

(Conference Material)

“Law and Development in China: Present and Future”

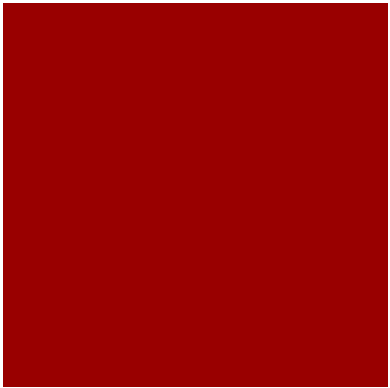
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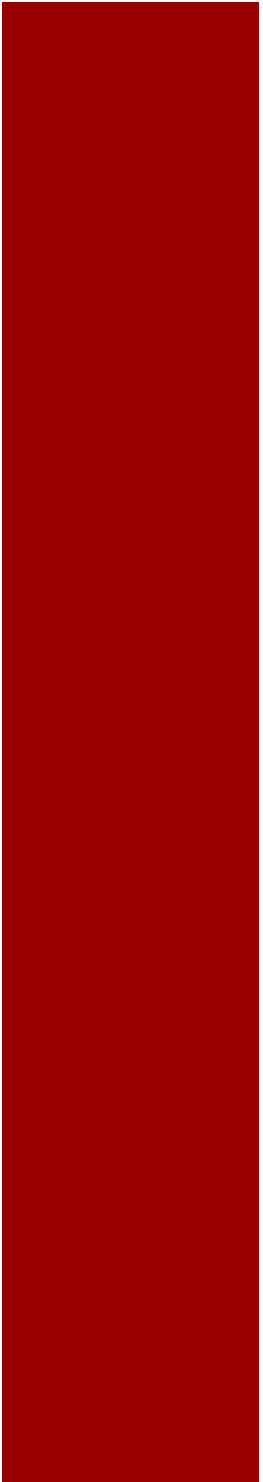
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The Great Transformation: Law, Development, and State-Building in China





A procedural definition of the rule of law

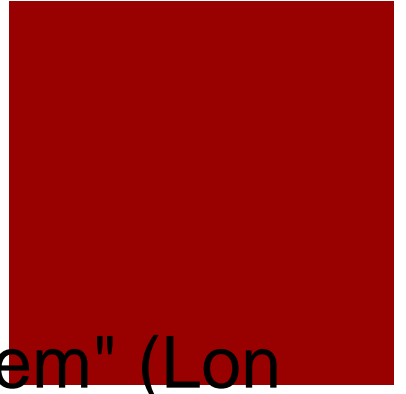


The rule of law is a highly contested concept

- thick/thin dichotomy
- substantive/procedural dichotomy

"Read any set of articles discussing the rule of law, and the concept emerges looking like the proverbial blind man's elephant - a trunk to one person, a tail to another." (Belton, 2005)

Defining the Rule of Law



Procedural elements for a constituting a "legal system" (Lon Fuller):

1. Generality
2. Promulgation
3. Prospectivity
4. Clarity
5. Consistency
6. Reasonableness: No impossible obligation
7. Constancy
8. Congruence

Other proposed elements

- Accessible, independent judiciary (or dispute resolution system)
- Substantive conditions:
 - human rights?
 - property rights?
 - market economy?
 - democracy?

Different emphasis: Law and Order



Different emphasis: Rights protection



An institutional approach to understand the concept of the rule of law

Primary institutions:

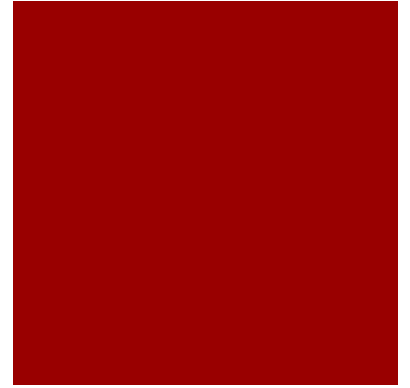
- Laws: well written and known;
- Judiciary with capability;
- A force able to enforce laws

Supporting institutions:

- for laws: legislatures, notary public, etc.
- for judiciary: bar associations, clerks and administrative works
- for enforcement: prisons, intelligence services, bail systems, etc.
- others: law schools ...

