

DeLisle transcript

This is a tough series of acts to follow from my senior colleagues. I couldn't decide which of three papers to give, so I will splice them all together and therefore not get fully to any of them. I want to address some of the broad themes that I think run through all three and focus on some points that I hope will be of interest, especially to those looking at the policy side of law reform and development issues in China.

The line-up for this panel is quite ingenious. We started out with a very pessimistic perspective: we'll likely never have the true rule of law in China because there are so many serious and deeply embedded impediments. We will close with Randy Peerenboom, who will give a relatively optimistic account. In between, we will have heard views that get increasingly optimistic. In many respects, the differences between pessimism and optimism are more matters of tone and emphasis than substance. We are all pretty much on the same page about where the strengths and weaknesses in China's legal system and legal development are. I'm going to try to take a step back and address long-term issues that I think support a relatively optimistic view, despite the many uncertainties and potential for failure that lie ahead.

Over the course of what has now been well over a quarter century reform, China famously has turned to law and relied very heavily on law to further an agenda that we all know: rapid economic development through embracing markets and deepening economic engagement with the outside world while maintaining a

reasonably stable and effective political system that remains authoritarian rather than democratic. If we unpack law's roles and the roles of the legal system in this project, we can see that law and the legal system are basically expected to perform three functions, and that law and the legal system have done a reasonably good and increasingly good job of performing these functions.

First, law is to support markets and to implement market-oriented reforms of an ever expanding sort, ones that go a considerable distance toward impersonal and purely economically-motivated transacting, although perhaps not getting all the way there. This is in part the story of contract law, starting with the fairly rudimentary law in 1981, various layers of increasingly market-oriented and freedom-of-contract-accepting specialized contract laws and finally the Uniform or Unified Contract Law adopted in 1999.

We have seen the same general pattern in the evolution of laws governing different types of enterprises in China. In the mid-1980s, the State-Owned Industrial Enterprise Law began to recast the roles and rights of planning-era firms for the new market environment. The Company Law of 1994 substantially revised in 2005, has gone much further down the path of creating a framework for enterprises that are expected to operate in markets for goods, labor and capital. In the interim, there have come numerous laws to recognize and regulate new types of economic entities that previously had existed in a legal gray area or had not existed at all. The diverse list includes TVEs, partnership organizations, private enterprises and

a rich array of foreign investment vehicles that Stanley Lubman's remarks today addressed.

Such laws have established the legitimacy and defined the powers and structures of such forms of economic organization and have mandated significant management autonomy and decision making power for firm-level actors. Some of these same laws, especially those concerning non-state-owned and other non-traditional enterprises, as well as tax laws, laws governing banks, security markets and so on, have been key legal means for establishing a more arm's-length fiscal relationship between the state and enterprises, both the types of enterprises previously deeply entangled with the state and newer forms of enterprises that never had been subject to such state control or benefited from such state support.

The same set of laws, especially the Company Law and the laws governing new kinds of business entities, an emerging regime for securities law and other contemporary reforms, such as G-share reform and other reforms to put in the market formerly non-tradable shares, the advent of legal frameworks for mergers and acquisitions--these laws comprise an agenda for ownership reform. They are radically restructuring, corporatizing, and sometimes privatizing. The pattern is one of pluralizing the modes of ownership and creating substantial non-state, including truly private, sectors.

To be sure, all of these have been legal changes that are far from perfect in their implementation, not least for the reasons that my predecessors on this panel have pointed out. The difficulties include: weak courts that remain relatively

bureaucratic in orientation and lacking in autonomy and professionalism; ambivalent or hostile attitudes toward important legal reforms among some vested interests in the bureaucracy and in the economy and society more broadly, and the absence of what Stanley Lubman would call a culture of legality and so forth. In addition, laws and legal reforms have been less than perfect in design. Don Clarke is right about the hangover of Statism in reform-era China, and his paper offers several important points that illustrate this problem.

Nonetheless, the accomplishments to date and the general trajectory of legal reform have been quite impressive. Moreover, beyond the design and implementation of legal reforms narrowly defined, reform-era legal changes also have performed a more immediately political function, essentially a signaling function by which the regime leadership says that it is serious about reform and serious about law, and that it will put key economic and political reforms in legal form. This entails an attempt to play both of those core themes—legality and reform—off one another so that they become mutually reinforcing.

