

Rule of Law in China: Chinese Law and Business

China's Trapped Transition Reconsidered

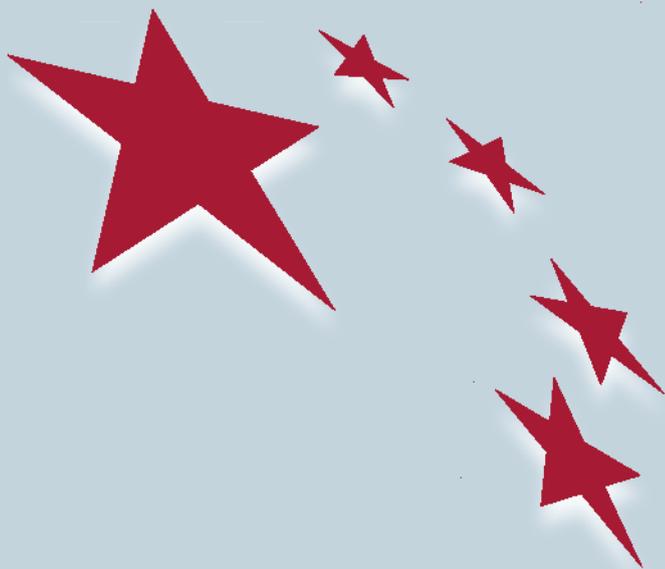
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The participants at the workshop raised many important issues and points to contest my thesis that China's transition from a state-socialist economy and totalitarian political system has fallen into a trap. In this reply, I briefly respond to some of the most salient issues raised at the workshop. The purpose of my effort is not so much to defend my positions and views, but to clarify and amplify them.

Trapped transition: what does the concept mean?

Several participants questioned the concept of a 'trapped transition', pointing out that it is both ambiguous (i.e., how to define a trap?) and 'teleological' (which implies an end point of a process of change). In the book, I explicitly state that 'trap' is used metaphorically. The analytical term is 'partial reform equilibrium'. By this rather convoluted term I mean a state of affairs in which incomplete reforms have created conditions that motivate the ruling elites to maintain the status quo and resist further reforms, hence the trap.

The comments on whether transition has to be 'teleological' are very serious. While I believe that transition does not necessarily imply an end point in theory (we all know where the beginning point is, but not the end point), I feel that the *direction of the transition* ought to be clear. In the Chinese case, the direction is toward a more market-oriented economy, more rule of law, and more democracy.

Measuring governance: deficits and trends

Is China's governance deteriorating or improving? How do we measure governance? Existing measures of governance rely mostly on surveys and have limited value. While it is true that China's governance performance, according to the World Bank's measures, is in line with its per capita gross domestic product (GDP) at market prices, we need to

note two points. Firstly, even adjusted for per capita income, China's governance is at the bottom 35–40 per cent of the countries included in the survey. Secondly, if adjusted for purchasing power parity (PPP), which will raise Chinese per capita income by at least 100 per cent, China's governance will be much more impressive than that of its peer group. The most problematic aspect of measuring governance is the selection and weighting of each component. To date, no analyst has developed a satisfactory tool to solve this problem.

Another issue raised is whether governance is improving in China. Dali argues that it is, based on the Chinese government's recognition of the problem and on its recent measures taken to address such issues as access to healthcare, corruption, banking reform, and public safety. While it is true that the crackdown on coal mine accidents appears to have reduced mining deaths in the last two years, the level of mining fatality in China remains the highest in the world. Improvement from a low base is encouraging, but is more easily achieved.

The Chinese government, to its credit, has clearly recognized the problems of declining access to healthcare and education, as well as the rising problem of environmental pollution. But has it adopted effective measures? The rhetoric from Beijing has not been matched by real action. According to Nick Lardy, Beijing has hardly increased its social spending in the last two years despite its rhetorical commitment to social harmony.