Institutional building:

- Capacity building
- or fundamental changes?



Rule of Law and Economic Development



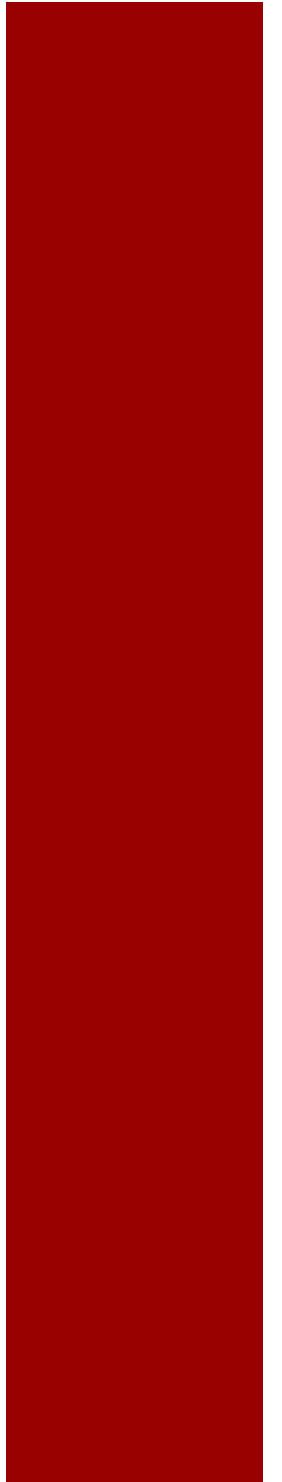
Competing theories

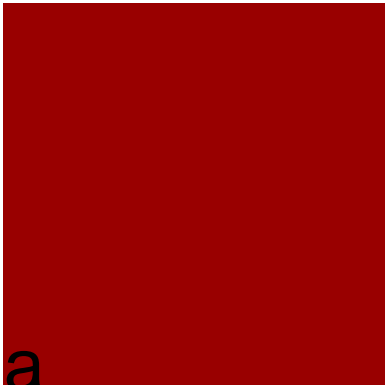
- Webber, Hayek, and North: rule of law as necessity (a legal order offering rights of property and contract as essential elements for economic development)
- Donald Clarke: Right Hypothesis and the China Puzzle
 - China problem: weak rights protection vs. highest economic growth (enormous expansion of output, employment, productivity, exports and incomes; unprecedented progress in poverty alleviation and material well-being; emerging as a major force in global markets)

An alternative explanation: rule of law is a matter of degree?



II. LAW AND STATE- BUILDING



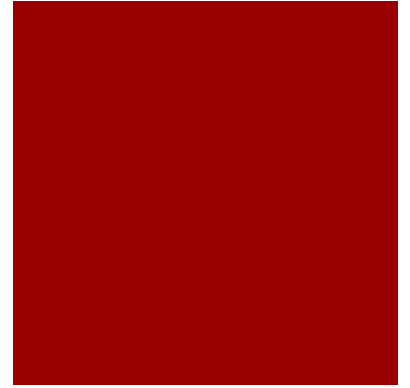
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- State-building defined: a process through which a functioning state is constructed. It could cover
 - state creation/nation building
 - creating political structure and legitimacy
 - constructing a shared sense of identity and common destiny (to overcome ethnic sectarian or communal
 - state capacity building

The goals of state-building and the setting of priorities

- Political settlement and peacekeeping to bring stability and security
- Humanitarian relief
- Governance structure
- Economic stabilization
- Nation building
- Development (infrastructural building, economic growth, poverty reduction, etc)
- Improving regulatory quality
- Providing public goods for social justice
- Capability to undertake reform measures (economic and political) to maintain sustainable development