Second, law reform and legal development in China have been designed to draw in foreign investment and expand foreign trade. As Stanley Lubman pointed out, the foreign direct investment vehicles have grown ever more numerous and ever more flexible, evolving from the early rigid version of the equity joint venture to cooperative joint ventures, the wholly-foreign-owned enterprise (which gives rise to one of the greatest dyslexic acronyms in Chinese Law, the WFOE, pronounced “woofy”), to more flexible joint venture structures to allowing foreign passive or

portfolio investment in listed shares, whether its in the B-share market within China or the overseas listing of some Chinese entities in Hong Kong, New York or elsewhere. Other relatively recent additions to the FDI landscape include somewhat hybrid vehicles, including one with another great acronym, the foreign investment company limited by shares (the FICLS, pronounced “fickles”), mergers and acquisitions arrangements whereby foreign buyers can take over Chinese companies, first with questionable legal foundation and now with a clearer regulatory framework.

In addition to the proliferation of vehicles, there has been an expansion in the sectors open to foreign investment. Again, Stanley Lubman’s remarks went into some of this. Early in the reform era, laws and policy established elaborate and cumbersome approval processes, emphasized foreign exchange balancing. Soon thereafter, the legal and policy framework added technology transfer as a core goal. The narrow restrictions have gradually been stripped away. In the middle 1980s, new articles on foreign investment expanded the range of favored types of projects and sectors. Beginning in the 1990s, foreign investment catalogues which set forth encouraged, permitted and prohibited sectors and projects for foreign investment, and also the legal frameworks underlying those catalogues, liberalized the foreign investment regime further.

It can now be fairly described as one that opens most areas of the economy to foreign investment and imposes selective restrictions to protect certain sectors from foreign take-over or competition. Such remaining barriers primarily benefit infant

or emerging industries that might not yet be able to withstand foreign competition. Also benefiting are some declining industries or other troubled industries in need of rationalization to become competitive. So-called national security-sensitive industries too are on the list of those barring or limiting foreign ownership.

Over the course of the reform era, there also has been an expansion of the geographic areas that offer special foreigner-friendly rules or that have the autonomous authority to make foreigner-friendly rules. It started with the SEZs (Special Economic Zones) at the end of the 1970s. The special regime then spread to the coastal cities in the 1980s. The list of special regions saw gradual additions throughout the later 1980s and beyond. The “Go West” policy of the 1990s sought to create incentives to draw more foreign investment to China’s underdeveloped and increasingly left behind hinterland. Next, the Northeast—China’s “rust belt” and home to many of the largest old-style state-owned industries—was added to the list. This proliferation of regions with special regimes to attract foreign investment reflects and was supplemented by a broader phenomenon that we have addressed often at this conference—the extensive de facto and often de jure decentralization of state authority to provincial and lower levels, including the legal delegation to sub-national governments to approve projects for foreign investment and make rules that affect foreign investors.

On the trade side, the story has been one of dismantling essentially an “anti-trade” system in which exports were permitted to produce revenues to pay for imports of necessities that China could not produce. The reform-era Chinese trade

regime is much more market-oriented, much more decentralized, and of course ultimately had to satisfy China's prospective WTO partners that it was good enough to warrant China's admission to the WTO. We saw the Trade Law of 1994 and substantial, WTO-consistent and liberalizing revisions several years later. Here too, there has been less than perfect implementation. Professor Lubman has gone into some of the issues here: the uncertainty of the legal framework, arbitrary and cumbersome approval processes, and numerous complaints percolating through the WTO dispute system about Chinese trade practices and laws. Criticisms include local protectionist barriers inside China, mercantilist approaches to trade at the national level and other improperly trade-restricting measures.

Many WTO-related complaints are about investment as much as they are about trade. Many commitments in China's protocol of accession to the WTO address investment matters. Trade in services, which is covered by the WTO's GATS and which China's accession protocol addresses, is as much about investment (in the local market to provide services locally) as it is about trade. Again, for all the complaints and concerns, there has been great progress compared to the pre-reform or even pre-1990's baseline.