The banking sector reforms, also cited by Dali Yang as another example of improvement, remain a work in progress. With capital injection in excess of 25 per cent of GDP and rapid economic growth in recent years, the financial health of the banking sector has definitely improved. But whether Chinese banks have fundamentally altered their governance remains in question. According to Victor Shih, they have not.

The most difficult issue facing analysts in measuring governance in authoritarian regimes is that such regimes conceal systematic failings while exaggerating achievements. As a result, official figures do not convey adequate information on the true conditions in the country. Even though China today is doubtlessly more open than before, the government does not provide much of the critical data on assessing governance, or at least in a sufficient amount to make such an assessment more accurate. For example, the official data on corruption are spotty at best. Data on environmental degradation, literacy rates, and dropout rates in schools are highly questionable.

Based on the experience of the former Soviet bloc countries, post-collapse revelations showed that the extent of the damage done by the communist regimes to their societies and environment was actually far worse than expected. Therefore, in evaluating governance in authoritarian regimes, it may be safe to assume that the conditions are worse than indicated by official data.

Is gradualism a success?

Evaluating China's economic reform is another contentious issue. In my book, I question the long-accepted view that China's gradualist reform is an unqualified success because of the distortions gradualism builds into the reform process and because of the problem of rent protection and dissipation by insiders. Barry Naughton's brief directly challenges this assessment. He believes that, if anything, gradualism has been even more successful than commonly understood because of the impressive growth China has achieved under this model. Judging by the growth record, there is clearly no denying that China's reform experience has been a stunning success.

However, economic growth is only one measure of transition, although it is among the most important yardsticks of progress. In assessing China's gradualist strategy, we need to do three things:

use a more comprehensive measurement of economic growth that takes into account the *quality* of economic growth,

place growth in the overall context of institutional reform, and

measure progress relative to other transition countries.

If we perform these three tasks, we will note that China's growth rate needs to be discounted to take into account:

environmental degradation (about 3–10 per cent of GDP per year),

rising income inequality,

the costs of writing off massive non-performing loans (about 25 per cent of GDP in 2005), and

official corruption.

Obviously, we have no accepted methods for how to discount growth on the basis of quality. But it seems to me that a minimum of a 3 per cent downward adjustment, which reduces China's growth since 1978 to around 6.8 per cent, would not be excessive.

Gradualism may have delivered stellar growth, but the record of institutional reform under gradualism has been far less impressive. Despite the increase in technocratic capabilities, China today does not have effective regulatory institutions (though more effective than before the reform, when there were practically none); its capital markets have lagged behind economic growth and function poorly; and the legal system is, at best, still evolving (see below). More importantly, after nearly three decades of reform, China's overall economic institutions perform at a less satisfactory level than both Eastern European transition countries and its large developing country peers.

One of the biggest differences between Naughton's view and my view is how to assess the effectiveness of policy implementation in China. While he cites examples of policies announced by Beijing designed to combat rent-seeking, reforming banks, and to dismantle monopolies, I remain sceptical about the effectiveness of their implementation. The announcement-implementation gap, in my view, remains large because the current central government has demonstrated time and again its inability to overcome local resistance to sound policies. Take illegal land seizure, for example. The problem is well known and the central government has announced numerous measures, but the problem persists.

This brings me to one serious shortcoming of my chapter on the predatory state. I completely missed the story of land sales, which generated huge revenues for local governments since the 1990s (and cushioned the blow of the recentralization of taxes) and became the principal channel of decentralized predation.

Finally, it is important to recognize the direction of reform in China. We need to judge whether it is moving forward or is stagnant. While many long-time observers believe that the process is moving forward, citing a long list of initiatives announced or taken by the Chinese government, I think that we need to apply strict benchmarks that would include:

the privatization of large state-owned enterprises (SOEs),

the liberalization of the so-called strategic sectors recently declared by the government as off-limits to the private sector,

the genuine independence of the central bank, and

the further reduction of the role of local government in economic activities.

Is political reform stuck?