Sequencing in the process of responsive state-building

- Political settlement and security
- Survival functions
- Expected functions



Political settlement

- Consensus among elites that bring about the conditions to end conflict, or
- Emergence of a group with sufficient power to start imposing or negotiating a settlement

Survival functions

- Security
- Revenue
- Governance and enforcement



Expected functions

- Achievement of an expected level of functionality
- Expectations differ between countries
- Some common expectations
 - Macroeconomic management
 - Infrastructural building
 - Development and shared growth
 - Property rights
 - Impartial dispute resolution
 - public health
 - Education
 - Provision of market-oriented institutions
 - Social security and welfare
 - Wealth redistribution
 - Human rights protection
 - Democracy
 - ...



Note

- Distinction between the two functions should not be viewed dogmatically as each has elements linked to the other
- But, in practice, building survival functions and building expected functions can be two staged of development
- Level of performance depends on commitment, capacity, and the nature of expectations

The role of law

For the survival functions

- Not necessary unless rule of law is understood only from "law and order" or enforcement perspective;
 - For instance, "The onset of economic growth does not require deep and extensive institutional reform" (Dani Rodrik, 1996)

For the expected functions

- For sustainable development, rule of law is probably necessary
- but not sufficient

How about legitimacy?

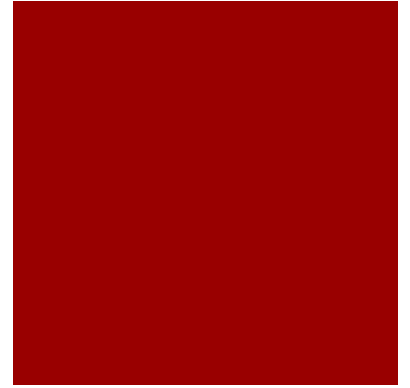


Domestic legitimacy: Acceptance by the people?

- Is election the only way to establish legitimacy?
- The relationship between revolution and legitimacy
- In non-democratic state, could consensus be achieved through other means of public participation (e.g. extensive consultation between the state and selected members of the public)?

Scope vs. strength

- Scope of state activities
- State strength or capacity



The state and its "builder"



Who are the builders?

- Foreign forces
- International donors/organizations
- Domestic elites (political parties)

The relationship between the state and its builders

- the builder is the "creator" of the state
- in the state-building, especially the state formation process, the builder might be above the state politically
- it is often the case that the builder uses various tools/instruments to "build" the state
- Monopoly of state power by the builder, whose reluctance to allow public participation/democracy may lead to the destruction of the state (or low quality state-building)

III. LAW AND THE CREATION OF A NEW STATE IN CHINA (before 1978)

- Traditional state: *tianxia*, one world under a dynasty, not a modern nation-state
- The emergency of the Chinese nation-state: since late Qing Dynasty, with massive foreign invasion

The creation of a Chinese nation-state

- From a macro history perspective, China's two political rivals, the Nationalist Party (*Kuomintang*, or KMT) and the Communist Party of China (*Gongchandang* or CPC), both played different, yet equally indispensable, roles in China's state-building process
 - KMT provided a superstructure
 - CPC created a bottom structure for the new China

PRC Legal History before the Reform era


- Abolition of the RoC legal system
- Land reform
- Industrialization

Abolition of the RoC Legal System

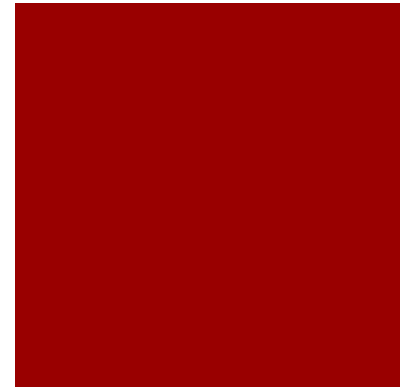
CPC Central Committee issued a document to completely "abolish" the Six Codes, which represented the entire legal system of the Republic of China; replaced with CPC's policies

