

Rule of Law in China: Chinese Law and Business

Russia and China

A COMPARATIVE PERSPECTIVE ON THE POST-COMMUNIST TRANSITION

MARINA KURKCHIYAN

The Foundation for Law, Justice and Society

in collaboration with

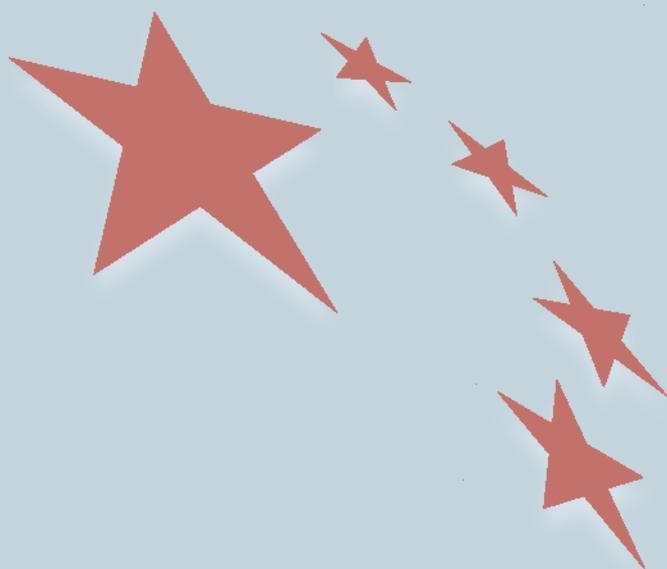
The Centre for Socio-Legal Studies,
University of Oxford

www.fljs.org



Contents

Introduction	2
Different Economic Models	4
Human Resources	13
Different Legal Cultures	15
The Political, Economic and Legal Interplay	22
In Summary	23



Executive Summary

- This investigative comparison of the post-communist transitions of Russia and China attempts to assess why China's growth has outstripped that of Russia, and whether Russia's stunted economic development may offer signs for the future growth of China.
- Russia's economic overdependence on its oil and gas reserves is a limiting factor in its overall development, whereas China has benefited from its huge workforce, cheap labour and the forces of globalisation to create a thriving supply-based economy. However, any slowing in the rate of economic growth in China may cause significant social unrest, and recent moves to reform labour laws, if successful, will increase production costs and make China less attractive for foreign investment.
- If China's development is to be made sustainable, it must cultivate a stronger consumer economy. Yet to achieve this, would demand a more rigorous implementation of the rule of law, and the Communist Party is reluctant to loosen its monopoly of power.
- Whereas Russia's transition from communism was characterised by an abrupt and destabilising privatisation programme, China's policy of introducing favourable legislation to attract foreign investment has proved the more successful in the short term. China's labour force is also far stronger than Russia's, due to its one-child policy and the large-scale emigration of young adults from Russia.
- The weak rule of law in both societies is attributed to the instrumentalist approach to law that characterizes both cultures. On an instrumentalist approach, the law is reduced in large part to a vehicle for serving specific political or private ends.
- China's formalistic interpretation of the meaning of law is attributed to its social philosophy dating from Confucian times, which is based on such traditions as 'guanxi' and mediation as a form of dispute resolution.
- The rule of law in Russia, by contrast, follows more closely Western models, but is undermined by the turbulence of its transition to a post-communist state during which the private sector assumed power and influence through the acquisition of natural resource assets. In response, the state's increasingly authoritarian stance has involved the corruption of the legal institution to serve its ends.

Introduction

The aim of this paper is to identify a series of questions about the economic development of Russia and China, with a particular focus on the differences between them. It is intended to serve as a guide for more extensive inquiries.

The similarities between Russia and China are well known and can be quickly summarised. These are countries with huge territories and population. Both have recent experience of dictatorial communist rule. For many centuries before that, both were harshly governed in authoritarian style by powerful, centralised elites. Both countries have long been known for their societal tradition of networking to evade authority and both now function in a manner that fails to match up to an ideal rule-of-law model. And of course, during the past generation both societies have been energetically engaged in a radical economic transition, moving away from state capitalism and towards a free-market economy. But despite these parallels, the economic achievements of the two countries are drastically different – at least in the public perception, and especially so in the minds of investors. Economically booming China is viewed as a spectacular success story, while slowly progressing Russia is typically seen as a relative failure.

In the Russian case, the statistics on economic development do demonstrate that significant progress is taking place. The economy is growing at a pace of 6.4% and in the past five years real personal incomes have increased on average by 12%, bringing GDP per capita up to the substantial level of \$11,100. Meanwhile the number of people in absolute poverty has declined steadily. In the classification scheme used by the World Bank to compare relative wealth, Russia is placed in the group of upper-middle income countries. Nevertheless, economic commentators point out that Russia has a poor business climate and that it is deservedly regarded as a risky and volatile market.

It has a weak and notoriously corrupt banking system. It also suffers from political interference in the ownership and operations of business firms including some of the largest multinationals as well as locally owned companies, and terms like 'arbitrary,' 'extreme' and 'unpredictable' are often used to describe that interference. These features of the Russian transition are discouraging even to domestic investors, not just to foreigners. Despite its progress, for many entrepreneurs the dominant image is that it is still a 'no go zone'.

China is oddly different. World Bank tables still place it in the lower-middle income group. Despite the stunning recent growth in the size of the total economy, GDP per capita is still only \$6,800 – well below the Russian level. China projects an image of immense success, with booming factories, brand new superhighways, clusters of skyscrapers symbolising newly rich cities whose residents appear to enjoy a wealthy lifestyle. All the apparently miraculous developments are made possible by an economy that is expanding at 10% every year. Investments are flowing into China at a rate of 44.4% of GDP (in Russia currently it is only 18.1% of GDP). The most common line (and often concern) in the economic literature on China is that it already stands as the second largest economy in the world after the US, as measured on a PPP (purchasing power parity) basis. There is no doubt that the general opinion among outside analysts that China is already an integral part of the global economy (whereas Russia is not) is fully justified.

In comparing the two countries, the general questions that need to be addressed are these. First, why should China have achieved such success in its post-communist transition while Russia is lagging behind? Second, how sustainable is Chinese development, and how does it compare with equivalent forecasts for Russia in the longer term? These considerations lead to more specific questions.

Why is China much more successful in attracting foreign capital than Russia, given the strange juxtaposition of governmental systems? After all, China is still under a remarkably rigid communist party rule, whereas Russia has elaborately democratised its political institutions. Why is China, a country with a drastically different legal tradition, more hospitable to Western businesses than Russia with its tradition of Roman law? Given the fragility of the leadership's grip on society in China, what is it that makes China look stable and secure in the eyes of a foreign investor, while Russia continues to appear to be volatile and unsafe?

It is clear that there is no simple answer to these questions, and it is not possible to single out one or two factors that would produce an incisive explanation of the several contradictory features in the overall picture. The same factor in different contexts might have differential effects, or at least a difference in importance. It is only the combination of factors and the accumulated contribution of each of them that can bring us closer to an understanding of why the situation is what it is. No single paper on this subject could cover all the possible avenues of

inquiry, and there is no ambition to try to do that here. However, this paper does offer an investigation of the overall problem, and suggests five directions of inquiry that appear to hold promise. They are (a) the different types of economy; (b) the different modes of transition; (c) the differences between the available human resources; (d) the distinctiveness of the legal cultures in Russia and China; and (e) the interplay between the political, economic and legal institutions in the two countries.

The issues explored here have been formulated on the basis of theoretical work in socio-legal studies combined with empirical research on recent trends and conditions in Russia. Inferences drawn from the hard evidence around the case of Russia then became a starting point for the analysis of Chinese development. This approach cannot yield empirical answers about China, but it does allow us to pose questions that will hopefully prove to be relevant and to suggest ways in which further inquiries into Chinese development might probe to a greater depth.

Different Economic Models

Russia's resource-based economy

The immediately obvious contrast between the Russian and Chinese economies lies in the nature of their respective business activities. Russia has placed its bid for development on natural resources: metals, timber and most importantly the exploration and sale of its rich deposits of natural gas and oil. At present these together account for 80% of Russian exports.

The main investors in the Russian economy are the global firms specialising in these products, notably the oil majors such as Shell and Exxon Mobil. They dominate the extractive industries together with a handful of domestically grown oligarchs who built their empires in the early 1990s when the fad for privatisation encouraged a chaotic sell-off of Russia's state assets. Any economy that is based on the exploitation of natural resources tends to be unbalanced.

Russia's economy today is, in the words of one commentator, just a 'one-trick pony'. All the elite attention, political as well as economic, is focused on performing just that one trick: to maximise oil revenue. This includes the private sector, which has already concentrated its capital investment in that single industrial sector. Like the government officials, private entrepreneurs have insufficient incentive to renovate other, less lucrative branches of the economy.

