

Rule of Law in China: Chinese Law and Business

Are China's Legal Reforms Stalled?

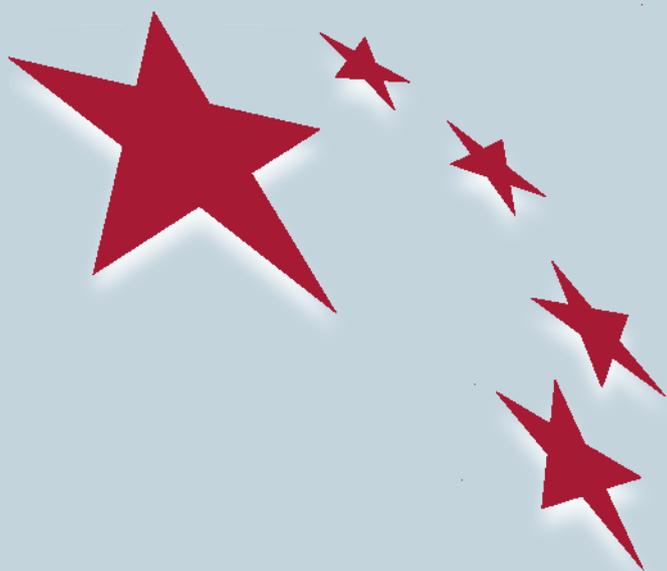
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Executive Summary

It is too early to conclude that China is trapped in transition. China is currently following the 'East Asian model', adapted in light of twenty-first century realities.

China has made remarkable progress in improving the legal system, since essentially beginning from scratch in 1978. China performs better than the average as a lower-middle country on the rule of law. It does reasonably well on most other core indicators of good governance.

Although China's rapid progress in improving the legal system and good governance appear to be slowing, it is incorrect that China's legal system as a whole deteriorated between 1998 and 2004.

The government's efforts to establish socialist rule of law have resulted in major changes to virtually all aspects of the legal-political system, including in Party-state relations, state-society relations, and to major governing institutions.

There are still many shortcomings in China's legal system, as there are in all legal systems and developing countries. It is readily acknowledged in China that deeper reforms are required. Yet such reforms are complicated and controversial.

An accurate assessment of China's legal system and its potential for development are hampered by the use of idealized standards from developed countries as a benchmark for reforms in developing countries, problems with existing data, the size and diversity of China, subjective bias, and the tendency to conflate the rule of law with democracy and the protection of civil and political rights.

Are China's Legal Reforms Stalled?

China has made remarkable progress in improving its legal system, essentially beginning from scratch in 1978. As the rule of law and other good governance indicators correlate highly with wealth, China's performance is arguably best judged relative to other countries of similar income.¹ China performs better than the average country in its income class on the rule of law. China does reasonably well on most core indicators of good governance relative to its income level, being above average on political stability, government effectiveness, and regulatory control. But it is doing worse on controlling corruption.²

However, China's rapid progress in improving the legal system and good governance appear to be slowing or reversing. China's rule of law and good governance rankings were all lower in 2004 than in 1998. Such evidence has led to dire predictions. It is now commonplace to suggest that the rapid pace of economic reform, combined with more modest political reform, have created a mismatch that threaten China's development. Minxin Pei has concluded dramatically that China is trapped in transition.³ Other commentators have issued similarly dire warnings about the fate of legal reforms, the alleged 'lack of rule of law', and continuing human rights violations.

This brief advances two main theses. Firstly, that the perception that China's legal system deteriorated between 1998 and 2004 is incorrect. Secondly, that it is too early to conclude that China is trapped in transition. China is currently following the 'East Asian model', adapted in light of twenty-first century realities.

Time will tell if China will be as successful as Japan, Taiwan, South Korea, Singapore, and Hong Kong.

The brief discusses legal reforms since 1998; places China's performance within a comparative context; outlines the developmental path followed by other East Asian countries; and offers some conjectures as to why so many commentators write off China as a failure.