Rationale:

- Lowering transaction costs to zero by eliminating all legal barriers to nationalization of all private property

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- Land reform: Redistribution of lands between peasants
 - Nationalization of assets owned by the KMT government
 - Expropriation of private capitalists' property through "joint venture" between the state and them

Results achieved



- Establishment of a substantial industrial base
- Massive infrastructural building
- Health care and education
- Elimination of the civil society and market
- State-individual relationship: individuals subject to state power (although state power is constrained by traditions of the CCP and the Chinese society)

IV. LAW AND THE INSTITUTIONAL FOUNDATIONS OF CHINA'S REFORM



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- First stage: 1978 – mid 1990s
 - Build the economical and political foundations through administrative control of allocation of resources
 - Second stage: mid 1990s to present
 - Developed best practice market institutions with the aid of rule of law
 - Toward a rule-based economic system
 - The Chinese experience defy conventional wisdom to a limited extent (a timing issue)
 - Conventional wisdom: Washington consensus (stabilization, liberalization, privatization and democratization)

(1) The 1st stage: reforming the system through administrative control

- No blueprint for the reform (except for a clear goal: improving living standards of the people and reestablishing legitimacy)
 - Gradualism
 - Experimentalism
 - Pragmatism
- Institutional changes in four areas
 - Regional decentralization
 - Entry and expansion of non-state sectors
 - Financial dualism
 - Market liberalization through dual-track system



Regional decentralization

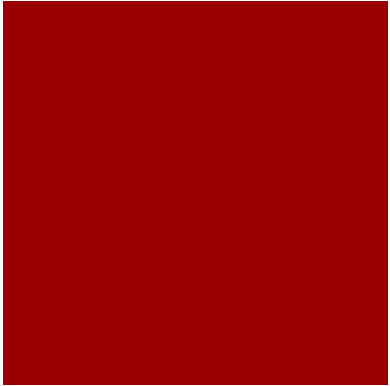
- Significant regulatory authority given to local governments
- Advantages
 - Regional experimentation and isolated negative influence
 - Regional competition
 - Informational advantage
- Disadvantages?



Decentralization in enterprise reform



- The primary objective: “power-delegating and sharing” (放权让利), through
 - increasing enterprise autonomy (including profit retention)
 - Enterprise contracting system
 - Accompanied by the fiscal and monetary policy reform: “profit submission” switched to “enterprise tax” (“利”改“税”) and “budget allocation” switched to “bank loan” (“拨”改“贷”)

- 
- The role of law:
 - reform measures codified in the *1988 Law on Industrial Enterprises Owned by the Whole People* and the *1992 Regulations on Transforming the Management Mechanism of Industrial Enterprises owned by the Whole People*.

Entry and expansion of non-state economy

- Creation of a private economy without privatizing state-owned enterprises
- A win-win situation?



Non-state sectors

- Private enterprises were eradicated in China in 1956
- Private ownership reemerged after 1978
- The growth of the township and village enterprises
- The legalization of private ownership



- China's reform approach towards a private-ownership economy: creating a private sector without dramatic privatization
 - Between 1978 and 1993 the share of non-state enterprises increased from 22 percent to 57 percent, which happened without any privatization of SOEs
 - Cf. reform approach of the former Soviet members
 - Typical Chinese pragmatism

Private ownership

- The 1982 Constitution recognized “individual economy”
- The 1988 constitutional amendments allowed for “private economy”
- Major amendments to the PRC Constitution in 2004: equal protection of private property
<http://www.china.org.cn/english/features/90056.htm>



Constitutional basis of private ownership

PRC Constitution, Art 11 [Private Sector of the Economy]

- (1) Individual, private and other non-public economies that exist within the limits prescribed by law are major components of socialist market economy.
- (2) The State protects the lawful rights and interests of the non-public sectors of the economy such as the individual and private sectors of the economy. The State encourages, supports and guides the development of the non-public sectors of the economy and, in accordance with law, exercises supervision and administration over the non-public sectors of the economy.