Because the oil industry is capital-intensive rather than labour-intensive, it does not create new employment opportunities on a significant scale. Although 21.4% of the Russian labour force do work in the industrial sector of the economy (a figure all but identical to the 22% of China's workforce who work in industry) the workers are mostly employed in decaying factories or declining sectors: the slow-to-change, inefficient, high-cost remains of the old Soviet factories and enterprises. Most of the workplaces across the entire Russian federation have not been properly renovated for a generation, either in terms of plant and equipment or, more

importantly, in terms of management style.

This situation makes the entire economy stagnant. The high world oil price enables the oil revenues to flow into the country and conceal the true economic picture. The country seems to be rich enough to support a moderate standard of living compared with the world as a whole, and in some ways it is. The wealth also permits the leadership to claim that progressive improvement is occurring in the economy, because that is what is being recorded by the main economic indicators.

However, the nature of the oil industry in all countries is such that although it tends to generate gigantic profits, only a very few benefit. If the whole of a national population is to share in the proceeds, the money must either be channelled directly to them by means of a sophisticated legal framework of wealth redistribution, or indirectly by spending it on things that benefit everyone, like infrastructure improvement or education. Such a scheme can only work successfully in a country with rule of law and well-organised, efficient and non-corrupt administration. Only a few have ever succeeded in doing this well. In recent years Norway has emerged as the exception that proves the rule. In contrast to Norway, it is clear that Russia lacks virtually all the conditions required to make its development balanced, effective and stable despite the unprecedented volume of profit flowing in.

Oil and gas are seen as strategically vital.

Because of that, the regulation of the industry is always a challenging, complicated and politically sensitive matter. This is particularly so in the Russian context. During the early stage of the transition, the Russian government made a number of deals that were unfavourable to itself, both with multinationals and with the oil barons that were emerging locally. In the view of outside observers at the time, it privatised the USSR's greatest assets on conditions that many people considered to be asset-stripping or

even plain robbery. In the government's own view, now that it is flush with the proceeds of the high oil price, the unfavourable deals were made only because it needed to attract foreign capital at a time when its bargaining position was exceptionally weak. The terms on which it issued a number of contracts to Western companies may have been humiliating, but it had no choice.

With the state gaining more confidence in recent years, the Russian government has started to make an effort to regain state control over the resources lost a decade ago. To achieve it, the Putin administration is employing the traditional method of 'rule of power and not of law' that dates far back through the Soviet period to the centuries of Czarist absolute rule. The recent examples are the de facto renationalisation of the extensive Yukos Corporation assets by accusing the company of massive tax avoidance, then bankrupting it, and finally selling the assets at a ridiculously cheap price to a state-controlled company, Rosneft. The current example is the spectacular cancellation of the Shell permit for the giant Sakhalin-2 project. This was cynically justified on newly-discovered environmentalist grounds. Many observers are convinced that this severe pressure is being exerted as a way to force Shell to sell 25% of its shares to another state controlled monopoly, Gasprom. The scale and unexpectedness of this deliberate policy to regain full influence over Russian strategic resources sends a chilling signal to the business community abroad. The action against Shell has been widely reported around the world and universally interpreted as being obviously political in nature. The demand for oil is such that even precedents as discouraging as these seem unlikely to stop oil investments from flowing into the country. However, it seems likely that these cases are building up such a negative image of Russia for potential investors in every other field that it may become an exception to the general trend whereby globalisation continues to expand in all national economies in the world.

To sum up, resource-based economies of the Russian type are tightly intertwined with politics. The wealth they produce is diverted either into the state budget

or into the hands of a few oligarchs. When that happens, the wealth is not available for the development of the economy. Investment, employment, incomes and welfare all suffer from the deprivation. There is of course a possibility that once Russia has succeeded in stabilising its political system and establishing the status of its renationalised oil and gas industry in the global economy, it will be able to channel its wealth into a balanced and widely distributed pattern of economic growth. Whether that will actually happen remains to be seen.

China's supplier-based economy

The Chinese economy, in contrast, was built up in response to the global trend towards outsourcing production from developed countries to poor ones, in order to benefit from cheap labour and other advantages such as lower taxation and weak regulation. This process became possible in China once the ruling Communist Party decided to open its previously closed market to foreign investment in order to promote economic growth. China notoriously has the world's biggest machinery of state; once the new free-market policy was introduced, it was implemented comprehensively – at any cost and at all levels of government. Legislation was brought in to attract foreign companies, typically by such means as reducing their corporate taxes to 15% (domestic firms have to pay 33%). Restrictions on migration from rural to urban areas were eased (though not abolished) so that labour-intensive manufacturing could expand in the booming towns. Roads, airports, harbours and other infrastructure facilities were rapidly expanded to facilitate the industrial growth.

The state-controlled media dutifully followed the Party line on the necessity for all this, praising economic achievements while keeping silent about the often legitimate grievances of the people. For example there was little report of the fact that ten million workers lost their jobs as a result of the wave of privatisation of the state-owned enterprises in the late 1990s. Judges were required to decide cases in favour of the new business firms in any case in which a firm's interests clashed with a citizen's interest. A typical

issue might involve people being evicted from their homes by developers. Many lawyers who went too far in the attempt to defend a citizen's rights were jailed or driven out of their profession.

The consistent implementation of China's industrial policy has within a remarkably short time turned the country into a network of supply factories so dominant in the global economy that it is justifiably known as 'the workshop of the world'. A key factor in promoting such a spectacular surge of foreign investment was the unquestioned credibility of the signal that the government sent to the outside world at the outset: the interests of the investors would be protected by the power of the authoritarian state. Even in those cases where the law is supposed to protect the workers, loopholes were carefully made available so that the traffic lights for overseas investors would continue to show green. For example, a law now exists to set a strict and reasonable limit to the maximum number of hours that anyone may work in a single week – together with a provision that this requirement can be avoided if exemption is granted by a local government. And it is avoided, frequently.

However, the overall effect of breakneck economic growth based on such principles does have its downsides.

To achieve such growth, the economy needs to exploit the labour force in an intensive manner and keep the cost down. The new corporate culture in China involves working long hours for low wages. The company in Longhua that supplies Apple with iPod digital music players is a typical example. According to one report the factory staff who assemble the gadget have to endure 15-hour shifts, seven days a week, for less than \$50 a month. The majority of the factory workers are internal migrants: peasants who have moved from the western and central countryside regions of China to the major cities which are mostly located nearer to the coastline in the east. Employment contracts are unsecured, with no sickness benefit or social security allowance. Workers have no right to organise

themselves in free unions, and certainly not to strike. Because their lives consist almost exclusively of hard labour, the workers tend to be continuously exhausted. Cases of workers dying through overwork are not uncommon.

As a predominantly supplier market, the Chinese economy does not have room for innovative development. Consequently it is doubtful that it will manage to change its status and become competitive with the developed markets. Because it lags behind the world leaders, it concentrates all its potential on cutting prices and copying western designs, techniques and sales methods. Despite its consistent expansion as a supplier economy, China started from a very low base and it is still unable to catch up with the fast-developing global market. After nearly 25 years of rapid economic growth, wages in China's manufacturing sector are still at 3% of the US level; after a similar period of rapid expansion in Japan and Korea in the years after World War II, wages were some ten times as high. China has taken a desperate lurch into the global market by pricing its products only a fraction above the cost of the raw materials. This is a process that some commentators describe as 'malignant competition', and all it has achieved is profitless growth. This makes comparison with other Asian economies somewhat questionable.

The challenge of transforming China's economy

To make development sustainable and to avoid social explosions the Chinese government now faces the task of taking the next step of the transition; it needs to shift the dominant pattern of its economy from a supply mode to a consuming mode. If this is to happen, the government needs to overcome a number of challenges. The most important is income redistribution. The population in general is not yet wealthy enough to bring about a shift to a consumer economy. Even for the newly emerging class of the better off, the total lack of a social security net means that people are inclined not to spend, but instead consider it prudent to save up for health care, for their children's education and for old age. There is a huge gap between rich and poor, with

family income disparity one of the highest in the world; China has an income Gini index of 44.4, which is higher than Russia's. The disparities are not a straightforward matter of layered classes, but multidimensional: between a poor western half of the country and a prosperous eastern half, between rural and urban, between migrating workers and stable residents, and in the cities between the new business elite and the vast influx of unemployed people from the rural villages. The great extent and intensity of rural poverty and the exhausted condition of the labour force are considerable obstacles to the opening up of what might otherwise be the second great strength of China: its population of approximately 1.3 billion, making for an almost bottomless market of potentially eager consumers.

It is clear that the urgency of moving to a new type of economy is recognised by the Chinese government. In recent publications local experts have been permitted openly to express misgivings about the impact of the large scale of foreign investments and the course of economic reforms. A discussion on the merits of equalising the income tax rates for foreign and local businesses has been initiated, although the necessary law has yet to be drafted. At the 2006 National People's Congress it was argued that if the sequence of mergers and acquisitions by foreign companies in China is allowed to continue unchecked, China's brands and its capacity to innovate will disappear. The need for independent innovation in technology and for less reliance on Western know-how has become an established theme of speeches by Chinese leaders in recent months. The recent commitment to an ambitious project to construct 5,400 km of high-speed rail track by 2010 while relying exclusively on domestic technologies, personnel and resources is an expression of their determination to demonstrate to the outside world China's readiness for scientific and engineering independence. However, China still has a long way to go.