Legal reforms in China 1998–2004 and beyond

The government's efforts to establish socialist rule of law have resulted in major changes to virtually all aspects of the legal-political system. Reforms have led to significant changes in Party-state and state-society relations, and to major governing institutions, including the people's congresses, the procuracy, the police, the legal profession, the judiciary, and the administrative law regime.⁴ Wide-ranging administrative legal reforms include the acceptance of a new conception of governance based on the principle of administration according to law (*yifa xingzheng*); strengthening the administrative law regulatory framework; improving the quality of the civil service; limited, albeit not insignificant, efforts at deregulation; recent measures to increase transparency and public participation; and attempts to strengthen the various mechanisms for reining in state actors.

Judicial reforms since 1998 fall into three broad categories: efforts to make the adjudicative process more efficient and just, reforms aimed at enhancing

1. See Peerenboom, R. (2007) *China Modernizes: Threat to the West or Model for the Rest*. Oxford: Oxford University Press.

2. Kaufmann, D. et al., (2005) *Governance Matters III: Governance Indicators for 1996–2004*. Available at: <http://www.worldbank.org/wbi/governance/pdf/govmatters3.pdf>

3. Pei, M. (2006) *China's Trapped Transition: the Limits of Developmental Autocracy*. Cambridge (MA): Harvard University Press.

4. For an institutional analysis of the impact of reforms, see: Peerenboom, R. (2002) *China's Long March Toward Rule of Law*. Cambridge: Cambridge Press. For an empirical demonstration of the rapid progress in the development of the legal system, see Jingwen, Z. (2007) *Zhongguo falu fazhan baogao (1979-2004)* [*China legal development report (1979-2004)*].

the quality and professionalism of judges, and attempts to increase the independence of the courts. The many significant reforms should be enough to call into question claims that the legal system has deteriorated since 1998.

Reforms of the adjudication process

Reforms designed to enhance efficiency and justice have altered every phase of the judicial process: from the acceptance of the case to the trial, issuance of the judgment, subsequent appeals, and enforcement.

A basic requirement of rule of law is that people have reasonable access to the court system. Although court fees are relatively low, courts often impose unauthorized additional fees, usually because they are inadequately funded. The Supreme People's Court (SPC) has responded to the charges of excessive and irregular fees by clarifying the fee schedules and allowing courts to postpone, reduce, or waive litigation fees for poor and socially vulnerable groups such as the unemployed, workers owed back-pay, or retirees seeking to collect pensions. Access to justice has also been improved through an expansion of legal aid centres and by easing the requirements for filing cases. The *Regulations on Legal Assistance*, effective of September 2003, provided the framework for an expanded legal aid system. By the end of 2004, there were over 3000 government-sponsored legal aid centres. Funding for legal aid increased from RMB 19 million in 1999 to over 200 million in 2004.

The total number of cases handled by the courts grew dramatically through the 1980s and 1990s, levelling off at between 6 and 7 million cases a year. In response to heavier caseloads and increasing backlogs, the SPC has encouraged greater use of simplified and summary procedures in both civil and criminal trials, thus enhancing judicial efficiency. The SPC has also issued regulations that clarify the time limits for disposing cases and various stages in the litigation process. Over 95 per cent of cases are completed within the time limits.

In an effort to increase efficiency and curtail corruption, the functions of accepting, hearing, supervising, and enforcing cases have been separated. Some courts are now experimenting with pre-trial judges who hold pre-trial conferences, facilitate the discovery and exchange of evidence, and carry out mediation. The new agenda calls for further improvements to the case management system, including the random assignment of cases, and greater use of pre-trial conferences.

Perhaps the most significant procedural reform has been the partial transition from an inquisitorial system to a more adversarial system in both civil and criminal cases. The switch to a more adversarial procedure is intended to increase efficiency and curtail corruption, as judges no longer need to travel outside the courts or meet *ex parte* with the parties to investigate the case and prepare the dossier. With the transition to an adversarial system, the parties and their lawyers have assumed greater responsibility for case preparation. Effective preparation requires greater access to evidence and witnesses. A number of measures have been introduced to clarify discovery and evidentiary issues. Civil and criminal evidence laws are currently being drafted to give better effect to the presumption of innocence, including the exclusion of evidence obtained through coercion or other means.