Art. 13 [Protection of Private Property]

- (1) Citizens' lawful private property is inviolable.
- (2) The State, in accordance with law, protects the rights of citizens to private property and to its inheritance.
- (3) The State may, in the public interest and in accordance with law, expropriate or requisition private property for its use and shall made compensation for the private property expropriated or requisitioned.

Cf. Articles in the Constitution on “Socialist Public Ownership”


Article 6 [Socialist Public Ownership]

(1) The basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people. The system of socialist public ownership supersedes the system of exploitation of man by man; it applies the principle of "from each according to his ability, to each according to his work".

(2) During the primary stage of socialism, the State adheres to the basic economic system with the public ownership remaining dominant and diverse sectors of the economy developing side by side, and to the distribution system with the distribution according to work remaining dominant and the coexistence of a variety of modes of distribution.

Article 7 [State Economy]

The State-owned economy, that is, the socialist economy under ownership by the whole people, is the leading force in the national economy. The State ensures the consolidation and growth of the State-owned economy.



[In China], The private sector is driving growth and can be strengthened further. *The scope of private ownership has become substantial, producing well over half of GDP and an overwhelming share of exports. Private companies generate most new jobs and are improving the productivity and profitability of the whole economy. The government has restructured the state-owned business sector, resulting in a massive loss of jobs. Still, a large part of the state sector remains to be restructured; policies to facilitate this process have been identified and are being expanded...*

OECD Economic Surveys: China (2005)

The case of township and village enterprises (TVEs)

- Government control helped the TVEs to
 - Be protected from the anti-private property ideology
 - Be protected from central government intervention
 - Acquire new capital



Market liberalization – “growing of the plan”



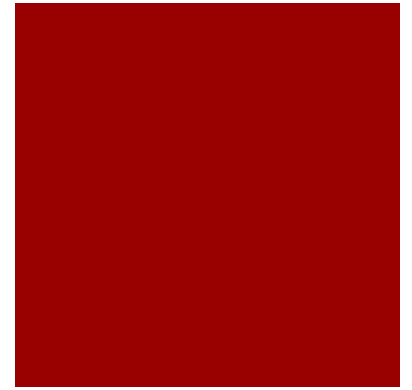
- Through a dual-track approach
 - To grow the products markets
 - Price liberalization was the key
 - Dual-track
 - (1) the market was first liberalized (market price) at the margin, while
 - (2) planned prices and quotas were maintained and then phased out later.
- The philosophy: liberalize without creating losers (at the expense of efficiency but politically appealing)

Financial dualism

- Mild financial repression: governmental control of international capital flows and restrictions on domestic interest rates and private financial activities
- Anonymous banking: relaxed regulation on the use of cash and anonymous household saving deposits