In domestic social policy, the Party's current line is the cultivation of a 'harmonious society'. The methods are to consist of building a social safety net, implementing a 'Go West' policy and establishing

labour protection. A 'Labour Contract Law' that is now under consideration would attempt to match some European standards in the quality and quantity of its provisions. The bill was discussed behind closed doors by legislators in Beijing in April 2007, and the law is now scheduled to see a vote on final passage in June. If the legislation is indeed passed as planned, it would improve worker safety, impose minimum wages, cut the maximum working week to 40 hours (i.e. eight hours less than in Europe) and impose safety and workplace requirements upon employers.

If such a law were to be enforced effectively, it would transform the economics of manufacturing in China. Labour costs would increase to the point at which sourcing products in China would become far less attractive for Western multinationals. There is already strong opposition to the forthcoming legislation from foreign-owned companies. The American Chamber of Commerce has sent a written plea to the Chinese government asking it to reconsider the proposed legislation and making it clear that a steep increase in production costs would force many member companies to suspend their activities in China.

The new rules might also create social tensions because the provisions would necessarily strengthen civil society. Most significantly, the Labour Contract Law would be meaningless without free trade unions, which at present are banned. Several possible scenarios can be imagined though not all are plausible. One is that to make the new system of regulation work as it is intended to, the passing of the Labour Contract Law will be followed by the liberalisation of workers' rights to free association and free speech. This in turn could be the starting point of the growth of an independent civil society – an outcome that cannot be desirable for the government. Alternatively, with the law in hand, the workers might start to agitate for their rights, threatening the Party's monopoly of power and triggering wider social unrest. A third possibility is that the new regulation of the labour force will remain little more than rhetoric, without meaningful implementation. This scenario seems the most likely, given the history of communist

power in China. But even if the new law is toothless, its mere existence might well become a new and additional cause of pent-up social frustration that could eventually explode.

Questions to explore: What specific regulations are found in an outsourcing economy of the Chinese type? What are the prospects of a successful transition from China's present stage of dependency on outsourcing to a sustainable, internally regulated and innovative economic structure? How will the new Labour Contract Law work in practice? If it is successful, how will it affect the nature and functioning of the Chinese economy? Has China enough potential to move smoothly from being predominantly a supplying economy to a consuming one, or will social unrest, political instability and economic slowdown become the more probable forecast?

Different paths of transition

At the very outset of the transition the Russian and Chinese leaders took radically different paths, at a different time, and from different starting points. A simple comparison of these features reveals both advantages and disadvantages for China's transition.

- *Accumulated experience:* An early, slow and progressive introduction of market reforms has meant that by now China has accumulated substantial experience of operating in the contemporary global market. In contrast, the early Gorbachev attempts at reform during the 1980s in Russia were remarkably ineffectual, even though at the time 'glasnost' and 'perestroika' were fashionable Western talking points. The fact is that the Russian transition only started in the early 90s, whereas the Chinese step-by-step reforms go back to 1976, beginning at the time of significant changes in the Chinese Communist Party leadership.
- *The development of the global market:* The timing of China's transition was also advantageous in relation to the development of the global market. While Russia had to find its niche in the new world system at a time when the current global market

was already shaped, the Chinese timing of its transition to a market economy, a full decade and a half earlier, allowed the party managers, local governments and others to adjust successfully to the newly emerging tendency of Western businesses to move production facilities abroad.

- *Industrial legacies:* The very different condition of the two economic structures was also favourable for Chinese development right at the starting point of the transition. Russia had shifted from rural agriculture to urban industry by the 1960s, and stepped into the market era with an already developed industry, albeit an inefficient, technologically outdated, heavy, inert and militarily orientated one. To make a new start Russia first had to deal with the shrinkage, closure or modernisation of the entirety of its great industrial monstrosity. In contrast the Chinese transition to the market moved in parallel to the transition from peasantry to industrialisation. Even now 49.4% of the Chinese population has remained rural (compared with 10.35% in Russia), and the low-income village masses continue to form a huge reserve to meet further demand for labour in the Chinese manufacturing industry. China was able to build up the right type of industry to fit the times and slot easily into the globalised world economy. Russia, on the other hand, had to fight its way through a difficult readjustment of an unfit industry on brownfield sites, and modify an elaborate but unsuitable infrastructure.

Considering the background, it is not surprising that China has acquired a number of advantages. It has been flexible and responsive to external demand from the very start of the transition and was not burdened with an outdated legacy of physical infrastructure. Moreover, the process of learning appropriate skills is perceived as a step forward by the Chinese workforce while the forced retraining of already qualified Russian workers for less skilled jobs generates psychological resistance and depression. In Russia most of the population associate the transition with confusion, the breakdown of their professional life and general distress. In China,

nearly everyone sees the transition as a time of hope, energy, uplift and improvement.

■ *Differing modes of transition:* The single most significant factor responsible for the disparity was the contrast in methods used to manage the transition. The Russian transformation was founded upon a total rejection of the communist past and the dismantling of nearly all of its institutional structures. An attempt was then made to have a completely fresh start. There was to be a re-written constitution and a whole set of newly designed political institutions within a democratic framework, and there was also to be an urgent rush of economic reforms so profound that they would supposedly create all the conditions necessary for rapid development. In addition, an economic policy known as 'shock therapy' was adopted. It consisted of creating a legal framework for a free market within a very short time, while also privatising the giant array of state assets virtually all at once. The assumptions behind this radical strategy were that market forces would quickly overcome the inevitable period of social hardship and then propel the new economy into sustainable prosperity. The market itself would bring law and order to Russia, because the spread of private ownership would create an automatic demand for reliable protection by law.

China's mode of transition was radically different. Its preference was also to liberalise the economy by setting up a free market and privatising the state's assets. But this was done gradually, while making sure that the process was kept under firm control and that the control was exercised by the pre-existing authoritarian government, which also retained many of its supporting institutions intact. The expectation was (and still is) that after, and only after, a sufficient accumulation of wealth and a satisfactory adjustment to the pressure of global market forces could the country move forward politically, first towards the rule of law and then towards a democratic political structure.

In practice, both transitional trajectories provoked a number of unexpected and unwanted consequences and now have to overcome formidable challenges.

■ *Different ways to achieve political stability:* The theory of the 'J Curve' suggests that closed regimes are often more stable than open societies, at least in the short term. The liberalisation of authoritarian regimes commonly brings about a period of dangerous instability, before the system returns to a political and economic equilibrium. To preserve stability in closed but stable regimes, it is easier and therefore more probable that the country will become even more authoritarian than it is to embrace liberal political reforms. Pressure from business leaders tends to encourage stronger authority rather than increased reform. From a business point of view democracy without the rule of law makes the environment unpredictable, and what business firms need is predictability: a stable set of expectations with clear rules. And as a number of researchers have demonstrated, the market does not resist an established network pattern consisting of mutual-favour relationships between business leaders and politicians. Rather, a market can adapt to such a network, and make it work for itself.

In Russia, the simultaneous breakdown of all the vital institutions on the one hand and the speedy introduction of numerous new laws and institutions on the other provoked a sense of insecurity from which the society has still to recover. In China, the institutions remain as closed and secretive as they have ever been, but they are stable. It is not surprising that investors feel more secure in their dealings with the intransigent old institutions of communist China than they do in finding the best way to cope with the ill-formed, pliable and still wobbly institutions of the new Russian democracy.

Nevertheless, it is not likely that China can sustain its paradoxical policy of combining political oppression with economic liberalism for much longer. Many commentators suggest that China's

development is following the pattern of the earlier 'tiger' economies of Asia. But elsewhere in Asia, rapid growth has usually gone hand in hand with political change, and there are hints that it is sought in China too, although the government shows no inclination to liberalise politically. Recently it announced yet more media restrictions, and began a formal investigation of charity organisations and environmental campaign groups who have received foreign funds for their work. Last year a record number of street protests were recorded and the police subjected a record number of human rights activists to beatings, arrests and imprisonment.

It is also extremely unlikely that China will be able to follow the Singaporean model in which an ultra-liberal economy is combined with a strict rule of law but no democracy. China is too big, too varied and too complex for that, and the authorities lack both the charisma and the credibility that the Singaporean leadership possessed during the critical years of transition. Will China avoid social and political uncertainty if it starts opening up? Or will it remain economically comfortable under what will probably be an ever more oppressive political regime? It is difficult to forecast.