The SPC has also taken other steps to facilitate enforcement in recent years, including issuing regulations that centralize enforcement functions, in order to overcome local protectionism and prevent local governments from removing or penalizing judges who enforce judgments against local companies. From 1998 to 2002, China's courts completed more than 12 million such enforcement cases, an increase of 83 per cent over the previous five years. The SPC's current reform agenda sets out further measures, including unified management of enforcement cases; clarification of enforcement procedures, including compulsory enforcement rules; the imposition of more severe sanctions on judges who fail to enforce judgments and others who obstruct enforcement; and requiring parties to submit accounts of their assets and allow compulsory audits.

Increase in professionalism

Reforms to the trial process have been accompanied by efforts to improve the quality and professionalism of the judiciary. Would-be judges must now meet higher educational standards, pass a unified national exam, and undergo three months of training before they assume post. In 2004, 97.7 per cent of the 20,000 candidates who passed the unified judicial exam had a BA degree or higher, while 51 per cent of all judges had BA degrees.

The promotion system for judges is now also more merit-based, with a greater role for higher level courts in the decision-making process. Supreme and high court judges are selected from lower level judges with at least five years experience, from amongst academics, and elite lawyers. In the basic level courts, presidents are selected from among the best judges in the court, and should be around thirty-five years old, with at least five years trial experience.

Most cases are heard by a collegial panel consisting of three judges, or two judges and a layperson. A potentially significant reform has been the implementation of a system where presiding judges are selected based on merit through a competitive process and given more authority within the court.

A number of reforms have also sought to make judges more accountable to the public, and to enhance supervision of the judiciary by the media. In 1999, the SPC emphasized that trials be open to the public. In practice, most cases are now open in most courts, although some restrictions in sensitive cases and on the foreign press remain.

Independence

The SPC has moved to increase the independence of the courts slowly, in part because of concerns about granting more power and discretion to incompetent or corrupt judges. There is something of a chicken and egg aspect of judicial reforms: a competent and clean judiciary infused with a sense of professional pride requires a high degree of independence and authority; and yet an independent and authoritative judiciary assumes competent and clean judges.

However, there has now been enough progress in raising the professional qualifications of judges and in curtailing corruption to begin expanding the independence and authority of the courts.

As noted, there is now greater emphasis on professional qualifications in hiring and promotion decisions, which strengthens the independence of judges. The SPC has sought to reform the longstanding practice of higher courts responding to inquiries from the lower courts for advice regarding legal issues in particular cases. This practice has been criticized for depriving the litigant of the right to appeal, since the higher court will already have decided the key issues. The Second Five-Year Agenda recommends that lower courts submit cases that involve generally applicable legal issues to the higher court directly for hearing, rather than seeking advice. This would eliminate the problem of the higher court making decisions in cases that it does not hear, and also preserve the integrity of the appeal process.

The SPC has also sought to address local protectionism and interference by government officials. The main causes of local protectionism are the way courts are funded and judges appointed. It follows, and is widely accepted, that local protectionism is primarily a problem in basic level courts. The main proposals are to change the way courts are funded and judges appointed, or to create federal or regional courts. The SPC Second Five-Year Agenda opts for both approaches.

The SPC can decide most of these reforms itself. More major changes in the way courts are funded and judges are appointed, eliminating or limiting the power of the people's congress and procuracy to supervise the courts, giving the courts the right to review and strike down abstract acts, and creating a constitutional review body are all beyond the power of the SPC. They are highly contested, in part because they affect the balance of power among state organs.

The authority of the courts

The authority of the courts has also clearly increased over the last twenty-five years. This is evident in the high rate of administrative litigation cases where courts quash administrative agency decisions, or a case is withdrawn after the agency changes its decision. Plaintiffs are much more successful in China than in the US, France, and Taiwan.⁵ The greater authority of the court is also evident in the low number of cases, less than 0.3 per cent, supervised by the procuracy, or people's congress, that result in a changed verdict. The enhanced stature of the court is also evident in the high acquittal rates for lawyers in cases where the police and procuracy prosecute lawyers on trumped up charges of falsifying evidence. Clearly the courts are sometimes able to stand up to the people's congress, procuracy, and the police.

The increased authority and independence of the court is also evident in the public's increased reliance on the courts for dispute settlement, and their declining interest in mediation and arbitration.