Thirdly, law has been relied upon to fix the other side of the "development without democracy" equation, that is to help guarantee social stability and a reasonably well functioning political system. There are several facets to law's expected role in performing this function. I will highlight three of them here. First, the regime has relied very heavily on "performance legitimacy." So, to the

considerable extent that law helps sustain markets and keeps the economic pie growing, law helps to forestall complaints from below that might generate unrest or demands for political change. To be sure, staking legitimacy on sustained rapid growth is a dicey business. Such economic expansion is hard to maintain indefinitely, and there may be a U-curve relationship between wealth-creating and demands for democratic political change. That is, as much classic modernization theory argues, a regime can buy people off with rising prosperity for a while, but in the long run a rising middle class may ultimately make strong demands for political change in the form of giving themselves—and perhaps their fellow citizens—a larger say in their governance. For those now at the bottom of the heap in China's severely and increasingly unequal society, the relevant pattern may not be the U-curve but the J-curve. According to another venerable political science theory, disorder and perhaps revolution may challenge a regime that has raised expectations for improvement among large groups of its people, who then come to see their relative fortunes plummet and even their absolute fortunes decline.

Second, law is supposed to help check market-subverting misbehavior by officials. Good governance is often achieved and perhaps ideally achieved through democratic politics, through competition in political marketplaces among wielders of state authority who are thereby held directly or indirectly accountable to the governed. China's leadership, however, has turned to law as a substitute for this government accountability function of democratic politics. So, for example, the use of criminal law to deal with corruption, or the turn to develop administrative law—

whether administrative litigation law cases or administrative compensation law or state compensation law cases, or administrative reconsideration requests—are all modes of using law to check problematic market-subverting behavior by officials or at least unlawful official behavior that is inconsistent with market-oriented laws and policies.

Litigation and other modes of contract and commercial dispute resolution are, at an immediate level, among private parties. Don Clarke has given us a useful corrective reminding us to look for lingering statism in Chinese law. Here, “statism” is not so much about preserving a large residual state role in the economy or state control over the economy. Rather, it is about private law’s roles in implementing and enforcing market-oriented laws and policies against resistant or inept official actors. Even when suits or disputes are between private parties, they are often about enforcing state policy, and vindicating those policies’ norms. In many contract and other economic cases, what is really going on is a complaint about, or a commercial problem born of, some kind of government interference with what is in theory a private right granted by a contract or some other type of rights-creating legal act. To be sure, this method of checking government misbehavior is unsystematic at best. But, this mechanism has sometimes been effective, both directly and in its deterrent effects, and is a significant change from pre-reform baselines.

Third, law is supposed to function as “politics by other means,” substituting for the political marketplace broadly by establishing a degree of government

accountability or government openness to citizen input, but at a safe sort—one that is atomizing, case-specific, non-democratic. This is another face of the use of law in anti-corruption drives, including the use of criminal law against the corrupt officials. It is another face of the rise of administrative law to permit challenges to state action. The litigation over takings of property rights recently has emerged as another important variation on this theme. Here, law is part of a broader package of means for addressing official abuses—mechanisms that include letters and visits, petitions, village elections and so on. These means of challenging government misbehavior (particularly where it has adverse economic effects) all stand in contrast to other, untolerated possible methods ranging from meaningful electoral democracy on the one hand, to violent mass protests, on the other hand.

These many functions that the elite or orthodox agenda has assigned to law reform in China, in some respects, exceed the roles of law in the conventional East Asian model, which has famously accorded law little role. Any claim about “the” East Asian model is difficult to sustain because the model is somewhat incoherent. It must lump together Singapore, Hong Kong Taiwan, Korea and, earlier, Japan during their phases of rapid development. Nonetheless, law plays a sufficiently large role in the Chinese strategy that it at least arguably far surpasses its place in a relatively standard or mainstream version of the East Asian Model.

Reform-era China’s reliance on law may be *faute de mieux*: China does not have elements that were key to achieving economic success in the East Asian Model states, at least according to conventional wisdom. China does not have the

technocratic elite of industrial policy designers that other East Asian countries had in that phases of high growth and economic transformation. The Chinese regime arguably does not enjoy the popular legitimacy and public belief in the system, belief in the policy approach taken by the regime that other East Asian Model governments have had. China is plagued by a much-noted crisis of confidence and loss of faith. China does not face the external constraints world markets imposed on Singapore and Hong Kong, threatening severe consequences for bad policy, governance and law. As a large continental economy—even one deeply engaged in the international marketplace—China has not faced such strong and immediate exogenous discipline for possible errors, incompetence or indifference in its economic policies or laws.