■ *Differential post-communisms:* For better or worse, the dismantling of all institutions and the introduction of rapid market reforms meant that the Russian economy as a whole is free from the legacy of direct political intervention. In the late 1990s and early 2000s there was even a reverse relationship in Russia: the political system was taken hostage and for a time was fully controlled by the newly emerged big business interests. The challenge that Russia is facing today is to continue to build its economic institutions in an orderly way while coaxing political democracy to actually work; it is already in place at the formal level. There is no institutional residue from Soviet times of central planning and political coercion in the Russian economy. The communist legacy is certainly present, but it can be found solely in the areas of bureaucratic mentality, pervasive corruption and inefficient management, and not in the shape of the economic institutions.

China shares Russia's post-communist tendencies towards bureaucracy, corruption and inefficiency, and it also has the additional challenge of adapting its economic institutions to the requirements of the market economy. Despite the high growth rate in the economy, the Chinese government has yet to face down the overbearing legacy of central planning by cutting away the close ties between the state, the state-owned enterprises and the banks. The banking system in China is prevented from operating at full capacity because it has been so badly weakened by the history of poor leadership and uneconomical lending under government direction that it now shoulders a fat portfolio of non-performing loans. The state-owned banks face a long and hard struggle before they can become truly commercial enterprises. And more widely, even though extensive privatisation has occurred, a significant state-controlled sector remains, and virtually the whole of it is significantly underperforming.

■ *Contrasts in welfare provision:* In moving to the market economy, both countries were unsuccessful in smoothly transforming the substantial provision of social protection in such fields as health care, education and pensions that were available in the pre-transition era. In Russia, despite a number of measures that were intended to supplement the state provision of basic services by insurance cover, a decade of financial and institutional crises made it impossible for the new mechanisms to start working. In that period the resentment and despair of public servants and ordinary citizens were expressed in numerous demonstrations, strikes and even hunger strikes protesting against the withdrawal of benefits, the long delays of salary payments to civil servants, the unaffordable cost of living, etc. But now, with international oil prices going up, Russia is stabilising its budget and channelling resources into the rehabilitation of social services while increasing pension payments and paying better salaries to staff in the public services. Although the average standard of living is still far from being adequate by Western standards, the social frustration that was apparent in the first decade of the transition has subsided in recent

years. It seems that the Russian social crisis reached its nadir in the late 1990s and has been slowly recovering since.

In the case of China, as one governmental official put it, 'we have pretty well done the easy reforms. What lies ahead now is doing the difficult ones.' Beneath all the visible progress, the frustration is building up. The gradual Chinese transition is generating social tension at a faster rate than the steady accumulation of wealth is helping to ease it.

China's problem today is how to introduce social security schemes and to ensure access to health and education. Under the old system, people were guaranteed a job for life and state-owned enterprises were obliged to take responsibility for all the social needs of their workers, including housing, health, education, pensions and general welfare. This was incompatible with market rules and necessarily collapsed with privatisation and so-called rationalisation (essentially, closing down) of the majority of the state enterprises. Self-reliant provision is still both unthinkable and impractical, so the government is now making an attempt to set up a system that would transfer responsibility for the security net from the workplace to the state. Failure to succeed in doing this quickly may well lead to destabilising the entire country, as social unrest spreads and the economy proves unable to boost consumption at a pace necessary to underpin self-sustaining economic growth.

The major disparity in economic activity and thus in living standards between the western inland region and the eastern coast is a problematic issue in Chinese development. The Chinese government is now providing transport and communication systems and making other attempts to encourage manufacturing businesses to extend their operations to the west. The expectation is that as the coastal areas reach a saturation point it would make sense to explore the much larger land areas to the west where labour costs are 25% lower than in the highly developed east, and where government economic incentives are available.

However, the productivity and skills of workers in the west lag far behind, the harsh natural conditions make production more expensive, and the greater distances between factory gate and container port create logistical obstacles.

A probable scenario might be that the increasing cost of manufacturing in the existing production areas in eastern China will push businesses outwards to other countries, rather than balancing Chinese social and economic development by stimulating them to migrate westward to the underdeveloped hinterland of Asia. How successful the government's attempts to regulate this process will be remains to be seen.

Right through its history, the Chinese transition has marginalised the countryside, which is still waiting for radical reforms. Farmers are not yet in control of their land, which deprives them of any chance to join the booming segments of the society. The pressures of a quickly expanding urban environment have forced many millions of farmers from the fields around the cities with little if any compensation, and anger is growing. Approximately half of all the people in China are still tied to the land, and nearly all of that very large number continue to struggle through life below the poverty line. The fear among China's policy makers is that if land reform goes ahead and the peasants acquire the freedom to sell the farms, the immediate impact will be an uncontrollable flow of many millions of people from the villages to the economically successful towns. That could well destroy the already fragile social stability.

However, the various signals coming from China are mutually contradictory. On the one hand in recent years there has been a steady increase in the already frequent and well-supported popular demonstrations, not just against low pay and poor conditions of work but also against the many other issues that cause social distress. They include absolute and relative poverty in the inland village areas, corruption among public officials, the removal or decay of services formerly providing health care, education and welfare, and the wholesale violations of both rights and liberties

by the agents of the state. In the view of many analysts, today the social structure right across China is pregnant with tension, rather like an earthquake zone criss-crossed with volatile fissures. The situation is often described as 'severely unstable,' or 'on a knife edge'. According to the Ministry of Public Security there were 74,000 protests in 2004, involving 3.76 million people.

On the other hand, it is also apparent that a large section of the population is much better off. According to World Bank data, around 280 million Chinese lifted themselves out of poverty between 1978 and 2005. The rapidly expanding middle class in the coastal region earns more money, owns more property and buys more consumer goods than ever before, and as a class is wholly disinclined to protest, engage in political struggle or support any revolt. It is also the case that so far, the ruling Party has dealt effectively with all the challenges posed of it; no single protest has ever got out of hand. So, at present no commentator can convincingly predict how the Chinese transition will proceed. No one knows whether a devastating social crisis lies ahead, or whether the Communist Party will be able to manoeuvre its way around it by mastering social policy.

- *The importance of social values:* In the Russian case, one of a number of unwanted consequences of the transition is that the 'shock therapy' had an immediate and negative impact on the social texture of the society. It broke down the inherited social consensus on meanings, shared beliefs and norms that must always underpin official

institutions if they are to function efficiently. The effect was the disintegration of the communal moral structure. Contemporary Russia has atomised down to the level of personal values, as opposed to sharing an agreed community space. So far, the gradualness of China's transition, its success and its confinement to the economic and related sectors together seem to have enabled the country to avoid this side effect, or at least not to experience it at the same devastating level. Yet one might speculate that the rapid economic growth, the massiveness of the internal migrations and the multidimensional transformations of the social structure must be having a profound impact on community relationships. The counter-argument is that unlike the Russian case, in China the structure, symbols and behaviour of political authority have carried on unchanged throughout the transition and political legitimacy is still there.

Questions to explore: What is the current trend of the Chinese transition? How is the policy of 'harmonious society' likely to be developed and implemented? Will that policy defuse the many social strains – between east and west, urban and rural, migrants and residents?

A separate set of questions could address the impact of the transition on the social texture of the society. What role do different sets of restraints (moral, traditional and legal) play in organising society and how has this configuration changed in recent years? Has the need to adapt to the reforms altered the underlying values, norms and socially accepted meanings that hold Chinese society together?

Human Resources

An important factor behind economic development is the state of human resources available in the country. The determination of people to bring about changes in their life, their ability to learn new skills and to absorb innovations, and the amount of energy that they are willing to invest in order to achieve improvement are among the drivers of economic success. Although the human resource factor is difficult to operationalise in a strongly scientific manner, an estimated comparison of the demographic data, of the health status of the two populations, and of their respective levels of know-how relevant to a market environment all place Russia in an extremely disadvantaged position relative to China.

■ **Population densities:** China is much better placed to attract outsourcing businesses because it can supply cheap labour on an unprecedented scale. A simple analysis of data suggests that while Russia has a territory two times bigger than China, its population is ten times smaller. If Russia is among the least densely populated countries in the world with an overall labour force of 74.22 million people widely scattered across its ten time zones, China is at the top of the list along with India and has 791.4 million people available as a labour force, disproportionately concentrated in the big cities clustered in the eastern part of the country. Bearing in mind that it is labour-intensive manufacturing that the global market most needs at the present time, this is an ideal pre-condition for setting up supply chains linking Chinese factories to the multinationals.

■ **Demographic structures:** The advantage that the Chinese labour force has over the Russian one is strengthened by the demographic structure of the population. China has a large working-age population with a small number of dependents, because of the Chinese one-child-per-couple policy. In contrast Russia is burdened with a higher proportion of elderly people (15.1% of the

population, compared with 7.7% in China) and continuing outward migration of the young adults. Hostile popular attitudes to migrants from other post-Soviet countries are not benefitting the Russian economy either.

However, although the Chinese age structure is favourable for the country's development today, the situation will soon be reversed. Life expectancy in China, traditionally low, is improving. The very same one-child-one-couple policy that has produced a vigorous workforce with few dependents in the present will push its effects into the next generation within the next ten to fifteen years, when the population of working age will go into decline and a bulge of aging people will impose additional pressures on the pension scheme and on health spending. The Chinese human resource base will become less productive and less consumer orientated. How the Chinese government is dealing with this entirely predictable trend is a question waiting to be answered.