I concede that, as Joe Fewsmith points out in his brief, a great deal of political reform is taking place at the grass-roots level on the initiative of reformist local officials. He cites many experiments as evidence of this bottom-up process. This trend is to be welcomed. But I remain unconvinced that these individual, low-level experiments actually amount to a shift in the direction or strategy of the ruling party. I base my doubts on the following:

no top leader has publicly endorsed experiments such as the two-ballot system in the selection of township mayors or the scrutiny of budgets by the local people's congress;

experiments are restricted to only a very small number of counties, perhaps no more than thirty, or one per cent of the total counties in China; and

even experiments in inner-Party democracy are unduly restrictive, both in terms of the number of Party cells allowed to experiment with this novel concept and in terms of the forms of democratic activities allowed in the Party.

The record on legal reform is clearly mixed.

I readily accept Randy Peerenboom and Jacques DeLisle's accurate description of many key reforms implemented in recent years. These reforms, to varying degrees, may have improved the capabilities and performance of Chinese courts. The efforts to increase the professional qualifications of judges, improve trial procedures, reform the criminal justice system, and make court proceedings more transparent are steps in the right direction.

However, assessing the effectiveness of these reforms is difficult because of the well-known implementation gap and the regional disparity in carrying out these reforms. Empirical research is needed to evaluate whether these reforms have actually raised the level of performance of Chinese courts.

The greatest problem in reforming the legal system, I believe, is judicial independence. Many of the reforms adopted actually do not reduce the Party's control of the judiciary (which is why they were allowed). I thus strongly urge the adoption of benchmarks in measuring legal reform in general, and judicial independence in particular. For example, as long as the following measures are not adopted, we need to remain sceptical about the progress and direction of legal reform in China:

the abolition of the political-legal committee of the Communist Party, which oversees and constantly interferes in the legal system;

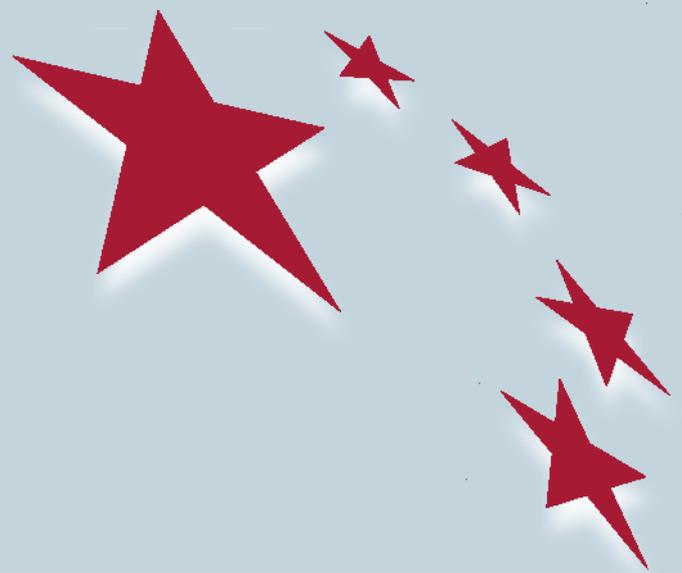
the transfer of power to appoint presidents and vice-presidents of local courts by local governments to a higher level of government;

the funding of local courts by the central government, instead of by local governments;

the relinquishing of power of certifying lawyers by the justice bureau and the transfer of the same power to an independent bar association; and

the exit of the Communist Party from the judicial system.

Until these benchmarks are met, it will be difficult to claim that China has made genuine progress toward building an independent judiciary.



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Pei is the author of *From Reform to Revolution: The Demise of Communism in China and the Soviet Union* (Harvard University Press, 1994) and *China's Trapped Transition: The Limits of Developmental Autocracy* (Harvard University Press, 2006). His research has been published in several journals and in many edited books. His op-eds have appeared in *The Financial Times*, *The New York Times*, *The Washington Post*, and other major newspapers.

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