Outsiders have mattered a great deal for Chinese law, but in a slightly different way. Since early in the reform era, China has relied heavily on foreigners' presence in the Chinese economy to develop its most dynamic sectors, including ones beyond those that were central to a strategy of export-led growth. The Chinese authorities understood that foreigners demanded a more robust legal order than pre-reform China had had. The foreigners might have been right that law was essential or important to their economic endeavors, or foreign investors might just have a law fetishism such that they demanded law even where it was not necessary. Either way, the foreign presence has meant that China has turned more heavily—if sometimes strikingly unevenly—toward law. Because of its sheer size, and because the rule of law is the dominant international creed of the era, China has received

greater outside pressure and help to develop Western-style or foreigner-approved legal systems than did its East Asian model predecessors (at least if one does not count British colonial creations in Singapore and Hong Kong).

I am not claiming that because reform-era China has pursued a strategy that relies on law in these ways, China necessarily will develop laws or a legal system that will perform the desired or necessary functions effectively or satisfactorily. Still, to date, the Chinese regime has been, as Douglass North rightly described it, remarkably effective at casting about pragmatically for solutions that seem to work. This includes its turn to law. The reform-era Chinese leadership has been willing to incur some costs and take some hits to try to build a legal system that performs the weighty roles assigned to it.

As this all suggests, and as many of my colleagues in the study of Chinese law have pointed out, the Chinese regime's commitment to law has been, and remains, clearly instrumental. This instrumentalism is, however, not a reason to discount, or to lapse into despair about, the prospects for legal development in China. This is the meaning of the first half of my attempt at a cute title, *Law is Not a Gentleman and the Gentleman is Not a Tool*. The law is a tool, but so what? Legal instrumentalism or an instrumental commitment to law as a means to achieving goals to which the regime is deeply committed is not something to sneeze at. Rather, it gives reasons for hope and reasons for belief that much of the official law development program has been and will be attempted quite seriously, precisely

because law serves goals to which the leadership has a deeper commitment than it does to the rule of law per se.

Moreover, the notion of a commitment to law that is more than instrumental strikes me as a bit romantic or at least overreachingly idealistic. From early on in the reform era, the Chinese regime undertook mast-binding, saying, in effect, “We are as serious about law as we are about reform policies.” Really breaching the promise about law badly thus becomes a quite costly thing to do. In addition, instrumentalism, has now become a second-order concern. In Chinese legal discussions among elite, connected reformers and more broadly and even among the citizenry, there is a sense that simply having law that works in the most crassly and immediately instrumental way to advance policy ends may not be enough. On this view, the legal system and laws must have some degree of autonomy. What is needed is a rule-consequentialist, as opposed to an act-consequentialist, approach to judging legal institutions’ efficacy and adequacy.

Whatever one makes of the debates about instrumentalism, the pressing issues in China’s legal development and legal system are more concrete, less abstract and more immediate ones.

Briefly, such challenges and difficulties that lie ahead for China in continuing to build laws and a legal system include, at least, three types. First, the agenda ahead for market-oriented law reforms is in some respects increasingly difficult and offers uncertain benefits. In many ways, the hardest work still lies ahead. The low hanging fruit was been reaped. Dismantling the planned economy, allowing market

incentives to work—these are relatively easy moves. Many of the problems that were left incompletely addressed by the first rounds of reform were pushed to the still-unreformed or incompletely-reformed parts of the structure, especially the financial sector.

Law has key roles to play in addressing this set of challenges. Banking is one area. Banks are still used to keep SOEs afloat, and are facing regulatory and market pressures to get their houses in order so that they can launch IPOs, facing competition from foreign-invested banks as WTO commitments to openness come on line, and facing the concern that savers will drain banks if they have the alternative option of a decently functioning stock market.

Stock markets remain a problem as well. Major reforms to the Securities Law went into effect this year. There remain ongoing struggles over putting into the market the formerly non-tradable government shares and legal person shares and over allowing private companies opportunities to list on the exchanges. In addition, there are the difficulties that flow from the absence or weakness of the intermediaries and evaluators who help stock markets function well. Regulatory frameworks for such actors remain immature and contribute to the problem.

Corporate governance is widely acknowledged to be a serious issue. Much of what is going on here can be described as a deep ambivalence or at least a serious dilemma about how much to treat the problem as one of insufficient management autonomy and how much to treat the problem as one of a lack of accountability of

management to the ultimate owners in the often-complicated structure of ownership that characterize many large Chinese firms.