■ **Quality of human resources:** In addition to the objective demographic mapping, there is also the question of the socio-psychological condition of human resources in the two countries. The policy adopted in Russia to take the society through the transition caused a mass depression to spread through the population in the 1990s. One observer called it a 'sickness of the soul'. The impact of the mass sadness is indirectly visible in the dramatic decline of Russia's population, which has fallen by 6 million since the Soviet Union collapsed even though large numbers of people have flowed into the country each year from the bordering post-Soviet Republics of Eastern Europe, the Caucasus and Central Asia. At the present time the population is continuing to fall, at a rate of 0.37% annually, while China is experiencing growth at a rate of 0.59% even though its strict policy of birth control remains in place and is harshly enforced.

The main reason for this demographic crisis is a startling death rate, which is more than twice as high as that in China: fifteen people in every thousand as compared with only seven per thousand in Russia. Most of the deaths are of working-age men, causing male life expectancy to drop from 64 years in 1990 to only 57 years in 1994 although the figure recovered a little to 59.8 in 2005. Analysis of the causes of this mortality crisis shows that men are dying prematurely from cardiovascular disease, alcohol, violent crime and a high rate of suicides. This points unambiguously to a social pathology rather than to the effects of a war or an epidemic; the Russian people are experiencing difficulty in adjusting to the drastic social transformations around them.

Because of the gradual pace of its transition combined with the steady sense of progress, China has not only avoided such a socio-psychological downfall but has actually achieved the very opposite. It seems to have generated an unprecedented degree of social energy and a general spirit of optimism as it ventures into the new economic space. Even so, the question of just how long this energy will be available to drive China's development forward remains a valid one. There is an open question about whether the exhaustion that many Chinese workers are already experiencing will form a depressing alliance with the pessimistic outlook of a rapidly aging population within the coming decade. Even if it does, it is not clear that it will necessarily have a cooling effect on overall economic activity.

■ *Diaspora support:* An important part of what is called human resources is the scale of know-how in any society. Know-how is an amalgam, made up not just of relevant knowledge as such but also of the scale, density and character of the network of social contacts, the presence and usefulness of informal channels for the circulation of helpful information, the available ways to arrange for financing a project, and so forth. This area is a complex one that requires further research, but what is clear is that China has substantially

benefited from having a whole series of large, successful and rich diasporas abroad. These 'overseas Chinese' have mastered life in a market economy and have been willing to invest their resources and connections back into the mainland. The existence of the powerful ethnic Chinese communities in Hong Kong, Taiwan, Singapore and the large business-orientated diasporas in major cities right across the West has played a substantial role in China's development. The successful emigrant groups serve as role models and provide ongoing support for the human resources within China. The connection between the mainland and the diasporas works at the formal level and not just at the informal levels, even if in some cases the formal links have been blurred at the top international level.

In contrast Russia has had no such resources abroad to strengthen its human resources. The principal wave of emigration to the West from Russia took place after the revolution of 1917. It was composed mainly of members of the aristocratic class, most of whom integrated into the culture in which they settled and did not survive as distinct and separate communities. The only self-consciously Russian diasporas were those in countries neighbouring the homeland: in the Soviet republics of Central Asia, Caucasus, Ukraine and the Baltic countries. At the start of the market era in the post-Soviet world they found themselves treated as alien and unwelcome minorities in many areas, and in addition they were living under economic conditions that were typically even worse than those prevailing in Russia itself. In the 1990s many of them migrated back to Russia as refugees – unemployed, desperate and poor.

Questions to explore: How is the existing Chinese demographic policy and the proposed changes in birth control strategy likely to affect human resources in the long run? How extensively and how deeply is the dependency of the economy on intensive labour-based activities affecting the health and psychology of the population?

A separate line of inquiry could evolve around the interplay between China and the Chinese diasporas in the context of economic development. This would include informal exchanges including the transfer of

knowledge and know-how, the analysis of financial flows coming in from the diasporas, and the role model of diaspora groups for proposed institutional development in China.

Different Legal Cultures

It is difficult, if not impossible, to describe and assess the economic environment in any country without first examining that country's legal culture. The legal culture is understood as the set of socially expected practices and the particular way of thinking associated with them that together bend social forces toward the law or away from it. The lens of legal culture allows an observer to see a current society as the end product of its own distinctive historical evolution. The concept relates the inherited behavioural traits of the past with the dynamics of the present, and integrates individual facts about the society's characteristic patterns into a larger picture so that hopefully they can be understood.

Russia and China belong to different legal and cultural traditions. Nevertheless the similarities between them in how law is embedded in the social texture are quite as striking as the differences. Furthermore, the similarities and differences are intertwined in such a way that it is not easy to separate them for the purposes of seeing them clearly. Things that may seem to be similar often have different roots and therefore carry different social meanings, while at the same time things that might superficially appear to be entirely different may in practice generate much the same kind of social outcomes. There is also a dilemma of how to weigh up on the one hand the relative importance of historical continuity with that past, and on the other, the radical transformations that have necessarily come with the major political and economic changes since then. However, a review of what is already known and approximately understood about the two societies can provide a tentative basis for speculation on the aspects of legal culture that most directly

affect business in the two countries: the generally held perceptions of law, habits in relation to networking, and the characteristic attitudes towards courts and mediation.

Instrumentalism

■ *Perceptions of the role of law:* In both societies the most significant characteristic of the legal culture is that the general perception of law is extremely instrumental: it is simply a mechanism to achieve policy objectives. There is no notion of law as an unqualified social good that is vital for maintaining social order and justice. At the macro level, law is still seen as a tool for social engineering, while at the micro level it is perceived more cynically as a device to ensure compliance with government orders. Law is not perceived as a constraint on state power or a storehouse of human rights, and certainly not as an independent institution standing between the people and the state or between private property and the state. In other words the concept of law is reduced to that of a means serving specific political or private ends.

The roots of the instrumentalist view of the role of law in organising society go deep into the past experience in both countries. Russia and China are almost identical in their unbroken history of authoritarian rule, their characteristic dominance of the political over the legal, their centralised forms of bureaucracy, and their interconnected institutions of state and church. Neither of them experienced anything to parallel the Western experience of the Papal Revolution of the eleventh century, so they were never introduced to the

concept of a division of power protected by the distinct legal statuses of civil and canon law. In the same way, their respective aristocracies never achieved a political confrontation and stand-off with the sovereign comparable to the one that in medieval England brought about the treaty of Magna Carta, the first of a series that successfully laid down constraints that could be placed upon the ruler. In both countries the legitimacy of the emperor's will was accepted without question throughout their recorded histories, right through to the twentieth century. Even after communist revolution in each country, the understanding of the instrumental role to be played by law continued more or less unmodified: law was there to facilitate a management of a centralised economy, to provide the framework within which to educate a 'new type of man', and to codify the manner in which all aspects of life in a new communist society were to be controlled. In Marxist theory the emphasis was entirely collective, not individual. In consequence the notion of personal or intrinsic rights of any kind – human, social, civil – was all but absent in both countries.

- *The differences between perceptions of the role of law:* Despite the pronounced similarities between Russia and China in their inherited attitudes to law, it is important to stress the differences in what this means for people in China and Russia.

In the Chinese case the instrumental vision of law was embedded in the traditional social philosophy. Confucianism, which was dominant in China for centuries, provided a world view in which law is seen not only as marginal but also as an undesirable way to maintain a good social order. According to the teaching, human behaviour should not be made to conform to externally imposed rules, but to respond without coercion to internalised norms and values. In Confucianism, law is intrinsically inferior to the multiple hierarchies of relationship, loyalties and mutual obligations that are vital for stability and social harmony. The absence of the notion of individual rights is compensated for by the norms of relationship.

Looking back at that ancient tradition, it is clear that one should not exaggerate the importance in the contemporary world of religion or official ideology in determining how people behave; nowadays, clearly, other things matter as well. But the very existence of the classical idea that law should not be dominant does provide a strong justification for the provision of alternative ways to solve problems and to preserve order in society. From Confucius to Mao and possibly even to Hu, law has never been regarded as the only way to maintain social stability; it has always been an inferior set of rules and has never given rise to positive social expectations. In this context the lack of a rule of law today is perceived in China not as a worrisome failure or deficiency, but as a wholly natural state of affairs. Within the Chinese legal culture, the general understanding is that there are other ways that can effectively satisfy the claims that people must inevitably make upon those around them and upon the more distant corporations, governments and other authorities.