The role of law in the first stage



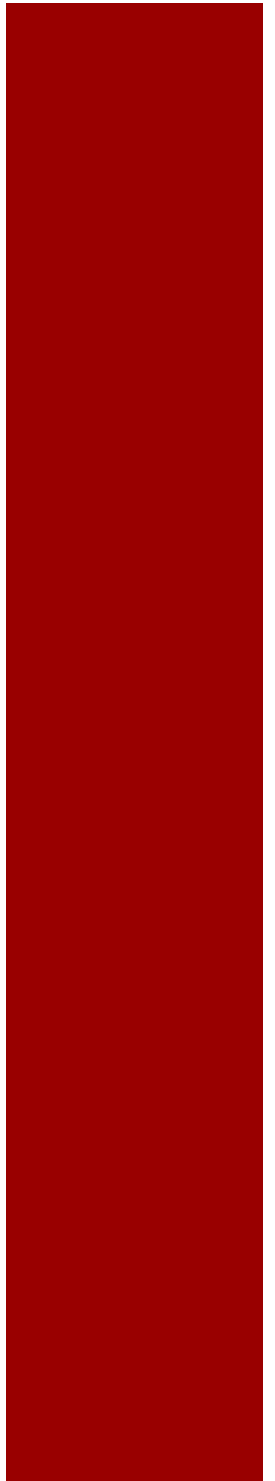
Implications

- Preparation for deepened market-oriented reform in the 2nd stage through unleashing forces of positive incentives, hard budget constraints, and competition
- Helped China avoid a Soviet-style collapse in the early 1990s
- Problems:
 - Some mistakes
 - Difficult reforms delayed
 - Frequent policy changes due to experimentalism



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- Establishing market-oriented institutions
 - From administrative governance to legal governance
 - Examples:
 - State administration (in accordance with law)
 - Transparency
 - Corporate governance
 - ...

WHAT'S THE
PROSPECT FOR
FUTURE
REFORM?



Authoritarian Developmentalism



- Enlightened authoritarianism
- Adopted in China (mainland), South Korea, Taiwan, Singapore, and arguably in Japan
 - Less successfully Malaysian, Indonesia
 - Failed in The Philippines?

Conditions for authoritarian developmentalism

- A strong and economically literate leadership
- Development and poverty reduction as a supreme national goal, ideology, and obsession
- An elite technocrat group to support the leader in designing and executing polities
- Top-down, coherent and flexible decision making
- Political legitimacy derived from successful economic development



Leadership

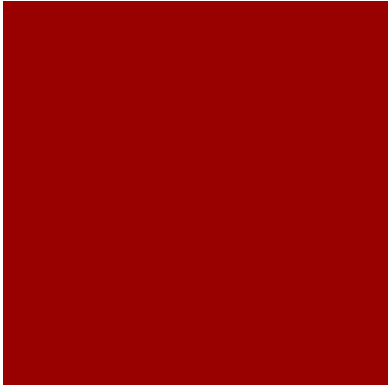
- Undemocratic
- Strong in executing policies and maintaining ruling (and ruthless to political opponents)
- Determination to pursue good policy for achieving economic development



The alleged necessity for strong leadership


- Those countries/economies all started with a low base (without much capital)
- An authoritarian system needed for massive and speedy resource mobilization

The institutional characteristics and requirements for development [accumulation and change] and for democracy [accommodation and compromise] pull in opposite directions... democracies have great difficulty in taking rapid and far-reaching steps to reduce structural inequalities in wealth. (Leftwich, 2005)



The country must unify different ethnic and social groups into an imagined community, build power and transport systems, attract investment, improve skills and technology, build schools and hospitals, crack down on crimes and social evils, relocate residents, manage urbanization and internal migration, conduct macroeconomic and trade policies, cope with global and regional shocks, and so on. If political participation of all concerned groups is allowed, and if all laws and policies must be debated thoroughly in the parliament, it is more democratic but takes too much time. If a critical mass of policies is not adopted quickly and simultaneously, the country cannot initiate or sustain growth.

Kenichi Ohno (2007)

- 
- Add to this is the fact that many East Asian economies faced security threat from internal and external sources
 - South Korea: from North Korea and other socialist/communist states (Russia, China)
 - Taiwan: mainland China
 - Singapore: surrounded by unfriendly states

 - Further, they all faced the threat of internal political chaos and ethnical unrest