Provisional summary

There have been countless positive changes since 1998 that have strengthened China's legal institutions and enhanced the professionalism of the judiciary. Certainly, there are still many problems, as there are in all legal systems, especially in large developing countries. It is readily acknowledged in China that deeper reforms are required. Yet such reforms are complicated and controversial. As reforms have continued, tensions and conflicts in the political system between the ruling party and state organs, among state actors, between state and society, and among different interest groups have increased. Few, if any, reforms will benefit everyone, even if they increase the efficiency of the system as a whole, or contribute to greater wealth. Even seemingly highly technical

reforms have a political dimension. Now that the 'easy' reforms, for which there has been a broad consensus, have been completed, the politics of reforms are becoming more pressing.

A crucial issue presented by Pei's thesis is the proper benchmark for determining whether legal reforms have stalled. He suggests several criteria, all directly or indirectly related to judicial independence: the abolition of the Political-Legal Committee, changes in the way judges are appointed and courts are funded, certification of lawyers by an independent bar association rather than the justice bureau, and the complete exit of Party organs from the judicial system. He claims that until these reforms are adopted, we should be sceptical about the progress and direction of legal reform in China. However, these reforms are controversial. It is not at all clear at this stage of development how independent the courts should be, given concerns about judicial corruption and the competence of some judges.

Complete withdrawal of Party organs from judicial affairs or the reform process would not be desirable. Judicial reforms in many countries stall because of turf struggles among state organs. At present, the Party is the only entity with the authority to resolve conflicts among the courts, people's congress, public security, and other administrative entities. Moreover, the legal system, even of those developed countries known for rule of law, does not live up to these standards. In many countries, justice bureaus do play a role in the regulation of lawyers. Similarly, the way judges are appointed and courts are funded vary tremendously.⁶

None of this denies the need for reforms. Rather, it raises the question of the appropriateness of judging China, at its current level of development, by the often idealized standards of developed countries. Any developing country in the midst of significant

5. Plaintiffs prevail in whole or in part in approximately 20–40 per cent of administrative litigation cases in China, in comparison to 12 per cent in the US and just 8 per cent in Japan and Taiwan. Peerenboom (2002), *op. cit.*, p. 400.

6. See, generally, IFES/USAID (2002), *Guidance for Promoting Judicial Independence and Impartiality*, USAID Technical Publication, pp. 12–20. Washington DC: USAID.

transition will fare poorly when judged against the goal or end-state of reform. But it cannot be concluded that they are 'trapped in transition' simply because they have not yet reached the goal.

China within a comparative context: the East Asian model

China is not unusual in encountering obstacles and opposition to the implementation of the rule of law and good governance at its current stage of development. Many countries are able to make some initial progress and show improvement in terms of economic growth, institutional development, and good governance, given low starting points. However, once they reach the middle-income level, they get bogged down. Powerful interest groups capture the reform agenda, opposing further reforms or pushing for reforms that do not broadly benefit the public. Economic growth slows or reverses. The reform momentum is dissipated. Some states settle into a stable but dysfunctional holding pattern, while others sink into chaos and become failed states.

Unfortunately, despite billions of dollars spent on law and development, the authors of the World Bank's study of good governance concluded that there is no evidence of 'any significant improvement in governance worldwide ... if anything the evidence is suggestive of a deterioration, at the very least in key dimensions such as rule of law, control of corruption, political stability and government effectiveness'.⁷ East Asian countries are the notable exceptions. Singapore, Japan, Hong Kong, Taiwan, and South Korea all rank in the top quartile on the World Bank's rule of law index. All of the countries in this top quartile, including the East Asian countries, are high or upper-middle income countries. This is consistent with the general empirical evidence that the rule of law and economic development are closely related and tend to be mutually reinforcing.⁸

7. Kaufmann et al. (2005), op. cit.

8. Chang, A. and Calderon, C. (2000) 'Causality and Feedback between Institutional Measures and Economic Growth', *Economics and Politics* 12:1: 69)–81.

Rigobon, R. and Dani Rodrik (2005) 'Rule of Law, Democracy, Openness, and Income: Estimating the Interrelationships', *Economics of Transition*, 13: 533.