The Russian story is different. Russian law was formed both within and without the Western legal tradition. In Harold Berman's apt metaphor, it was an illegitimate son of Western law. Although Russian formal law has its strongest roots in the tradition of Roman Law, Russian society and governmental organisation has never stepped out of the Byzantine form of bureaucratic organisation. This was built upon the principles of the primacy of political relationships, the importance of having a single undivided power and the need for a powerful, heavy-handed civil service. The tradition was always radically different from the continually evolving legal norms and the ongoing interplay between different branches of power that were found in the major countries of the Roman law tradition. In the Byzantine–Russian type of society it is not law per se but the power of political hierarchy and the prominence of legitimate leadership that keep the society together and enable it to function. Even so, throughout Russian history the theory has never worked efficiently. Only at the very top of the

political pyramid has the emperor/tsar or in the early stage of building communism the leader of the party, Lenin and then Stalin, enjoyed a degree of legitimacy that placed them on the same footing as God occupies in the more hierarchical religions. Lower down the pyramid of power, legitimacy could never be taken for granted; it always had to be preserved by coercive power and the efficient suppression of dissent and disobedience.

In Russian history, a number of attempts have been made to 'Westernise' Russian culture and introduce elements of Western law alongside the modernisation of economic, agricultural, military, industrial and social practices and institutions. The widely admired efforts of Peter the Great in the seventeenth century were followed by those of tsars Catherine II in the eighteenth century and Alexander I and Nicholas I in the nineteenth century, and of course in the twentieth century by the early Bolsheviks and yet again by Gorbachev under late communism. However, none of those reforms went far enough. Whenever reform was tried, the 'new' law was imposed by power – power being a commodity of which the state consistently had a generous supply. While the ordinary people were subjected to the new law, the dominant elites stayed above it.

Although each reform did have a noticeable impact, none succeeded or could succeed in modifying the fundamental interplay between law, politics and society. Even the communist revolution, despite being violent enough to tear most pillars of the social structure of the society away from their foundations, actually reinforced the existing political pillar even while replacing its personnel. In doing so the revolution extended the traditional Russian dominance of the political forces in society over the legal, social and economic elements. Over the centuries, the fruitless attempts to bring a Western type of legality into Russian everyday life by means of repeated and consistently unsuccessful struggles to change the way in which society was functioning has brought about an unintended

consequence: the formation of a social climate of legal and political cynicism. In the Russian case the lack of rule of law is not perceived as a natural condition, as it is in China, but as a total failure of politics to reform society. In Russia this situation is a source of deep frustration and bitterness.

■ *Implications of different traditional approaches:*

From the standpoint of successful economic development, it is a complex matter to assess the full implications of these two different approaches to the instrumental role of law in either the short term or the long term. A few points do however seem to be incontestable. It seems that in China the lack of a proper rule of law in the Western sense is not causing social discomfort, and is not destructive of the social cohesion of the country. People may be resentful of one or another policy decision, but they are apparently not resentful of the right of the authorities to make it. In Russia, in contrast, the unfulfilled expectations of a promised legality that have accumulated through history have resulted in a largely negative image and distrust of the state. In the view of many people throughout the country, nothing can ever be done in Russia and things will never get any better. Against this view, it may be that if, one day in the future, the political climate is favourable it might be possible to restore the popular ambition for Russia to move closer to a social organisation controlled by a rule of law because the underlying demand for it is there. In the Chinese context, such a move is extremely unlikely, not just because it is perceived as inherently alien but also because most people would see it as superfluous. But if we accept the typical economist's argument that for successful development it is not a rule of law that is important but rather a stability of rules then the Chinese model of instrumentalism has clear advantages.

However, in both countries the contemporary rhetoric is that they are moving towards a rule of law model. This should not be interpreted in the Western sense of independence, transparency, impartiality of legal procedures and above all the doctrine of 'rule of law and not of man'. In the Chinese case it means little

more than laying claim to a policy instrument to facilitate modernisation and wealth accumulation. Any reference to law in its public pronouncements strengthens the Communist Party's ability to justify some of its actions and to extend the operation of the free market in China. In the Russian case the appeal of the rule of law is that it could serve as an instrument for re-establishing political stability and reasserting the traditional power of the bureaucracy.

Formalism

■ *The 'hard law' approach:* In both countries the instrumental role of law is complemented by a formalistic interpretation of the meaning of law and an overblown conception of what law can achieve. Formalism in this case is a vision of law as a set of rigid rules, accompanied by an assumption that by its nature any correctly devised law accurately represents reality. That leads on to the belief that once a good law exists, it does not require any 'softening.' That is because if it is indeed a good law then by definition it provides a single clear answer to a problem, so no discretion is required to fill the gap between the content and the practice. The extensive and uncritical borrowing of Western legal texts as a vehicle for the transitional reforms of the 1990s was one of the expressions of formalism. Even after a decade of decidedly mixed experience with transplanted law, the dominant talk within the political class nowadays in both Russia and China is often about good laws or even perfect laws that should be strictly obeyed to make the policy work. There is little discussion of the problematic implications and interpretations of law in practice.

■ *Different types of formalism:* But again, despite the similarity of the tendencies in both China and in Russia to see law as a 'hard' construct, it seems upon closer examination that we may be dealing with two different types of formalism. In the case of China, it is noticeable that the academic literature provides a mostly speculative interpretation of Chinese formalism, and the interpretation is not usually substantiated with significant empirical data.

Bearing this in mind, it is reasonable to assume that formalism in China has now become a feature of formal Party policy and of the ideology. Meanwhile, popular norms of everyday life have evolved within the soft, informal format of social relationships among which formalistic interpretations of law are not an issue. In this model the main problem arises at the level of implementation of the formal policies, when no space has been left for compromises and negotiations.

In contrast, Russia's extreme version of formalism has been adopted as the only concept of law throughout of the society. The rigidity of the formalistic approach has gone far beyond the minimal necessity that a law must be precise and hard, and instead has encouraged a bureaucratic way of thinking that has clogged the whole society with petty restrictions. This in its turn has triggered such widespread and visible avoidance that it has overpowered the regulative side of law. '*Ne pozvoleno*' and '*Nel'zia*', both meaning 'it is not permitted', are probably the most commonly used phrases in Russia – and probably also the most often violated. The role of law in the society has shrunk to that of a instrument readily available to advance the interests of any individual or business firm willing to pay the cost of litigation.

The tension in contemporary Russia between an expectation of how things should be (that life should be regulated by strict and just rules) and how it actually is (a life in which law does not serve the purpose for which it was produced) generates contradictory feelings. On the one hand, there is a strong belief that things should be brought under control. On the other hand, there is a sensation of intense disappointment in the face of persistent and repeated failures by all the regulatory and enforcement agencies. People and politicians alike design ways to impose one control system upon another, but without actually trusting anyone else to implement them. This contrasts with the picture presented by the observers of Chinese practice, where trust is not in short supply at the local level of communities and families. The issue in

China is evidently not a lack of trustworthy people, but rather how to get access to them and to maintain a lasting relationship with them.

Informal networking practices

■ *Differences between Chinese and Russian networking practices:* This brings us to a problematic phenomenon that exists as a major social institution both in Russia and in China: the use of personal connections and informal relationships as a way of finding short cuts through bureaucracy, shortening a lengthy supply chain, or overcoming business competition. It is apparent that in both countries there are severe obstacles to anyone who wants to make things happen. There are problems in meeting the formal stipulations of law and regulation. Corruption is pervasive throughout both societies. The courts and other legal institutions do not enjoy the trust and respect of the people. As a result most businesses rely heavily on informal dealings, bribery included, in order to keep going. More generally, law is clearly not among the main forces that regulate and stabilise either Russia or China. In the Chinese context the various informal practices are collectively known under the term 'guanxi'. In Russia there is no universally accepted equivalent term, although the activities it would refer to are universally present. (In an attempt by observers to fill this linguistic gap, the term 'blat' has recently appeared in the academic literature. But 'blat' is badly misleading as a way of describing the current practices. It is a recycled term, adopted from the old Soviet vocabulary to describe the energetic but informal redistribution of goods in an economy of shortages.) Regardless of the terminology employed, however, it is important to make distinctions between *guanxi* and the corresponding informal dealings found in Russian society. It needs to be made clear that we are talking about two different kinds of social experience.

In the academic literature one can find two ways of explaining *guanxi*. One approach links it to the unique Chinese culture and to the legacy of

Confucian morality within that culture. The second and more recent approach portrays it as a network of connections deliberately and strategically built up for the purpose of advancing self-interest. Some researchers distinguish a traditional or 'social' type of *guanxi* found in the rural communities from a more instrumental or 'market' *guanxi* that is typical of the bigger towns. But within a broader interpretation of Chinese society, the two forms of networking do not contradict each other and do not exist separately. In practice they have become intertwined. Both networks are extended outwards from the same inner circle of family, kinship and community, and both are operated and supported according to the strict moral norms of duty, obligation, loyalty, discretion and reciprocity.

