota: regulate money supply through regions
  – Quota of equity shares: regulate securities market through regional governments
    • Designed to control the size of financial markets and to keep balance among regions
  – Pollutant emission quota: regulate environmental pollution
  – Other examples:
    • Bankruptcy quota
    • Work place safety quota, e.g. how many is allowed to die
    • Import/export quota
Stylized operation of quota system

Central Government’s Planning:
- Determines National Quota;
- Decompose into regional quota;
- Allocates quota to regions

Regional Governments:
- Based on their Career concerns (e.g. regional competition);
- and overall local interests
- Allocate quota to relevant units;
- Collect/report info if required

Central Gov’t’s enforcement
- Overall vs. one indicator assess performance → resource performance → appointment

National Regulator/Ministry
- Review info;
- Issue regulatory requirements
Quota system operates together with regional competition

- Under the RDA regime regional competition was the driving mechanism for reform/growth
  - Subnational governments compete for growth
  - Regional competition resolves incentive problems
  - Also determine the direction of regional experiments
- Quota system is part of the regional competition
  - Decentralized regulatory responsibility and information collection
- Promotion and resources needed for competition are linked to fulfillment of quota based regulation
- As a transitional regime the quota system never worked well
  - Although administratively it might implement a decree fast
Why this kind of admin based regulatory system may not always function

• Take Land quota, credit quota, pollutant emission quota and food-and-drug regulation as example

• Sub-national governments’ interests are in conflict with the subjects of those to be regulated
  – Local governments care more about growth
    • For promotion; for fiscal revenue; for opportunities of rent-seeking and corruption
  – Local governments can easily manipulate the information

• The resources to be regulated are directly controlled by local governments
  – Other than promotion, the central government has no leverage in incentives
When regional competition fails to work

• When the economy is relatively developed, regional governments’ competing for GDP becomes a problem
  – The transition from central planning to market is over
  – The transition from very poor to moderately poor is over
  – Regional competition/experiment do not work beyond these transitions

• But there is no way to design a comprehensive indicator for regional competition
  – The old problem faced by central planning

• No better solution for incentives than regional competition in the RDA regime

• Incentives of subnational governments are further distorted => regulatory failure becomes more severe
RDA regime is the source of problem

- Appointed bureaucrats are not responsible to the citizens
  - The local governments are only accountable to the bosses
  - There is no way to design an incentive scheme
- No checks and balances, no separation of powers
  - Unstoppable power abuse, rent seeking, corruption
- Regulation becomes tools of keeping monopoly, rent-seeking
- Corrupted regulatory regime destabilizes the socio-economy
  - Chinese government’s huge/growing expenditure on “maintaining social stability” indicates the seriousness of the problems
  - 2011 social stability budget 624 billion RMB (95 billion USD) vs. defense budget 600 billion RMB
  - 2012 social stability budget doubles that of the defense budget
Conclusion

- The Chinese regionally decentralized regulatory regime was a transitional solution when the legal institution is very weak.
- It is admin based and its function was associated with regional competition.
- When regional competition fails to work and the judicial independence is absent, this admin based regulatory regime further degenerates—due to seriously distorted incentives of regulators.
- There is no alternative than building a law-based regulatory system.
- Requires judicial independence.
Thank you!