The 'East Asian model' involves the sequencing of economic growth, legal reforms, democratization, and constitutionalism, with different rights being taken seriously at different times in the process.⁹ More specifically, it involves:

An emphasis on economic growth rather than civil and political rights during the initial stages of development, with a period of rapid economic growth occurring under authoritarian regimes. A pragmatic approach to reforms, with governments following some aspects of the Washington Consensus, and rejecting or modifying others. In particular, with governments adopting most of the basic macroeconomic principles of the Washington Consensus for the domestic economy; rejecting or modifying the neoliberal aspects that would greatly reduce the role of the state through rapid privatization and deregulation; with the state also more active in reducing poverty, and in ensuring minimal material standards;¹⁰ and gradually exposing the domestic economy to international competition, while offering some protection to key sectors.

As the economy grows, and wealth is generated, the government invests in human capital and in institutions, including reforms to establish a legal system that meets the basic Fullerian requirements of a procedural or thin rule of law.

Democratization, in the sense of freely contested multiple party elections for the highest level of office, is postponed until a relatively high level of wealth is attained.

Constitutionalism begins to emerge during the authoritarian period, including the development of constitutional norms and the strengthening of institutions. Social organizations start to emerge, and 'civil society' begins to develop, albeit one

9. For a more extensive discussion of the East Asian model, see Peerenboom (2007), op. cit.

10. While China has done reasonably well in addressing poverty, the focus on aggregate economic growth has led to rising inequality. The relatively low amount of public spending on education and health, and market forces in the health sector, have increased social tensions. In recent years, however, the government has begun to increase public spending on education, health, and welfare services.

subject to limitations. Citizens enjoy economic liberties, rising living standards, and some civil and political rights, with limitations in areas deemed threatening to the state.

There is greater protection of civil and political rights, including rights around sensitive political issues. Ongoing abuses of rights still occur, with rights frequently given a communitarian or collectivist interpretation rather than a liberal one.

The long march to the rule of law?

Why are commentators so eager to conclude that China's is on a long march to nowhere, rather than to rule of law, democracy, and prosperity, like other successful East Asian states that followed a roughly similar path?

One possible explanation has to do with the choice of the standard for comparison, which often determines the outcome of the assessment. Often, the actual performance of China's government institutions or its human rights record are compared against idealized accounts of good governance and the rule of law, or to normatively inspiring, yet frequently violated, idealistic standards championed by human rights activists.

Another approach is to compare China's human rights record, and the performance of its legal system and government institutions, to the record and performance of much wealthier countries. Comparing China to much wealthier countries leads to the unsurprising conclusion that in China there are more deviations from the rule of law; government institutions are weaker, less efficient and more corrupt; and citizens enjoy fewer freedoms, while living shorter and more impoverished lives.

A second explanation for the overly negative accounts is that problems with the data may create a misleading impression of the severity of the problems. For instance, the World Bank's lower rankings for China on the rule of law and good governance index may be attributable to the addition of new data sets and, more significantly, large margins of error. After new data sets were added,

China's scores from earlier years were lower than had been reported previously. Large deviations might also explain the apparent 'deterioration'.

Aggregate indicators of the rule of law serve a useful purpose in facilitating broad comparisons between countries. However, a complex notion such as the rule of law is hard to capture in a single variable. China is a huge country with considerable variations in the development of its legal system. Different areas of law are progressing at different rates, with the commercial law among the strongest, and criminal law among the weakest. The quality of the judiciary varies according to the level of the court, the region, the division within the court, and the type of case. Problems such as judicial competence, local protectionism, and corruption mainly affect basic level courts. An adequate assessment of legal reforms requires the broad notion of the rule of law to be disaggregated.

Overall, the legal system has improved since 1998, consistent with greater problems in some areas and slower progress in others. Very different portraits can be presented by focusing on different areas.

A third possible explanation is subjective bias. The surveys aggregated by the World Bank rely on subjective perceptions of the judiciary. Legal reforms are, however, often very technical. The media tend to simplify issues, and to focus on egregious cases that are not representative of the legal system as a whole. The focus on negative stories leads to excessively critical views, not just in China, but everywhere. Public distrust of judges and the legal system is high, even in countries with well-established legal systems. Over 40 per cent of British citizens have little or no confidence in judges and the courts. In Canada, only 5 per cent of people express a great deal of confidence in the criminal justice system.

If media reports exaggerated legal system problems everywhere, then the effect across countries might be more or less the same. Reliance on subjective responses may be particularly problematic in China's

case, however. China acceded to the World Trade Organization (WTO) in 2001 with great fanfare. In order to obtain congressional approval, President Clinton and the pro-business lobby argued that China's accession to the WTO would promote rule of law, facilitate institutional development, even leading to democracy and better protection of human rights. Foreign investors may have been disappointed that China's accession to the WTO did not produce these miraculous changes overnight. But they should not have thought it would.