Government-led industrial policy



- Government selects industries for support/establishment
 - Strategic planning: identify industries most suited to the next stage of development
 - Japan: MITI
 - South Korea: the Blue House Committee under President Park Chung Hee
 - The committee also decided the location, scale of the project and the size and degree of government support
 - Initial support: free/cheap infrastructure, monopoly position, export performance based subsidies, bank loans, foreign exchange allocation, tax benefits
- State ownership: state direct investment
 - A variation: strong state-industry relationship
 - Japan: *Keiretsu*
 - Korea: *Chaebol* under gov's strong influence
 - Taiwan: SOEs
 - Private firms were induced by incentives. Note state ownership was not the goal (different from the socialist states)
- Interventionist macro economic policy
 - Fiscal policy
 - Tax policy
 - Trade policy: trade protectionism to trade liberalization
 - Administrative regulation

Change of policy at the second phase



- Change of policy orientation in the 1980s
 - Internal:
 - problems accumulated and policy attacked: the increasing complexity of the economy made efficient intervention technically more difficult
 - Change in the political system
 - Foundation built to compete in international markets
 - External:
 - U.S. began to run trade deficits and pressured to pry open those countries' markets – forced liberalization
 - Asian Financial Crisis 1997-98: Korean government used this opportunity to privatize banks, reduced the size of the *chaebol* and increased competition

Government and institutions building



- Institutions supplied by the government:
 - (Economic) Rule of law: contract law, property law, business organizations law, bankruptcy law, etc
 - Limited social safety network

- Institutions created under the tolerance of the government
 - NGOs
 - Commercial practices

Corruption and rent-seeking



- In those economies industrialization stage, political and rent-seeking considerations played little role.
- Personal benefits obtained by the strong leader and corruption officials were small relative to that of the economic growth
- Reasons:
 - Legitimacy depends on economic delivery
 - The leader was not personally a rent seeker
 - Officials (especially those policy makers) have also the tendency to pursue good policy
 - Corruption with delivery

Development and Social Changes

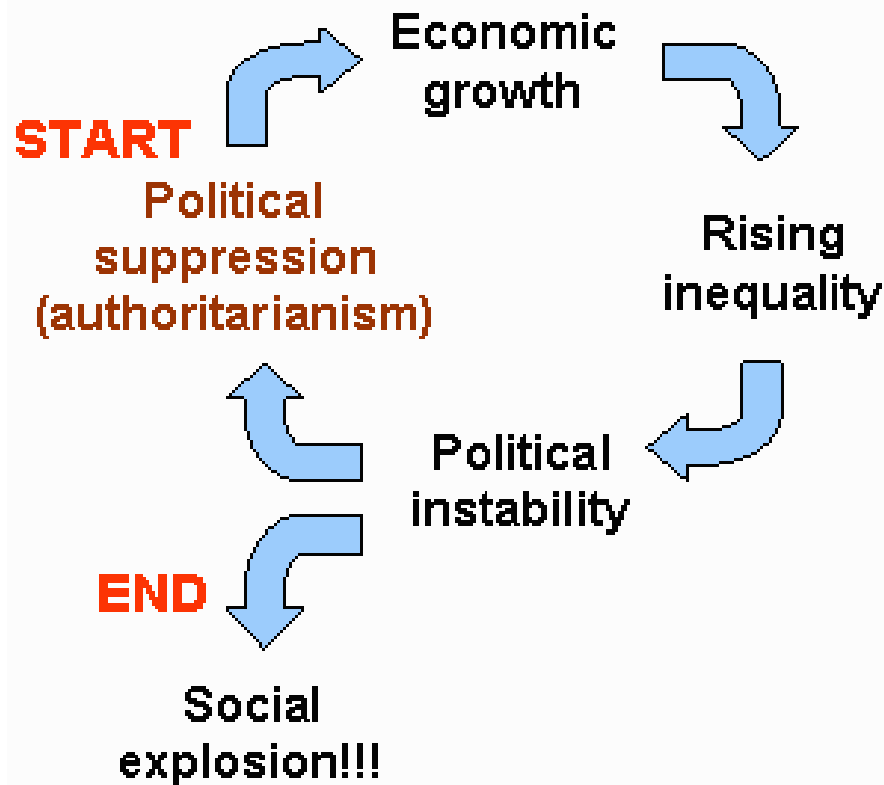


- Economic development and social transformation
 - Increased social mobility and destructed social structure lead to more discontent
 - Income disparity and increased social tension
 - Environmental destruction
 - Declined level of morality
 - Political conflicts might eventually stymies developmentalism itself