■ *The 'zones' of guanxi:* According to Yunxiang Yan, the various networks of personal relationships can be classified into three characteristic 'zones'. First there is the 'personal' zone that is strictly limited to the extended family. Second there is the zone of 'reliable' friends who can always be trusted to provide help whenever they are asked for it. And third, there is the 'effective' zone, made up of more distant relatives and friends-of-friends who together form a broader circle that can be kept open for recruitment. This set of networks is a dynamic construct that requires continuous re-creation through frequent communication, regular exchange of favours, and occasional gifts and assurances of mutual support. It reflects the embedded structure of social life throughout China. The relationship network is socially expected, approved, and ceremonially underpinned. It is a form of social interaction that functions smoothly, operating under the guidance of well-established rules. The rules of the networking game include reciprocal support, trust and reliability; to break them would bring the humiliation of social disgrace backed up by loss of 'face' and of future appeal as a business colleague. The effectiveness of the rules of the game is based on the understanding that the building up of relationships is a long-term

resource, that networking should be seen as a normal part of both social and working life, and that the bonds of friendship and kinship also consist of a genuine expression of feelings.

Are market forces in China modifying the rules of the networking game in the form of globalised competition, accelerated economic growth and sporadic political reform of relevant economic institutions? At present there is insufficient research-based evidence to answer that question with any confidence. Some observers claim that in the more economically advanced towns such as Shanghai and in the more challenging spheres of business, the law is gaining more prominence and *guanxi* is falling into a corresponding decline. But the more widespread view is that networking practices in China are by no means in retreat; we are merely observing transformations in the form of *guanxi* to meet changing circumstances.

- **Russian informal practices:** In contrast, Russian networking practices are not held together by normative principles and do not have a strong foundation in deep-rooted social habits. Russian family and kinship relationships are generally no closer, more intimate or more significant than those in the West. It would be accurate to say that Russian friendship is more informal and intense, but it is never preordained and it does not come with socially monitored rules prescribing duties and obligations that include such onerous demands as sacrifice and secrecy. Nor is there in Russia any notion equivalent to that of 'losing face' for breaking the rules of a networking relationship.

Instead, Russian networking practices typically come from two radically different sources. One is a mafia-type power hierarchy within formal organisations and based on the notion of dependency. At each level and for the organisation as a whole, the superior provides protection in exchange for loyalty to him. This system works as long as the power structure exists. With any reshuffling of the structure or any weakening or

loss of the dominance-and-dependence relationship directly between people, the relationship is almost certain to become ineffective. Unlike the Chinese equivalent, it is a short-term relationship driven by openly expressed self-interest.

The second source of informal practices and a search for contacts has grown up in response to the legal formalism and petty bureaucratic restrictions that are universal in Russia. This often develops into socially tolerated forms of corruption such as bribery, nepotism, patronage and fraud. It is not surprising that although many people in Russia engage in such practices, they are nevertheless perceived as being predominantly criminal in nature. This leads to the bizarre and apparently self-contradictory situation in which networking is widespread but is nevertheless not only disapproved of in society, but also sincerely believed by the great majority to stem from the dishonest nature of particular individuals – most especially government officials.

- **A comparative perspective:** This account of the differences between Chinese and Russian perceptions of networking is not entirely clear-cut, but it reflects the dominant pattern. Indeed, there are reports that the more contemporary and cynical forms of *guanxi* induce frustration in the population in China much as they do in Russia, and are often considered to be examples of corruption. Nevertheless, according to the China specialists, '... behind the public denunciation of [contemporary] *guanxi* lie the admiration and even approbation of it; indeed, even with the free market economy, the modern Chinese cannot live without *guanxi*' (Su, Littlefield). In contrast to that situation, Russians feel uncomfortable whenever friendship or collegiality or indebtedness is exploited in order to seek out and secure an otherwise inaccessible favour. Nevertheless they frequently do just that – while wishing that the day would come when they will never have to do it again, and yet not believing that it ever will.

This brings the discussion to another significant distinction between China and Russia. Even though communities in China routinely sustain their shared under-the-counter arrangements by invoking basic normative principles, that is not the case in Russia. In contemporary Russia the moral structure of society has disintegrated. In the past generation it has atomised down to the level of personal values after abandoning the morality of an agreed community space. However, the idea of a broken consensus should not be confused with unethical behaviour or immorality. It seems that the problem in Russia is a general one, not a problem of individual attitudes. It consists of the absence of a valid, commonly accepted foundation upon which to interpret situations, make judgments, impose restrictions or encourage socially approved behaviour. Should this condition be attributed to Russia's distinctive and ongoing legal culture? Or is it a more temporary effect of the recent multiple transitions in economy, polity and society on the current shape of Russian legal culture? It may be that when the restructuring of all the major social institutions is carried out before any corresponding social change has taken place – as happened to Russia in the 1990s – the growth of the informal moral norms that are needed to make any new institutions work in practice becomes the most difficult part of the great transition. It is inevitable that the necessary informal norms take time to come to life.

Tradition of mediation

Mediation as a typical means of dispute resolution is another characteristic that pushes the legal cultures of China and Russia apart, and in this case it is a straightforward matter. There is nothing in Russian history to parallel the traditional Chinese practice of informal mediation, which formed the primary mode of dispute resolution in that society for many centuries. The dominant ideology of Confucianism asserted the virtue of compromise as a means of achieving harmony, which was the highest social value prescribed by the ideology. In order to bring this about in as many situations of latent conflict

as possible, the organisational structure of imperial China was orientated to make every dispute an internal matter that would be capable of being solved through mediation within one or another of the primary social institutions of family, clan and neighbourhood. The role of mediator was traditionally expected of the older members of the group. Social pressure was firmly applied to respected members of the relevant family or clan, or to rural headmen or whoever was generally accepted within a neighbourhood as its informal leader. Lubman identifies a series of factors that combined to make mediation the preferred form of dispute settlement: the hazards of litigation, the widespread fear of any involvement of any kind with government officials, the dominant ethical code and the strength of the primary social institutions. In traditional China mediation became formally institutionalised through an array of rituals and symbolic gestures that included tea drinking, feasting, meaningful gift exchange and the apologetic shaking of hands that were clasped in front of the chest in the direction of the aggrieved.

Despite Maoist China's determined attempts to cut all ties with the past and to build a new society in its place, the tradition of mediation has survived right through the period of communist hegemony. Although the ancient mediation practices were significantly altered when they were politicised and taken under state control, the marked preference for mediation rather than adjudication was sustained even at the level of official government policy. Even in the early stages of communist rule in China, when almost the entire legal system and set of social institutions were modelled on those of the Soviet Union, China introduced a 'people's mediation committee' which had no analogue in Soviet Russia.

As for contemporary China, there is no doubt that the Chinese do actively engage in mediation for resolving disputes although there has not been sufficient empirical research to fully describe it or to analyse the transformation that the forms and procedures used must have necessarily undergone in the adaptation to a free market framework. At the same

time the official statistics on the rate of litigation in economic disputes do convey an interesting message: the number of cases brought to court in China by Chinese citizens, is steadily increasing – yet the vast majority (according to some authors around 90%) of those cases are eventually settled out of court through informal mediation.

In the Russian context, all the cornerstone principles involved in third-party mediation, especially compromise and trust, are simply alien. In sharp contrast to China where an ability to reach a compromise is considered to be a valuable skill, in Russian society any predisposition towards it has a tendency to be associated with weakness, cowardice and defeatism. A dispute is commonly seen in Russia as a confrontational relationship in which a 'zero-sum' outcome is to be expected. In addition, trust has always been in short supply in Russia. That is not to say that informal mediation never takes place; it is part of human life and it happens everywhere. But in today's Russia people involved in a typical dispute about some aspect of property, business, family

affairs or life in his local neighbourhood would not hope for or expect an institutionalised settlement to be reached through a mediated compromise.

Questions to explore: At present an extensive literature is available on the Chinese legal system and the traditions on which it is based. It explores the influence of Confucianism on Chinese legal consciousness, assesses the lack of independence of Chinese lawyers, describes the internal morality of Chinese legal culture and presents various theoretical discussions on the rule of law in China. There is, however, inadequate field research on how agreements between the various organisations are reached and enforced, and on how disputes between them are approached, managed and resolved. This area could be a potentially fruitful starting point in researching contemporary Chinese legal culture, and potentially it could demystify it. It would be especially valuable to examine the findings to see what they imply for the ways in which Chinese behavioural patterns can, do and should interact with the established Western ways of going about business.

The Political, Economic and Legal Interplay

The economic environment is very much a product of the institutional configuration in any given country. How the economy works depends to some extent not only on economic factors, but also on what role is given to the legal institution in regulating the relationship between politics and the economy.

In both Russia and China, the state does not feel shy about intervening in legal affairs and neither country could claim to have a legal institution that is free from ongoing political influence. Yet the forms of dependency and the institutional reaction to it are different, and can be well demonstrated by representative examples from each country.

In Russia a prominent recent example is provided by the trial and subsequent imprisonment of the oil oligarch Mikhail Khodorkovsky. When his business

empire grew to a giant size, he felt strong enough first to make an attempt to dictate high politics in the country and then to move his business from the national level to that of the global market by taking a big chunk of the strategically important energy industry away from state control. At that point Khodorkovsky was accused of massive tax evasion and sentenced to a lengthy period in jail. His assets were de facto renationalised.