Moreover, while China, by and large, has lived up to its WTO commitments, the Office of the United States Trade Representative (USTR) and foreign chambers of commerce reports have emphasized areas where further improvement is required. Some of them are actually required by the WTO, but others are just wishful thinking on the part of foreign investors seeking to further their own interests.

Arguably the biggest source of subjective bias is strong normative commitments, which often get the better of scholarly objectivity and common sense. Far from a shiny pagoda on the hill, a model for developing states, China for some is an evil empire, a godless communist regime, brutally and wantonly oppressing its people for no other reason than the self-interested preservation of power. Critics are often quick to attribute any failure in governance to China's political system, while downplaying similar problems in democratic states. Yet the government has managed to maintain political stability and steady growth despite such unexpected and potentially disruptive events as the Asian financial crisis, SARS, increased oil prices since the war in Iraq, and rising trade protectionism and hostility towards China in Europe and America. The view that 'if only China were a democracy all would be well' ignores the ample evidence that democracy is hardly a cure for all ills.

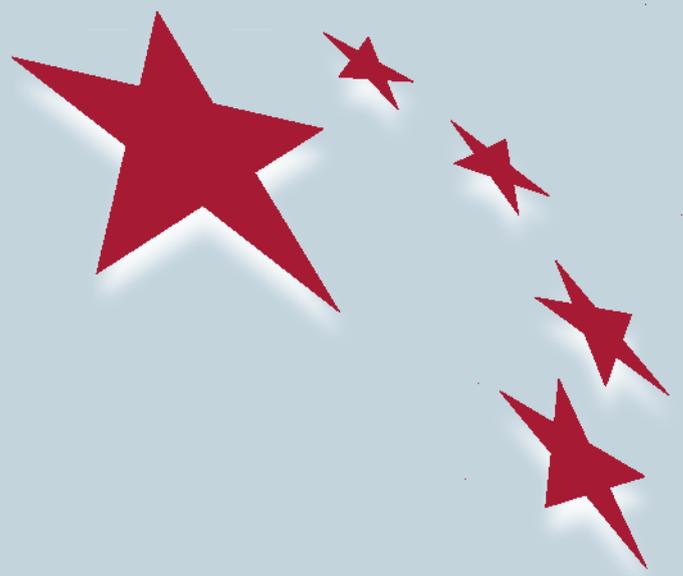
Empirical studies have shown that electoral democracy (in the sense of competitive multi-party elections with citizens voting for leaders at all levels of government) and the rule of law tend to be reinforcing, albeit weakly.¹¹ However, electoral democracy is neither necessary nor sufficient for the rule of law. Some nondemocratic states have had or now have legal systems that meet the requirements of rule of law. Singapore, for instance, is generally ranked as one of the best legal systems in the world by investors, even though human rights groups claim Singapore lacks rule of law, citing limitations on the democratic process, and civil and political rights. Hong Kong is another example. Until the handover to China in 1997, the system was widely considered to be an exemplar of the rule of law, notwithstanding the lack of democracy and a restricted scope of individual rights under British rule. Even after the handover, the legal system continues to score high on the World Bank's Rule of Law Index.

Conversely, just as nondemocracies may have strong rule of law and compliant legal systems, democracies may have legal systems that fall far short of the rule of law. Guatemala, Kenya, and Papua New Guinea, for example, all score highly on democracy and yet poorly on rule of law.

Conclusion: time will tell

China is facing many of the same issues as other developing countries. China is now entering a difficult phase in the reform process, but it is too early to conclude that China is trapped in transition. Other East Asian states would also have appeared trapped in transition at a similar stage of their development. The success of other East Asian states suggests that China may be able to overcome the obstacles. Their success, combined with the failure of so many other states, suggests that the most likely way for China to overcome the middle-income mire is to continue to follow the East Asian model.

11. Rigobon and Rodrik (2005), *op. cit.*



The Foundation

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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.

The Foundation's 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 our particular perspective constitutes a unique approach to the study of the role of law and its relationship to other aspects of society in China.

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