The bankruptcy law is probably the most delayed statute in reform-era Chinese legal history. It stood on the verge of enactment for many years. It was held up for reasons that include worries about the consequences for workers at troubled enterprises, the fate of state property made vulnerable to creditors' claims, and what should or should not be done to protect the interests of various stakeholders in imperiled firms.

Further administrative law reform is similarly vexing. It raises many questions that are difficult and controversial among Chinese law and policy makers, their would-be advisers and critics. How much public input is there to be and what form should it take? What kind of restraints are to be put on the bureaucracy in its role in making the rules that govern the system? These are part of the unfinished agenda of legal reform because they raise genuinely difficult problems of legal design, implementation and interpretation, and because they also implicate touchy questions of political reform.

Second, there are WTO-related issues. There is a non-trivial risk of a significant backlash against legal and legal system-related WTO obligations in China. China undertook many difficult and costly changes to conform with WTO requirements as a precondition to joining the WTO. Despite all the quite justified complaints about China's implementation since its accession to the WTO, China has continued to undertake considerable, sometimes painful WTO-mandated reforms.

Still, friction with trade partners and problems of Chinese implementation continue and in some respects are likely to increase. Intellectual Property Rights protection is, of course, a perennial concern. A dispute over trade in semi-conductors nearly triggered a WTO dispute process against China. Auto parts loom as another. U.S. concerns about the bilateral trade deficit and charges that China manipulates its currency to run a surplus potentially intersect with China's WTO obligations. And so on.

Pressures for protectionism have emerged in China. There are more calls in China for pushing back, for making use of the illiberal mechanisms permitted by the WTO regime to protect Chinese industries, for being more aggressive in making anti-dumping claims and challenging other countries for engaging in unfair subsidies to their industries. These pressures come against the backdrop of broader, sometimes populist rhetoric in China that criticizes the terms of the accession deal for requiring China to write a "blank check" to join the WTO, and that complains about China's having not received the ordinary benefit of less developed country status or transitional economy status when entering the WTO.

There's also the problem of mission creep. The WTO is not the GATT. China started pursuing membership in the international trade regime when it revolved around the relatively modest GATT. The WTO requires a good deal more in terms of member states' substantive laws and practices, and has a far more robust dispute resolution process. In recent years, pressures have mounted to expand the WTO's reach to address environmental issues, labor rights and broader human rights.

I think the United States' proponents of China getting into the WTO may have done themselves a disservice by overstating the impact that WTO membership could be expected to have on China. Pitman Potter has argued, very expansively, that China's living up to what the WTO requires or assumes will demand profound legal and political change in China. Clinton sold PNTR (permanent normal trading relations)—a change required as part of China's WTO accession—to Congress in language that sounded like what Chinese propagandists call peaceful evolution: WTO entry is going to transform China. Such rhetoric pushes Chinese buttons and conjures up visions of WTO mission creep and a potential cause for backlash from the PRC.

Third, there is the political side to this as well. Internationally, China increasingly wants to be not just a regime-taker but a shaper of international legal institutions and the international order more broadly. There are areas where China's preferences and interests on many issues, ranging from trade to human rights to state sovereignty, will not necessarily line up with the existing regimes' norms.

In China's domestic politics too, there is a persisting and, I would argue, possibly deepening top-level ambivalence toward constitutionalism or quasi-constitutionalism that are widely and plausibly associated with a robust rule of law. The populist strain of the Hu-Wen leadership is partly complementary to a turn to constitutionalism, but it is only partly complementary. There is a good deal of tension here. Hu-era populism, at the very least, bumps constitutionalism concerns

down the agenda, putting them below doing social justice or, perhaps, advancing a nationalist agenda. There is an unfortunate elective affinity between constitutionalism and the very open, market-oriented agenda of the Deng and Jiang years, such that a populist attack on inequality-producing and instability-risking economic policies easily becomes bound up with a rejection of constitutionalist prescriptions that often come from the same intellectual circles. In the context of the broader chill in the intellectual climate for liberal reformist intellectuals that has come with the Hu Jintao era, the near-term prospects do seem to have dimmed for proponents of relatively liberal constitutionalist reform.

The last thing I will mention is federalism. Establishment Chinese constitutional thinking and legal structure do not allow for a true form of federalism. So, if that is your prescription of a way for China to cope with many of the problems we've been discussing, don't hold your breath. Thank you.