To organise his defence, a large team of international and domestic lawyers were hired. This was a front-page story both in Russia and in the Western press, with representatives of the world media monitoring every step in this political and legal saga. Interestingly, when the case came to court the focus of the defence was not the predictable legal argument that the defendant was innocent or that violations of

procedural rules had occurred. Instead the main line of defence was that Khodorkovsky was running his business at the time of the alleged offences just like other oligarchs, and that picking on him for prosecution was unjust, and was motivated purely by politics rather than any need to enforce the law.

This example can be contrasted with the Chinese case of Zheng Enchong who filed hundreds of lawsuits on behalf of the Shanghai residents who had been evicted from their homes because of the government's modernisation policy in the city. The Chinese government charged Zheng with 'violation of security law' after he faxed a public document to an American human rights organisation. After a secret trial, he was put in jail.

Another Chinese example is the prominent case of Zhang Jianzhong, who was prosecuted on a formal charge of fabricating evidence although there is a strong belief among the public that he had been targeted for his representation of defendants in two corruption cases. Interestingly, although individual Chinese lawyers were afraid to speak about the case, and even more reluctant to point out in public the evident political motivation behind the prosecution, organised professional groups did respond to it. An example was the All China Lawyers' Association which issued a petition with elaborate legal

arguments – using, in other words, the language of law to criticise a fundamental injustice.

A comparison of those cases suggests some hypotheses that could be tested in further inquiries into the configuration of political, economic and legal institutions in the two countries. It seems that in both countries, political will is the decisive power. Yet in Russia it is in fierce competition with the power of big business, and the legal institution is sometimes used to suppress business corporations when they show signs of getting out of control. In China, political power is completely unchallenged, which means that it can afford to collude with business interests on a tactical basis. The available space for freedom of speech and political opposition in Russia cause prominent legal cases there to become extremely politicised. Legal arguments can get lost in the back-and-forth process of a political fight. In China the tendency is the opposite; there is an attempt to use legal and professional language to express political disagreements.

Questions to explore: In China, what is the current interplay between the three institutions of law, economy and politics? What is the role of the legal institution in this interplay? What role, if any, might legal institutions play in opening up the political regime in China?

In Summary

The implications of this analysis for Chinese and Russian development

At present China enjoys several major advantages over Russia that make it a more attractive proposition for foreign investors. They include the type of market, the almost unlimited supply of cheap labour, the efficient (albeit inhumane) manner in which human resources are exploited, the more harmonious and compromise-oriented legal culture, and perhaps most importantly the superior management of the post-communist transition in China. In China the

emphasis has been placed firmly on economic rather than political transition in order to maintain stability throughout, and it has proceeded effectively. The timing has been favourable, and the well-adjusted gradualism of the transformation has combined to generate a superior development of market relationships as compared to the former USSR.

Russian progress is not as negative as it seems. Whenever Russia is assessed as doing badly, the emphasis on politics is always foremost – which is misleading because the country's economic progress

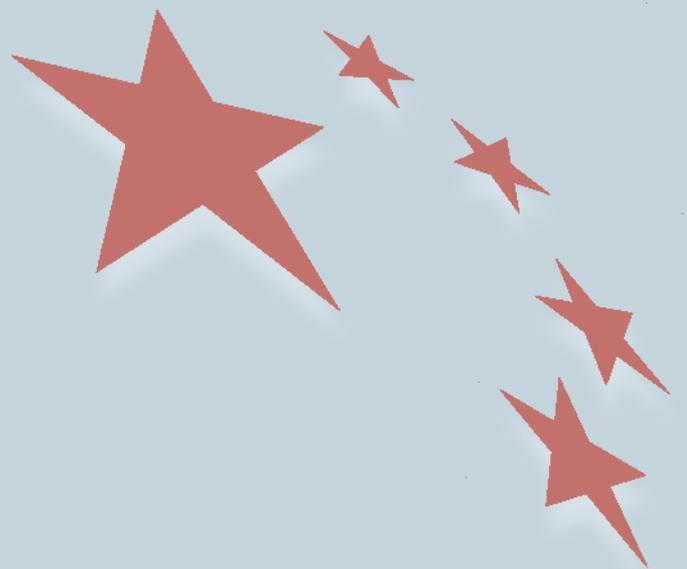
is apparent. The doubts are understandable because the governmental aspect of the new Russia is worrisome and the country is constantly under radar surveillance by Western observers. However, one should bear in mind the level of social destruction that Russia suffered from the abrupt radical dismantling of all its institutions at once.

The future of China is every bit as unclear and worrying as that of Russia. Unlike Russia, China has yet to attempt large-scale political reform and when it does it will need to overcome huge challenges. It must contain the tension between a centrally ruled regime and an open liberal economy, it has to manage the widening discrepancies between the rich and the

poor and also between its rural and urban populations, it has to deal with far greater internal migration flows than anywhere else in the world and to control the tensions between new migrants and established settlers in the booming towns, and it must at some stage transform its economy from a supply model to a consumer model without significantly increasing its labour costs. Above all it needs to make its legal institutions work efficiently so that it can participate fully in the globalised world economy. And this political-economy agenda is only a part of the broader range of problems including foreign and defence policy that China will have to solve in order to find and safeguard its preferred niche in a stable and prosperous world.

Sources

- Berman, H. J. (1970) 'Soviet Perspectives on Chinese Law'. In: J. A. Cohen *Contemporary Chinese Law*. Cambridge, MA: Harvard University Press.
- Blanchard, O. and Shleifer A. (2000) 'Federalism with and without Political Centralization: China Versus Russia' Working Paper 7616, National Bureau of Economic Research (NBER). Cambridge, MA.
- Burawoy, M. (1996) 'The State and Economic Involution: Russia Through a China Lens', *World Development*, 24, 6: 1105–1117.
- Hu, A. (2007) *Economic and Social Transformation in China: Challenges and Opportunities*, Abingdon: Routledge.
- Kurkchiyan, M. (2003) 'The Illegitimacy of Law in Post-Soviet Societies'. In: D. J. Galligan and M. Kurkchiyan *Law and Informal Practices: The Post-Communist Experience*. Oxford: Oxford University Press.
- Kynge, J. (2007) *China Shakes the World: The Rise of a Hungry Nation*. Phoenix.
- Lubman, S. (1999) *Bird in a Cage: Legal Reform in China after Mao*. Stanford University Press.
- Lubman S. (1967) 'Mao and Mediation: Politics and Dispute Resolution in Communist China', *California Law Review*, 55: 1284–1359.
- Peerenboom, R. (2007) *China Modernizes: Threat to the West or Model for the Rest?*. Oxford: Oxford University Press.
- Pei, M. (2006) *China's Trapped Transition: The Limits of Developmental Autocracy*. Harvard University Press.
- Potter, P. B. (2001) *The Chinese Legal System: Globalization and Local Legal Culture*. London: Routledge.
- Su, C. and Littlefield J. E. (2001) 'Entering Guanxi: A Business Ethical Dilemma in Mainland China?', *Journal of Business Ethics*, 33: 199–210.



The Foundation

The mission of the Foundation is to study, reflect on and promote the understanding of the role that law plays in society. We do this through the identification and analysis of issues of contemporary interest and importance. The Foundation provides this insight to practitioners by making the work of researchers and scholars more accessible and useful to them.

Rule of Law in China: Chinese Law and Business

The main objective of the programme is to study the ways in which Chinese law and legal institutions encounter and interact with the social environment, including economic and political factors, at local, regional, national, and international levels. Our perspective in pursuing this objective is that of entrepreneurs considering investment in China, the lawyers advising them, executives of an international institution or non-governmental authority, or senior public officials of another country. The combination of this objective and the particular perspective constitutes a unique approach to the study of law in China. Lawyers advise on the law, entrepreneurs assess the financial opportunities, and other professionals develop and implement plans and policies. None of these, however, fully engages the role of law and its relationship to other aspects of society.

Marina Kurkchiyan is Foundation for Law, Justice, and Society Fellow at the Centre for Socio-Legal Studies at the University of Oxford, and Research Fellow of Wolfson College. She is a sociologist who specialises in comparative legal cultures, the post-communist transition, and the impact of public policy on social structure and human behaviour. She has conducted research in several transitional countries, and as a consultant to the World Bank, the Department for International Development, the Open Society Institute and the UNDP, she has completed a number of official reports on the interaction between law and society in relation to development. Her academic papers have dealt with the socio-legal aspects of development, education, health care, poverty relief, the informal economy and respect for law. Her current research project explores the impact on formal and informal legal practices of the EU extension to Eastern Europe. She is also engaged in researching the importance of law for economic success in China on behalf of the Foundation for Law, Justice and Society.

For further information please visit
our website at www.fljs.org
or contact us at:

The Foundation for **Law, Justice and Society**

Wolfson College
Linton Road
Oxford OX2 6UD
T · +44 (0)1865 284433
F · +44 (0)1865 284434
E · info@fljs.org
W · www.fljs.org