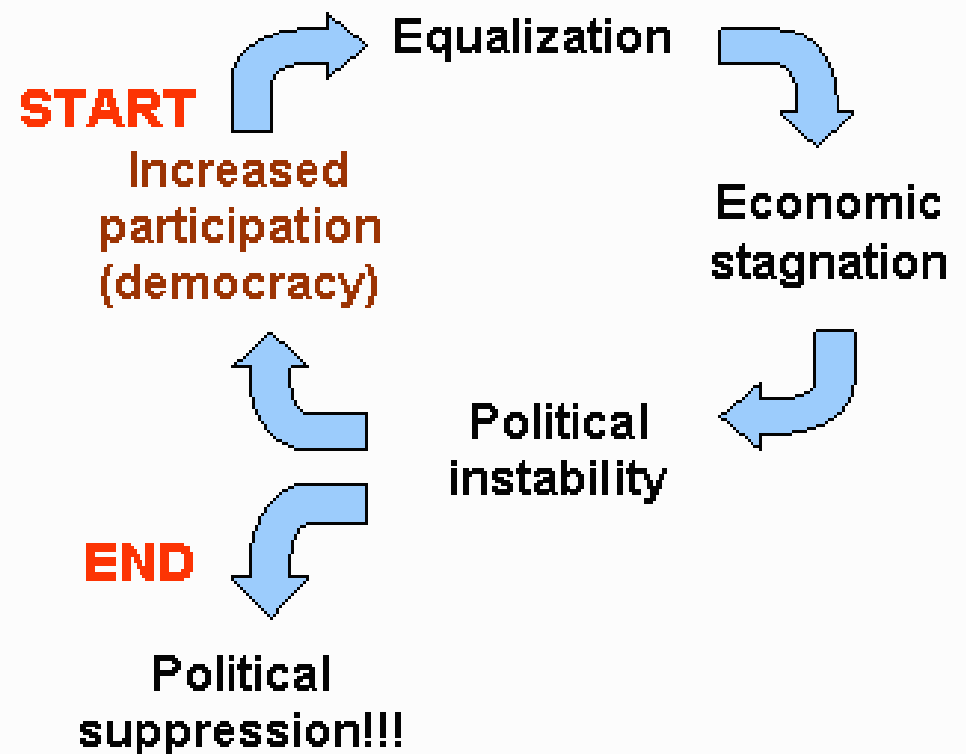
No Easy Choice?



Technocratic Model



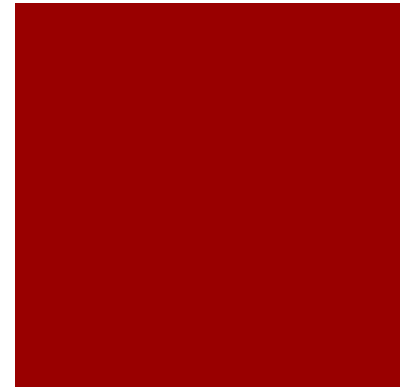
Populist Model



Source: Compiled from Huntington and Nelson (1976).

Conclusion:

- Authoritarian developmentalism is not sustainable; it will create its own enemies



FUTURE PROSPECTS

- Trapped in transition or collapse?
- Transition to democratic developmentalism model featuring market economy, open election and rule of law
- An alternative model?



Transition to Democratic Developmentalism?



- Recall:
 - Authoritarianism is not sustainable
 - Development creates conditions for democracy-oriented political reform
 - Rule of law (and probably constitutionalism)
 - Wealth-equipped individuals and families who by nature resent violence
 - Highly educated middle class who are tired of authoritarian rule